FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

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September 24, 2015

Employee Benefits Security Administration
Office of Regulations and Interpretations
Office of Exemption Determinations
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: Regulatory Definition of the Term "Fiduciary" as it Relates to Investment Advice; Conflict of Interest Proposal (RIN 1210-AB32); 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 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 Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks; Proposed Amendments to Class Exemptions 75-1, 77-4, 80-83 and 83-1; Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters (RIN 1210-ZA25)

To Whom It May Concern:

Thank you for the opportunity for the Financial Services Institute (FSI) to submit additional comments for the record on the proposed rulemaking regarding the definition of the term "fiduciary" of an employee benefit plan and related proposed prohibited transaction exemptions (Proposal) and to elaborate on certain issues that were raised by the Department during the hearings held earlier this month.

At the outset, we wish to acknowledge the Department's decision to preserve commission-based investment accounts under the Proposal. It is indisputable that such accounts can and do serve the best interests of retirement savers. Since 2009, FSI has advocated that such accounts (and all other investment accounts in which retail investors receive individualized advice) should be subject to a uniform best interest standard, supported by sensible compliance procedures and focused, useful disclosures, in a manner coordinated among all the regulators with jurisdiction. In its structure, the Proposal takes a similar approach.

FSI remains of the view, however, that the Proposal would create a regulatory regime that is operationally too complex, too cumbersome, and far too costly to manage, and that erects counterproductive obstacles for commission-based accounts. This position was described in detail in our comment letter, submitted to the Department on July 21, 2015, as well as in our August 12, 2015 testimony. In our view, the Proposal will make it significantly harder for consumers to receive high quality, personalized retirement advice — in particular, clients with small account balances for whom advice will become cost-prohibitive if the Proposal goes forward as written — thus decreasing investor choice among and access to retirement advice from a trusted advisor.

While a number of the following comments are framed in the specific context of the proposed Best Interest Contract Exemption (BICE), they are also applicable to other exemptions for which comparable terms have been proposed.

I. Comparison of Proposed BICE and FSI Alternative

FSI believes that an exemption with simpler terms than the proposed BICE would accomplish the Department's objectives of enhanced investor protection, but at a substantially lower cost to the retirement system, and thus with fewer barriers to investor access to and choice among professional investment services. Our alternative would better "... provide businesses with the flexibility to adopt practices that work for them and adapt those practices to changes [the Department] may not anticipate, while ensuring that they put their client's best interest first and disclose any conflicts that may prevent them from doing so" – the objective of the exemption as described by the White House.[1]

To illustrate the differences between the proposed BICE and an alternative "best interest" exemption applying the principles suggested by FSI in Section XI of its July 21 comment letter, we have included in the Appendix A to this letter an example of the customer experience in the IRA rollover setting under existing law, as modified by the proposed BICE, and as suggested by FSI (Example).

FSI believes that financial advisors can and most often do serve the best interests of their retirement investors. As the Example illustrates, FSI suggests a standard of care that would (i) accept the market reality that compensation to firms and financial advisors will vary among product types and product providers and (ii) unequivocally require financial advisors to put the best interest of their retirement customers first, supported by focused policies and procedures designed to manage material conflicts and a streamlined disclosure system. This approach omits the more granular requirements of the proposed BICE as duplicative, inefficient or operationally unworkable. Instead, our alternative relies on the standard of care itself, in the context of the investor protections provided by the existing non-ERISA regulatory framework supplemented in very targeted ways, to achieve the Department's objectives. At the same time, it would minimize both the costs to the retirement system and the opportunities for conflicts with other regulatory regimes. FSI believes that this approach, in conjunction with the robust existing regulatory regime,

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[1] FACT SHEET: MIDDLE CLASS ECONOMICS: STRENGTHENING RETIREMENT SECURITY BY CRACKING DOWN ON BACKDOOR PAYMENTS AND HIDDEN FEES, at https://www.whitehouse.gov/the-press-office/2015/ 02/23/fact-sheet-middle-class-economics-strengthening-retirement-security-crac.

will ensure that firms can adopt business practices that work for them to the degree suggested by the White House, while retirement investors are protected to the degree sought by the Department.

FSI would in particular emphasize the following elements of our alternative approach:

A. The Best Interest Standard Should Incorporate the ERISA Duty of Loyalty.

FSI's suggested articulation of the best interest standard is intended to comport with Section 404(a) of ERISA,[2] as well as with similar standards applicable under federal securities laws.[3] As such, it is intended to incorporate the Section 404(a)(1)(A) duty of loyalty to act "solely in the interest" of and "for the exclusive purpose" of providing benefits to participants, beneficiaries or the IRA owner, as applicable, as well as defraying the costs of the retirement arrangement. This duty of loyalty does not bar all competing interests on the part of the fiduciary; ERISA Section 404(a) permits a fiduciary advisor to recognize a benefit incidental to a prudent investment transaction so long as the retirement investor's interests are put first.

This latter point provides the rationale for the omission in the FSI formulation of the "without regard" terminology featured in the Proposal. The intent of the FSI formulation is not to evade any duty of loyalty. Rather, our articulation of the best interest standard will avoid any misconstruction that putting the client's interest first means that the financial advisor is not allowed any competing interest whatsoever. Inasmuch as the "without regard" language does not appear in Section 404(a) or the regulations thereunder, that additional language might be misread to have independent significance or to create a new legal standard. Our members see a material risk that an arbiter other than the Department, perhaps influenced by certain of the studies cited by the Department in support of the Proposal, might conclude that a financial advisor cannot act "without regard" to his own interest even if he puts the retirement investor's interest first. This is a point on which the best interest exemption must be unambiguously clear.

B. The Best Interest Standard Should be Supplemented by Streamlined Disclosures.

Disclosures are an indispensable element of a best interest exemption. In a retirement system that calls on plan fiduciaries, participants and IRA owners variously to make key decisions about retirement investments, it is essential that well-conceived disclosures be available to inform those decisions. This is the bedrock on which ERISA investment regulation rests — a substantive fiduciary standard supported by various disclosures under Parts 1 and 4 of Title I — which appropriately can serve as the basis for the best interest exemption as well.

Any such disclosures will be most efficacious if they are very specifically designed for the purpose for which they are intended. In the context of the BICE, the substantive standard is intended to assure the quality of the recommendations provided by the fiduciary advisor. The disclosures are intended to allow the retail investor to understand the economic perspective the

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[2] Thus, while this suggested standard of care would require a financial advisor to provide advice that is in the best interest of the customer, it would not necessarily require recommending the lowest cost investment option. Cost would be an important factor in assessing the appropriateness of an investment recommendation, but not the only factor. See, e.g., Advisory Opinion 2002-14.

[3] See, e.g., FINRA Rule 2111. It has long been recognized that a broker-dealer has a duty to deal fairly with the public. See Charles Hughes & Co. v. SEC, 139 F.2d 434 (2d Cir. 1943), *cert. denied,* 321 U.S. 786 (1944), FINRA Rule 2010 and FINRA Supplementary Material 2111.01.

fiduciary advisor brings to the recommendation. The concern our members have about the disclosures proposed by the Department is that they are costly without being effective in the retail setting. The information would be better communicated to the investor in a simple, succinct, to-the-point narrative form consistent with the models of the summary prospectus and the ERISA Reg. §2550.404a-5 disclosures. While the details of course differ, the Department's observations in preambles leading to the §2550.404a-5 regulations are instructive:

> Also, the Department is persuaded by RFI commenters that most participants and beneficiaries will probably not review large amounts of detailed investment information. Information that is too detailed may overwhelm participants, and commenters are concerned that the costs associated with providing overly detailed information, which ultimately will be borne by participants, significantly outweigh any possible benefits. However, the Department also is persuaded that the form in which information is required to be presented should serve to encourage and facilitate its review by participants and beneficiaries....[4]
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> While a critical objective of this rulemaking is to ensure that all participants and beneficiaries in participant-directed individual account plans are furnished the information they need to make informed investment decisions, the Department remains sensitive to the possibility that too much information may only serve to overwhelm, rather than inform, participants and beneficiaries....[5]

The disclosures suggested by FSI are tailored to provide the retail investor, in an accessible manner, the key information needed to understand the advisor's interest — concise narrative descriptions of investment product types, business relationships, compensation arrangements and material conflicts provided through a public website and a short disclosure form, together with sources of additional information including about the specific compensation to be received by the financial advisor in connection with a particular investment.

C. The Best Interest Standard Should Rely on the Financial Advisor and the Firm Together to Manage Potential Conflicts.

As illustrated by the Example, a best interest exemption can rely on checks and balances among the financial advisor and the broker-dealer to effectuate the best interest standard.

- In the independent broker-dealer setting, the initial responsibility for any recommendation always rests with the financial advisor. The advisor is both an independent contractor and the professional with direct experience with the customer. The firm sets the menu of investment products and providers available on its platform – which most often is quite broad – and the advisor develops a recommendation for the customer from among the investments on that menu without direction from the firm.

- The firm currently evaluates under the FINRA suitability standard, and all other applicable requirements, any recommendation accepted by the customer and presented as an order for execution. Under a best interest exemption, the firm would

[4] 73 Fed. Reg. 43014, 43016 (July 23, 2008).
[5] 75 Fed. Reg. 64910, 64918 (Oct. 30, 2010).

also evaluate whether the investment is within the range of choices a prudent retirement investor would make in the circumstances, subordinating the economic interests of the advisor and the firm to those of the retirement investor. If the firm determines that the recommendation does not meet this standard, the order would not be executed and the order request would be returned to the customer and the financial advisor for further consideration. This is a robust element of the supervisory process; firms are accustomed to rejecting orders that are not supported by the customer information provided by the financial advisor.

- The firm would also have in place supervisory processes implementing the FINRA conflict of interest report and rollover guidance (Regulatory Notice 13-45), adding additional oversight at potential pressure points for conflicts and in the rollover setting.

The approach suggested by FSI does not transfer the firm's conflicts to the financial advisor. Rather, it mitigates conflicts throughout the recommendation process and relies on checks and balances as part of that mitigation. This process leverages existing regulatory structures to which financial advisors and firms are accustomed, and the best interest standard can be incorporated into those structures without the costs and uncertainties of a new compliance model.

D. The Best Interest Exemption Should be Available for Discretionary Accounts.

For similar reasons, the best interest exemption can and should appropriately be extended to discretionary investment advisory accounts. In these accounts, the financial advisor is compensated by a level asset-based advisory fee basis. The firm may (or may not) receive compensation that differs by investment but any such differences are not reflected in the compensation received by the advisor. As a result, the risk that the advisor will put those compensation differences to the firm before the interest of the customer is highly attenuated. The best interest standard, coupled with appropriate conflicts policies and disclosures, provides an equally effective solution in these circumstances as in the case where the financial advisor is only providing advice and receiving commission-based compensation.

E. The Asset Definition is Unnecessary in the Best Interest Exemption.

We offer additional comments on the "asset" definition. Many comment letters and much hearing testimony included discussion about investment types excluded by the Proposal and the possibility for mirroring the performance of those assets using investment types permitted by the Proposal. The options for constructing a prudent retirement investment portfolio are beyond counting. For example, some customers and advisors prefer to include investments that mimic alternative investment classes, while others prefer the alternative investments themselves. To the extent that such a preference, on the part of a financial advisor, reflects the advisor's interest rather than the customer's, the advisor would violate the best interest standard. Accordingly, there is no need for the Department to break from the statute and long-standing regulatory practice by introducing a "legal list" requirement in the BICE, because the best interest standard inherently addresses those issues. Moreover, by limiting the universe of permissible investments, an advisor may be stymied from providing best interest advice based on the customer's express needs, preferences, and risk tolerances, as suggested in the Example.

A "legal list" approach also creates problems as the market evolves and new investment types emerge. Absent an amendment to the BICE, those new products would be outside the scope of the exemption. Product innovation for retirement investors would be stifled, or at least made more complicated and expensive. This is the antithesis of "principles based" regulation.

The "asset" definition thus should be omitted in the final exemption.

F. A Conventional Grandfather Rule Should be Adopted.

Finally, we would add to our prior comments on the BICE grandfather rule the following example. Consider the case, after the Applicability Date, of an IRA owner approaching age 70½ and thus the obligation under the Internal Revenue Code to commence required minimum distributions. To the extent a financial advisor notes the need to take that required distribution to the IRA owner, that communication may under the Proposal be fiduciary "investment advice" in the form of a call to action to take a distribution from the IRA. To the extent that distribution entails some liquidation of one or more of the Assets about which the financial advisor provided services prior to the Applicability Date, the proposed exemption for pre-existing conditions would cease to apply and grandfathering would be lost. This is thus another way in which the proposed BICE creates an impediment for financial advisors to see to the best interests of their customers, and in this instance involving a tax compliance matter. For this reason, as well as the other reasons noted in our July 21 letter, a conventional grandfather rule should be adopted.

II. Further Commentary on the Regulatory Impact Analysis

As previewed in our July 21 letter, FSI has partnered with Oxford Economics to study the Proposal and, specifically, the Regulatory Impact Analysis (RIA). The study is included in the Appendix B to this letter. In connection with the cost-benefit justification of the Proposal, it is essential to appreciate that:

- Of the approximately 100 securities firms that are members of FSI, approximately half are local or regional firms that have under $35 million of annual revenue; and

- *Every one* of the over 160,000 advisors licensed with independent broker-dealers — more than 60% of all producing registered representatives — is an independent business person, operating a Main Street business serving the local community, with (on information and belief) under $35 million revenue of annual revenue.

The independent broker-dealer industry thus is substantially comprised of small businesses that must be taken into account under the RIA's Regulatory Flexibility Act analysis.

In its report as recently issued, which is attached to this letter, Oxford Economics concludes that, *inter alia*:

- The RIA materially underestimates the compliance cost of the Proposal and the challenges it presents to the survival of small broker-dealer firms if it is implemented as proposed;

- The Proposal will result in startup costs ranging from $1.1 million to $16.3 million per independent broker-dealer firm, depending on firm size. These startup costs are roughly 4 times the RIA's high and 20 times its preferred estimates. Oxford Economics provides the following breakdown of startup costs by firm size:

	No. of Firms from RIA	Oxford Estimates		RIA Preferred Estimate	
		Per firm	Total	Per firm	Total
Large	42	$16,266,000	$683,172,000	$1,091,000	$45,822,000
Medium	137	3,350,000	458,950,000	145,000	19,865,000
Small	2,440	1,118,000	2,727,920,000	53,000	129,320,000
Total	2,619		3,870,042,000		195,007,000

- The Proposal will result in less access to advisory services for small and medium-sized investors. One unintended consequence might be that it will become harder for minority investors with small asset holdings to seek advice from financial advisors; and

- The Proposal will result in industry consolidation likely to force small broker-dealers out of business.

The Department's Office of Policy and Research has already expressed an interest in understanding more about the methods and data underlying the Oxford Economics analysis, and FSI has submitted a separate response to that inquiry.

While FSI and Oxford Economics are confident of the attached analysis, we expect we and the Department may in the end disagree about the reasonably expected costs and benefits of the Proposal. That there is a basis for such a disagreement — that both avid proponents and constructive critics of the Proposal can point to evidence supporting their views — suggests to us at the very least that the consequences of the Proposal are sufficiently uncertain that every effort should be made to minimize its potential downsides. The alternative FSI suggests for the "best interest" exemption, among other things, represents such an effort.

III. The Proposed Investment Advice Definition

While our July 21 letter offered comments only on the carve-outs under the proposed investment advice definition, we noted with interest the discussions during the hearing about the inclusive elements of the proposed definition. In our view:

- The nature of the inquiry required under Section 3(21)(A)(ii) of the statutory fiduciary definition is inherently different than that required under Section 3(21)(A)(i) or (iii). Under the latter subsections, a person either does or does not have, e.g., discretionary control over the management of plan assets or discretionary authority in the administration of the plan. Section 3(21)(A)(i) or (iii) describe functional responsibilities that can be identified on an objective basis. In contrast, under Section 3(21)(A)(ii), whether a person is providing investment advice that should be subject to Section 404(a) and 406(b), and IRC Section 4975(c)(1)(E) and (F), turns not only on the nature of the activity, but also on whether a trusted advice relationship has been established; that is the characteristic that distinguishes fiduciary advice from arm's length investment sales activity. Therefore, the investment advice definition cannot wholly be an objective determination, but also must take account of the parties' contemplation.

- Furthermore, that contemplation cannot be one-sided. For there to be a relationship of trust, the financial advisor and the retirement investor both must understand that such a relationship has been formed.[6] In addition, for the financial advisor's status and legal liability to turn solely on the understanding of the retirement investor would create compliance, evidentiary and credibility problems that are wholly avoidable in the circumstances. In essence, if only the investor's understanding is relevant, the firm would be obliged to build a compliance system around facts not within the firm's reach or control, and the financial advisor would be required to prove a negative (that the investor did not expect the adviser to act as a fiduciary) in the event of any dispute.

- At the hearing, the Department explored the question of whether expressly reintroducing the concept of mutuality in section (a)(2)(ii) of the proposed regulation would effectively gut the definition, by allowing a putative fiduciary advisor to create the impression of a trusted relationship and then disclaim fiduciary status in obscure documentation. As we read it, however, the structure of the proposed definition already solves that concern. If a person is providing one or more of the services described in section (a)(1) of the regulatory definition and either represents or acknowledges that he or she is an ERISA fiduciary, then that status attaches by reason of section (a)(2)(i) (and, we note, with the participation of both parties). The section (a)(2)(ii) element of the definition, and the question of mutuality, is reached only if there has been no representation or acknowledgement of fiduciary status.

IV. Remedies

We find the question of remedies under the best interest and related exemptions to be among the most difficult issues raised by the Proposal, as evidenced by the substantial attention these issues received at the hearing. We supplement our comments in our July 21 letter with the following observations.

A. Arbitration

We feel compelled to briefly respond to the attack in the commentary and at the hearing on the use of FINRA-Dispute Resolution arbitration to resolve customer claims involving ERISA and IRA accounts. FINRA provides both a favorable forum for investors, as is evidenced by their success in FINRA arbitrations, and myriad procedures designed to protect investors which are not available in other arbitration forums or, in fact, the courts. It is a certainty that ERISA fiduciary status and the best interest standard will be cited against our members in arbitrations, should the Proposal be adopted.

[6] We do not mean to suggest that the parties must appreciate that the retirement advisor has taken on ERISA fiduciary status, but rather only that a trusted relationship has been formed.

If the Department reacts to the challenges to arbitration clauses by treating ERISA and IRA accounts differently than other investment accounts, the effect will be: (1) increased costs to both investors and investment professionals; (2) increased investor confusion; (3) increased litigation uncertainty; (4) conflicts with other regulatory requirements; and (5) the potential erosion of the benefits of FINRA arbitration to investors. Accordingly, any final exemptions, like the Proposal, should continue to allow both arbitration as a forum for "best interest" complaints and mandatory arbitration provisions.

1. FINRA Provides a Fair Forum for Investors at a Reduced Cost to Other Litigation.

FINRA arbitration contains numerous procedures — many of which were adopted in response to recommendations from investors and counsel for investors — that were specifically designed to provide a fair and cost-effective method for investors to pursue claims against FINRA members and their registered representatives. As a consequence, investors obtain either a settlement or award in their favor in the vast majority of FINRA arbitrations, along with a frequently expedited, less-costly, and more convenient process.

As an initial matter, it is important to note that concerns that FINRA arbitration somehow amounts to broker-dealers sitting in judgment of themselves is unsupported by the facts. FINRA is regulated by the SEC, and its rules — including those for its arbitration process — are subject to SEC approval. Any FINRA rule must be approved by the FINRA Board of Governors, the majority of which are public members, and also go through a public comment process through the Federal Register. FINRA arbitration rules must also be approved by the National Arbitration and Mediation Committee (NAMC), the membership of which must be at least 50% non-industry.[7] Further, arbitration clauses by FINRA members are carefully circumscribed. Any arbitration clause must meet the detailed requirements of FINRA Rule 2268.

FINRA rules also are designed to ensure that any agreement to arbitrate is knowingly made, and that such agreements cannot strip customers of theories or types of recovery as is common in arbitration agreements not subject to FINRA rules. Among other requirements, FINRA Rule 2268 mandates that any arbitration provision: (1) must be highlighted; (2) must be disclosed immediately preceding the customer's signature; (3) cannot limit the customer's right to recover any form of damages or advance any specific legal theory; and (4) cannot limit the power of the arbitrators.

The suggestion that industry-affiliated arbitrators are on each FINRA arbitration panel is categorically wrong. To be clear, every customer has an absolute right to an all-public panel if he or she so chooses. In response to comments from counsel for customer claimants, since 2011 FINRA has specifically granted customers the right to an all-public panel.[8] In 2015, these all public panels awarded damages to customers in 49% of decided cases, which is in line with the awards by such panels in previous years.[9] While comments and testimony on the Proposal

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[7] FINRA Rule 12102. The current chairman of the NAMC is Ryan Bakhtiari, a former board member and president of the Public Investors Arbitration Bar Association (PIABA). Attorneys who represent claimants constitute the majority of NAMC's Board. See https://www.finra.org/ arbitration-and-mediation/national-arbitration-and-mediation-committee-namc (listing the membership of NAMC) and https://piaba.org/member-directory/ryan-k-bakhtiari (providing Mr. Bakhtiari's PIABA and NAMC experience).
[8] FINRA Rule 12403.
[9] See https://finra.org/arbitration-and-mediatio/dispute-resolution-statistics.

questioned the service of former industry professionals on all-public panels, these commenters failed to note that FINRA — in response to similar comments — amended Rule 12100 as of June 26, 2015 to permanently bar individuals with any significant connections to the securities industry (including, for example, attorneys and accountants) from service as all-public arbitrators while temporarily barring those with more limited connections (including the family members of those in the securities industry).[10]

FINRA arbitration is designed to minimize the costs and burden on customer-claimants. In contrast to many arbitration forums that assess equal fees on the parties, FINRA's fee structure favors the investor, with the industry party bearing a significantly larger portion of the filing fees.[11] FINRA offers hearing locations in every state, Puerto Rico, and London, with a number of states having multiple hearing locations.[12] Further, FINRA endeavors to select a hearing location that is most convenient for the customer, not the parties jointly.[13]

FINRA also safeguards a customer's ability to present his or her claims to an extent not seen in court or in other arbitrations. Under FINRA rules, motions to dismiss prior to the completion of a customer's case at hearing are all but prohibited. Rule 12504 — adopted in response to comments from counsel for customers — specifically notes that "[m]otions to dismiss a claim prior to the conclusion of a party's case in chief are discouraged" and provides a gauntlet of procedural hurdles before a motion can be granted (which can only occur after a hearing with the full panel). Moreover, Rule 12504 requires that an industry defendant bear all hearing fees associated with a motion to dismiss when the motion is denied.[14] The rule also requires that reasonable attorney's fees and costs be awarded for frivolous motions and permits a panel to impose additional sanctions.[15] Any dismissal must be unanimous, and the Rule states that:

> The panel cannot act upon a motion to dismiss a party or claim under paragraph (a) of this rule, unless the panel determines that:
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> (A) the non-moving party previously released the claim(s) in dispute by a signed settlement agreement and/or written release; or
> (B) the moving party was not associated with the account(s), security(ies), or conduct at issue.[16]

As this provision makes clear, even the absence of a cognizable claim is not enough to allow a defendant to dismiss a customer's claim. As a consequence of Rule 12504, even frivolous claims survive to final hearing; therefore, most FINRA arbitrations are resolved by settlement, through mediation, or after the completion of a full hearing before the arbitration panel.[17]

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[10] FINRA Rule 12100(u).
[11] FINRA Rule 12900.
[12] See https://www.finra.org/arbitration-and-mediation/finra-hearing-locations.
[13] FINRA Rule 12213. Section 12213(a)(1) states: "The Director will decide which of FINRA's hearing locations will be the hearing location for the arbitration. Generally, the Director will select the hearing location closest to the customer's residence at the time of the events giving rise to the dispute, unless the hearing location closest to the customer's residence is in a different state, in which case the customer may request a hearing location in the customer's state of residence at the time of the events giving rise to the dispute."
[14] FINRA Rule 12504(a)(1) & (9).
[15] FINRA Rule 12504(a)(10)-(11).
[16] FINRA Rule 12504(a)(6).
[17] See https://finra.org/arbitration-and-mediatio/dispute-resolution-statistics.

2. If Arbitration Clauses Are Prohibited for ERISA and IRA Accounts, Litigation Costs May Significantly Increase, There Will Be Added Uncertainty, and the Efficacy of FINRA Arbitrations Will Be Diminished.

Investors often discuss their investment options with their financial advisors in the context of their entire relationship, and alleged misrepresentations often occur without regard to account. Consequently, determining whether certain alleged damages related to an ERISA and IRA account (thereby potentially removing the case from arbitration) or instead another account would prove problematic. Other claims necessarily involve an evaluation of the entire customer relationship. For example, would an investor have a concentration claim that she could bring in court if her IRA was diversified in isolation, but contained concentrated positions when viewed in the context of an entire portfolio? A proposal that would give rise to extensive litigation simply to sift out the appropriate forum for each claim before even starting to adjudicate the merits of those claims would not serve the interests of the parties, the retirement system or the judicial system.

A prohibition on pre-dispute arbitration clauses for ERISA and IRA accounts would lead to other negative consequences for investors and the financial system as a whole. As an initial matter, such a change — if it were to have any effect at all — would lower the number of arbitrations administered by FINRA. This in turn could render it infeasible for FINRA to maintain hearing locations in all states. Fewer arbitrations would also reduce the incentive for qualified individuals to go through the application and training process to become FINRA arbitrators, reducing the quality of the arbitration experience. At worst, the FINRA arbitration process could be undermined in a manner that jeopardizes its viability – to be of any utility to the parties, arbitration has to be all or nothing.

Finally, a revision to the proposed rule relating to arbitration would create inefficiencies, uncertainty, and additional costs. If the Department were to bar pre-dispute arbitration agreements for ERISA and IRA accounts, there would be overlapping claims involving related accounts of the same customer of the same advisor at the same broker-dealer firm that would be heard in different forums. Furthermore, in many cases it would be unclear whether a mandatory arbitration clause in fact applied to the claims at issue. Despite the clear, unequivocal, and conspicuous arbitration language required by FINRA Rule 2268, investors still bring cases in court arguing that their claims are exempt from arbitration. Such claims will become much more difficult, costly, and time-consuming to adjudicate when claims related to some accounts (but not others) are permitted in court.

B. Other Comments on Remedies

The apparent contemplation of the Proposal is that the private right of action created by the BICE would be adjudicated under state contract or tort principles. We continue to have serious reservations about introducing into the retirement system, through the BICE and other exemptions, a federal standard that in its enforcement is subject to the idiosyncrasies and variances of state law. "ERISA's carefully crafted and detailed enforcement scheme provides strong evidence that Congress did not intend to authorize other remedies it simply forgot to incorporate expressly."[18] That is particularly the case for financial advisors who are fiduciaries to ERISA plans. That statute already provides federal remedies for the commission of a nonexempt prohibited transaction. In that circumstance, it is impossible to square an additional remedy under state law with the statutory structure of ERISA including its preemption provisions.

Also, the Department has been clear that damages are the intended remedy if the best interest standard is breached. Correction of a nonexempt prohibited transaction is functionally required by Section 502(i) of ERISA and IRC Section 4975(b), however. Consequently, rescission may be necessary even in the absence of damages. This possibility effectively would convert the best interest standard into a strict liability standard, contrary to the Department's intent. This point must be resolved in any final exemptions.

Conclusion

Over 300,000 comment letters have already been submitted to the Department and four days of public hearings have passed. Those most familiar with the retirement and investment industry have been vocal in their concerns. While a diverse array of commentators have raised different points, experts on the industry have broadly expressed the concern that the Proposal would be harmful to retirement investors. As the Department moves forward, FSI urges it to weigh its interest in regulating the sale of investments, which is already heavily policed by agencies charged with that duty, with the consequences to the U.S. retirement system in the event that the experts are right.

The mission of the Employee Benefits Security Administration (EBSA) is to assure the security of the retirement, health and other workplace related benefits of America's workers and their families. FSI believes that with the Proposal, the very mission of EBSA — a secure retirement for Americans — is in some jeopardy. The effects of the Proposal, as drafted, would be far-reaching, impacting foundational aspects of our retirement savings system, including the availability and cost of basic advice and education about investing. The business interests of FSI members are also at stake, of course, and we are concerned that the Proposal will have substantial deleterious effects on independent broker-dealers and advisors as small businesses. In addition to the likely cost increases on retirement products and advice that retail investors will see, the regulatory burden will fall disproportionately on smaller firms that cannot take advantage of scale.

FSI believes that the Department can achieve its goals without the risks and problems associated with the Proposal, including the BICE. The alternatives proposed and comments provided by FSI provide a workable solution that maintains investor access to broker-dealer

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[18] *Great-West Life & Annuity Ins. Co. v. Knudson*, 534 U.S. 204, 209 (2002).

models that have served retirement investors well for decades, while enhancing the protections provided to those investors.

Again, we thank you for the opportunity to testify and provide you with the thoughts and concerns of our members as well as to answer some of your questions on these important issues. Please let us know if we can be of any further assistance. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

David T. Bellaire, Esq.
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APPENDIX A

Example

Carl the Customer, an employee of SmallCo in Smalltown, USA, is retiring next week. The only investment decision he has ever made in his life has been to invest his SmallCo 401(k) Plan account balance in the Plan's 2015 Target Date Fund, a "to retirement" target date fund. The SmallCo Plan offers, in addition to target date funds, a total stock mutual fund, a total bond mutual fund, and a money market fund. The Plan does not offer annuities or other lifetime income benefits. Carl must decide whether to reinvest his 401(k) account among other investments offered by the Plan, to take a distribution, or to rollover to an IRA. Carl is not seeking new employment, so a transfer to a new employer's plan is not an available option. Carl is eligible to start receiving Social Security benefits.

1. At his retirement party, Carl seeks out his neighbor Anne the Advisor, a financial advisor licensed as a registered representative and investment advisory representative of an independent securities firm (Firm) and a licensed insurance agent. Carl asks Anne what she thinks about rollover IRAs. He says he would really like to take a lump sum distribution to pay off the mortgage on his house but that his boss gave him a rollover distribution form and told him that he really ought to rollover to an IRA. He asks Anne to explain how these rollovers work and whether she thinks it is in Carl's best interest to do that rather than pay off his mortgage. Anne tells Carl that he actually has several options to choose among, and suggests meeting the next day at her office so she can better explain them.

Existing Law	BICE	FSI Alternative
• Anne is at all times required by FINRA rules to observe high standards of commercial honor and engage in just and equitable principles of trade. • The Firm has trained Anne in these standards. • The Firm also has adopted standards regarding titles and professional designations that its registered representatives can use with the public. Anne cannot hold herself out as having	• Anne and the Firm are subject to all "Existing Law" requirements. • Anne is not yet acting as an ERISA fiduciary because she has not given a recommendation in the FINRA sense, so the conditions of BICE are not yet implicated. The Firm has filed its one-time notification of the Department that it intends to rely on the BICE. • One key difference is that Anne is unlikely to explain the pros and cons of	No difference from BICE at this early stage.

Existing Law	BICE	FSI Alternative
expertise in retirement investing unless she has obtained and maintains one of a limited number of professional designations. **Conclusion** – FINRA rules set a high principles-based standard for broker-dealers and financial advisors which is reinforced by specific regulatory requirements.	investment products that have been excluded from the definition of "Asset" under the BICE. So regardless of whether Carl desires and would benefit from a direct investment in a non-traded REIT or option hedging strategy, Anne is unlikely to discuss these options.	

From the outset, the interaction between Carl and Anne is subject to FINRA's rule requiring member firms and their associated persons to observe high standards of commercial honor and engage in just and equitable principles of trade.[19]

- Anne's Firm, as is typical with most broker-dealers serving the retail public, provides training to Anne and her fellow registered representatives on these standards and principles as they apply to interactions with customers and prospective customers. This training is delivered in a variety of ways: as part of the "firm element" of the Firm's continuing education program (which the Firm is required to maintain under a FINRA Rule), through other training and mentoring programs provided by the Firm, during annual inspections of each branch office of the Firm, and through written compliance manuals and other guidance provided by the Firm to its registered representatives. In this regard, FINRA rules require a firm to maintain a continuing and current education program for its registered representatives to enhance their securities knowledge, skill and professionalism. The Firm has designated a principal responsible for the Firm's "firm element" continuing education program; this principal conducts an annual evaluation and prioritization of the Firm's training needs and develops a written training plan for the Firm on a year-by-year basis.[20] The Firm also conducts periodic training for its registered representatives, at least annually, focused specifically on compliance matters.[21]
- The Firm also has adopted standards regarding titles and professional designations that its registered representatives can use with the public, consistent with guidance in FINRA Regulatory Notice 11-52. The Firm's standards prohibit the use of professional designations that may suggest expertise in retirement investing, except in the case of designations awarded by a limited number of organizations that the Firm has determined have a rigorous curriculum, an emphasis on ethics, continuing education requirements, a method for determining the registered person's status regarding the designation and a public disciplinary

[19] See FINRA Rule 2010.
[20] See FINRA Rule 1250.
[21] See FINRA Rule 3110.

process. In addition, the Firm requires a registered representative desiring to use such a designation to remain current with continuing education or other requirements necessary to remain in good standing with the issuing organization, and to demonstrate a level of experience in retirement planning and other related matters, as well as the ability to work with investors in this regard.

2. Over the next two weeks, Carl and Anne arrange by email to meet several times. Anne conducts all her email exchanges with Carl using the Firm's email platform, and those emails are retained by the Firm along with any other form of correspondence between Carl and Anne. During their meetings, they talk about Carl's overall financial situation, his expected needs and objectives for his retirement years, and his available assets. At Anne's request, Carl brings in various documents that quantify his assets and liabilities, including his Social Security benefits. Anne also asks Carl about the financial legacy, if any, he hopes to leave after he passes away. Anne in turn explains what a rollover is, and the pro's and con's of all the various options available to Carl. They look at the investment menu materials published by the SmallCo Plan. To advance his investment literacy, Anne provides Carl financial education and retirement planning materials. The materials Anne provides to Carl are "retail communications" approved by the Firm for use with clients and prospective clients. Anne makes a notation in her files regarding the communications provided to Carl. Finally, through their conversations and the use of interactive tools, Anne develops a sense of Carl's tolerance for investment risk and his receptivity to potential investment types and providers. In these discussions, Anne does not recommend any specific course of conduct, even though Carl in a good natured way is starting to press for a specific recommendation. Anne does explain to Carl the services she provides, such as financial planning, as well as the method of compensation for these services. Carl has an opportunity to ask any questions about fees and payments and request additional information regarding compensation arrangements.

Existing Law	BICE	FSI Alternative

• Brochures, webpage information or other materials are communications with the public subject to FINRA rules.
• Communications must be based on principles of fair dealing and good faith, be fair and balanced and provide a sound basis for evaluating the facts.[22]
• The Firm's website includes disclosures about its revenue sharing arrangements
	• Anne and the Firm are subject to all "Existing Law" requirements.
	• Under the analysis suggested by the Department at the hearing, Anne is still not acting as an ERISA fiduciary. She has not given a recommendation in the FINRA sense, and at most her activities constitute non-fiduciary investment education.
	• The Firm also expects that it is not yet
		• The Firm maintains a public website disclosure disclosing:
		  ○ A detailed schedule of typical account fees and service charges;
		  ○ A page containing, for each type of packaged product (e.g., mutual funds, variable annuities, unit investment trusts, etc.), basic information useful to retail investors like Carl, including narrative descriptions of the types of

[22] FINRA Rule 2210.

Existing Law	BICE	FSI Alternative
and any particular product providers with which it has "preferred" or similar relationships. • All materials provided or posted on a webpage are reviewed and provided by the Firm's advertising compliance program to ensure compliance with FINRA requirements. • Any email, letter or other written correspondence between Anne and Carl (even just an email confirming their meeting time) would be considered "correspondence" under FINRA rules and must be retained by the Firm under SEC rules and supervised by the Firm. The Firm has a program to retain and review electronic communications for compliance with securities laws.[23] • Anne may discuss with Carl only the types of investments and securities that she and the Firm are authorized to transact in under FINRA rules. • Anne is gathering information that would allow her to make a "suitable" recommendation to Carl and meet "know your customer" and other legal requirements. • Anne is also gathering information reflecting the range of considerations discussed in FINRA guidance for rollover advice.	acting as an ERISA fiduciary, although the absence of a platform exception for IRAs complicates that conclusion. • The Firm is maintaining a publicly available website that Carl can access at any time, which provides detailed compensation information about each of the investments the Firm currently has available or sold to investors within the scope of BICE within the last 365 days. The website has thousands if not millions of detailed entries. Carl finds it overwhelming and spends no time with it. • Finally, out of prudent conservatism, the Firm has adopted bright-line compliance policies on when the contract required by BICE must be presented and executed. Under these compliance policies, Carl's building request for a specific recommendation triggers the BICE contract requirement, and Anne cannot provide any further assistance to Carl until he enters into that contract. **Conclusion** - The Department's disclosure regime duplicates current broker-dealer current disclosures concerning revenue sharing and marketing allowances. Compliance with the BICE causes broker-dealers and financial advisors to present	arrangements in which the Firm receives an economic benefit from a product manufacturer; ○ A list of all product manufacturers with whom the Firm maintains arrangements that provide economic benefits to either the financial advisor or the Firm, grouped in tiers by such economic benefits. **Conclusion** - FSI recommends enhancing existing broker-dealer web site disclosures with information that is designed to enhance investor understanding and decision making without information overload.

[23] Exchange Act Rule 17a-4 and FINRA Rule 3110.

Existing Law	BICE	FSI Alternative
Conclusion - Communications with the public are subject to significant supervision by the broker-dealer and FINRA. In addition, a financial advisor's recommendations are subject to a rigorous suitability analysis. Compliance with this standard requires a financial advisor to collect all relevant data from an investor prior to making a recommendation Finally, conflicts of interest are disclosed via the broker-dealer firm's web site.	potential clients with a contract prior to the investor's decision to do business with the firm and advisor.	

This next step in Anne's evolving interaction with Carl triggers additional and substantial SEC and FINRA requirements designed specifically to protect retail investors like Carl from harmful or abusive practices.

- Any brochure or other materials, or webpage information about the Firm referenced by Anne would be considered a communication with the public under FINRA rules, and subject to content standards mandating that communications be based on principles of fair dealing and good faith, be fair and balanced and provide a sound basis for evaluating the facts.[24] Anne's Firm has adopted policies prohibiting its registered representatives from using any brochure or materials relating to the Firm's business other than materials provided by the Firm. In addition, the Firm's policies (included in its compliance manual) prohibit Anne and her fellow registered representatives from maintaining or posting any webpage information other than information posted by the Firm, or approved by the Firm for posting by registered representatives.
- The Firm maintains an advertising compliance program for the development, review and approval of communications used by its registered representatives. This program differentiates between retail communications (those used with retail investors) and institutional communications (those used with institutional investors), consistent with FINRA rules.[25] Any retail communication proposed to be used by the Firm or a registered representative must first be reviewed by a qualified securities principal with expertise in FINRA and SEC communication rules designated by the Firm and cannot be used unless it has been approved by that principal. This principal is also responsible for ensuring compliance with any applicable filing requirements before the retail communication is approved for use. FINRA imposes filing requirements on certain types of retail communications, including those

24 See FINRA Rule 2210.
25 See FINRA Rule 2210.

for mutual funds and variable insurance contracts. FINRA maintains an advertising department that conducts a substantive review of filed communications, with power to direct that a communication not be used if the department determines the communication fails to meet FINRA standards. The Firm, as is typical for many broker-dealers, maintains an internal list of approved communications accessible by its registered representatives that they can use with retail investors. The Firm has instructed its registered representatives that they cannot make changes to any approved retail communications, unless those changes are also approved. Advertising compliance is verified during annual branch office inspections conducted by the Firm's compliance department or other authorized persons.

- Any email, letter or other written correspondence between Anne and Carl (such as an email confirming their meeting time) would be considered "correspondence" under FINRA rules and must be retained by the Firm under SEC rules and supervised by the Firm.[26] The Firm has a program to retain and review electronic communications for compliance with securities laws. The Firm also has provided training to its registered representatives regarding correspondence with customers. This training encompasses permissible and impermissible content (for example, that they are not permitted to make any guarantees of investment performance), the types of correspondence that must be reviewed and approved before use, and permissible and impermissible media for electronic communications. In this regard, the Firm has adopted policies prohibiting its representatives from using any electronic media for communicating with customers other than the Firm's email platform. In light of this policy, Anne's email exchanges with Carl were conducted using the Firm's email platform.

  The Firm's procedures for the review of email communication designate the principals and supervisors responsible for conducting reviews, the standards and processes for the review and applicable escalation protocols. The Firm's procedures require the designated principal and supervisors to review emails for compliance with applicable securities laws, regulations and FINRA rules, including the relevant content standards in FINRA rules, as well as other areas of concern identified by the Firm and relevant to its business mix, size and structure. The Firm, like most broker-dealers, employs risk-based review procedures, primarily through the use of a lexicon to identify emails (those based on sensitive words or phrases) subjected to supervisory review. The Firm has imposed reasonable security measures to keep the list confidential and periodically evaluates the efficacy of the lexicon. The Firm also considers targeted concentrated reviews of employees' emails when warranted.

- Even in this initial setting, Anne may discuss with Carl only the types of investments and securities that she and the Firm are authorized to transact in under FINRA rules. SEC and FINRA rules recognize more than 20 different business lines (as listed on Form BD, the registration form for broker-dealers), each involving different securities markets, business practices and expertise, compensation practices and risk and conflicts considerations. A firm seeking authority to engage in a business line must demonstrate, among other things, that supervisory, management and compliance personnel have sufficient expertise for the business line and that the firm has adequate systems, facilities and financial capital to engage in the business. The Firm has obtained authority to engage in the following lines of business: (i) broker selling corporate equity and debt securities, (ii) selling

[26] See SEC Exchange Act Rule 17a-4 and FINRA Rule 3110.

group participant (corporate securities other than mutual funds), (iii) mutual fund retailer, and (iv) broker selling variable life insurance or annuities. Given the Firm's authority, Anne can discuss with Carl only investments in those business lines.[27]

- Anne is gathering information that will be used to populate the Firm's new account form, if Carl decides to move forward. Anne also uses the new account form as a vehicle for explaining financial and investment concepts to Carl. The new account form was designed by the Firm to collect information about the client required to be maintained by the Firm under various rules, including FINRA's "know-your-customer" rule,[28] customer account information rule,[29] and suitability rule,[30] as well as rules adopted under the USA PATRIOT Act, such as anti-money laundering rules and the customer identification program (CIP) rule. SEC rules also specify information that broker-dealers must collect for their records, particularly in the case of natural person customers.[31] The new account form also is used to collect information used by the Firm to assist with supervising recommendations made to the account owner and transactions effected for the account, discussed below.
- Anne is also gathering information reflecting the range of considerations discussed in FINRA Regulatory Notice 13-45, "FINRA Reminds Firms of Their Responsibilities Regarding Rollovers," including:
    - Investment Options—An IRA often enables an investor to select from a broader range of investment options than a plan. The importance of this factor will depend in part on how satisfied the investor is with the options available under the plan under consideration. For example, an investor who is satisfied by the low-cost institutional funds available in some plans may not regard an IRA's broader array of investments as an important factor.
    - Fees and Expenses—Both plans and IRAs typically involve (i) investment-related expenses and (ii) plan or account fees. Investment-related expenses may include sales loads, commissions, the expenses of any mutual funds in which assets are invested and investment advisory fees. Plan fees typically include plan administrative fees (e.g., recordkeeping, compliance, trustee fees) and fees for services such as access to a customer service representative. In some cases, employers pay for some or all of the plan's administrative expenses. An IRA's account fees may include, for example, administrative, account set-up and custodial fees.
    - Services—An investor may wish to consider the different levels of service available under each option. Some plans, for example, provide access to investment advice, planning tools, telephone help lines, educational materials and workshops. Similarly, IRA providers offer different levels of service, which may include full brokerage service, investment advice, distribution planning and access to securities execution online.

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[27] To simplify the Example, we have excluded other lines of business that independent broker-dealers often conduct – e.g., government securities, municipal securities, and various forms of investment partnerships. These investment types often are productively included in a retirement portfolio, although not always in an IRA.

[28] FINRA Rule 2090.

[29] FINRA Rule 4512.

[30] FINRA Rule 2111.

[31] See SEC Exchange Act Rule 17a-3.

- Penalty-Free Withdrawals—If an employee leaves her job between age 55 and 59½, she may be able to take penalty-free withdrawals from a plan. In contrast, penalty free withdrawals generally may not be made from an IRA until age 59½. It also may be easier to borrow from a plan.
- Protection from Creditors and Legal Judgments—Generally speaking, plan assets have unlimited protection from creditors under federal law, while IRA assets are protected in bankruptcy proceedings only. State laws vary in the protection of IRA assets in lawsuits.
- Required Minimum Distributions—Once an individual reaches age 70½, the rules for both plans and IRAs require the periodic withdrawal of certain minimum amounts, known as the required minimum distribution. If a person is still working at age 70½, however, he generally is not required to make required minimum distributions from his current employer's plan. This may be advantageous for those who plan to work into their 70s.
- Employer Stock—An investor who holds significantly appreciated employer stock in a plan should consider the negative tax consequences of rolling the stock to an IRA. If employer stock is transferred in-kind to an IRA, stock appreciation will be taxed as ordinary income upon distribution. The tax advantages of retaining employer stock in a non-qualified account should be balanced with the possibility that the investor may be excessively concentrated in employer stock. It can be risky to have too much employer stock in one's retirement account; for some investors, it may be advisable to liquidate the holdings and roll over the value to an IRA, even if it means losing long-term capital gains treatment on the stock's appreciation.

BICE. The proposed BICE impacts the customer experience at this stage in various ways. First, the Firm is maintaining a publicly available website that Carl can access at any time, which provides the following information about each of the investments the Firm currently has available or sold to investors within the scope of BICE within the last 365 days:

Type of investment	Provider name, subtype	Transactional			Ongoing			Affiliate	Special rules
		Charges to investor	Compensation to firm	Compensation to adviser	Charges to investor	Compensation to firm	Compensation to adviser		

As the Firm makes available mutual funds and annuities from dozens if not hundreds of product providers, each of which may have multiple share classes or pricing structures, the website has hundreds if not thousands or even millions of detailed entries. Unfortunately, the detailed entries contain mostly narrative descriptions, cross-references and ranges because the information elicited cannot be boiled down to a simple number or formula in the vast majority of cases. For instance, in the box titled "compensation to the adviser" the entries state that advisers may receive between 50% and 91% of Gross Dealer Concession depending on a number of factors detailed in a footnote at the bottom of the page. Anne's Compliance Department is concerned that this disclosure methodology may not be sufficient but is uncertain how to meet the requirement for the thousands of financial advisers who act as the Firm's representatives. This information and format is designed for financial professionals.[32] It is not at all useful for retail investors.

Also, because some of this information is not readily available to the Firm and/or is difficult on calculate on a transaction basis, creating and maintaining this website is a costly and uncertain endeavor. The Firm purchases at least some of the data from an outside vendor. These costs increase the price to Carl of the services provided by Anne and the Firm, even though it is of no utility to him. See the discussion below of the compliance costs projected in the Oxford Economics report attached to this letter.

Finally, in order to rely on the BICE, Anne must obtain Carl's signature on a contract (incorporated by the Firm with the new account agreement) containing the provisions required by the BICE before delivering any recommendations. Because Carl is pressing for a recommendation, the Firm's compliance policies require Anne to suspend her assistance to Carl until he has signed the account agreement. (This is the most reliable way the Firm has found to operationalize the BICE contract requirement in a manner that assures compliance with the exemption.) Carl is entirely perplexed about being asked to sign an agreement before he has received any investment recommendation, much less decided to engage Anne and the Firm. Carl's reaction puts Anne and the Firm in a quandary. Any recommendation must be deferred until Carl becomes comfortable with this procedure and signs the agreement.

FSI Alternative. Our alternative also calls on the Firm to maintain a public website disclosure (or provide paper copies free of charge) but, in sharp contrast to the BICE, its disclosures are designed to allow investors to better understand both the existence of payments to be made to the Firm and financial advisor, and the purposes of such payments. The expanded disclosures featured on the Firm's website include: A detailed schedule of typical account fees and service charges;

- A page containing information for each type of packaged product (e.g., mutual funds, variable annuities, unit investment trusts, etc.) that includes:
  - Educational information describing the product,
  - Considerations for selecting a particular share class or ways to reduce sales charges (if applicable), and
  - Narrative descriptions of the types of arrangements in which the Firm receives an economic benefit from a product manufacturer. The narrative descriptions include a statement on whether these arrangements impact financial advisor compensation; and,
- A list of all product manufacturers with whom the Firm maintains arrangements that provide economic benefits to either the financial advisor or the Firm.

[32] Preamble to Proposed BICE Exemption, 80 Fed. Reg. 21960, 21973 (April 20, 2015).

- To the extent the Firm maintains tiers representing different levels of arrangements with product providers, the Firm groups the product providers by tier and provide a narrative description of the benefits that different tiers offer. Differences in economic arrangements within a band tend to be narrow.

As compared to the website proposed in BICE, this website provides an investor-friendly, concise, cost-effective disclosure of conflict information in a narrative form. It apprises the investor, in the most direct and accessible manner, of the presence, nature and scope of any competing interests on the part of the advisor and the firm. It is consistent with the judgments made by the Department in ERISA Reg. §2550.404a-5 about how such information is most usefully and effectively communicated to retail investors. And it can be developed and maintained by the Firm utilizing existing resources, without purchasing data from vendors or costly systems builds.

3. Carl meets with Anne again, this time to discuss Anne's recommendations for meeting Carl's retirement investment and income needs. Anne presents an account agreement for Carl to sign, along with other disclosures and information the Firm requires be given at account opening. This information covers fees and charges imposed by the Firm. Carl responds that he wants to hear Anne's recommendations before signing any documentation, and in any event, wants to take the information home with him to review. Carl then receives Anne's recommendation that:
    a. His assets available for retirement income can better be structured to provide a dignified standard of living, including servicing his debt obligations, if he does not immediately pay off his mortgage;
    b. He roll his 401(k) balance out of the SmallCo Plan to an IRA. SmallCo does not subsidize the costs of Plan recordkeeping and operation, so the Plan offers mid-priced investment options in order to defray those costs. Carl is no longer actively employed and is unlikely to make use of the Plan loan facility in retirement, so there is no reason for him to continue contributing to the payment of those Plan costs;
    c. He use a portion of the rolled over balance to purchase, in IRA form, a specified market-priced single premium immediate fixed annuity issued by ABC Insurance Company, an insurance company generally recognized as having a stable claims-paying ability. The annuity together with Social Security would provide Carl a baseline retirement income that he cannot outlive; and
    d. He invest the remainder through the IRA in a specified portfolio of diversified, buy-and-hold mutual funds offered by the Northeast Fund Group, to provide for emergencies including extraordinary health costs, other liquidity needs, and inflation protection. The recommended portfolio utilizes a larger set of investment strategies than those available under the Plan, in order to improve the projected efficiency of the investment strategy. Structuring the portfolio as a commission-based brokerage account using A shares, taking into account sales charge breakpoints, projects to be less expensive to Carl over time than using an advisory account structure. Two of the recommended funds offer fee waivers for IRAs. Any increase in total cost over leaving Carl's remaining balance in the Plan reasonably reflects, at a minimum, the value of the time, expertise and services provided by Anne and the Firm. Anne also notes that Carl is not comfortable making his own

investment decisions and is concerned that left to his own devices would try to time the market by moving out of equity funds during market downturns and coming back after long bull runs. Carl has also told Anne that he is very worried about having to make investment decisions on his own. Anne believes that by providing Carl with ongoing assistance he will have greater peace of mind during his retirement years.

Anne gives Carl copies of the "investor kit" containing sales materials for the investments and prospectuses for the mutual funds she has discussed. Carl takes the information home with him.

Existing Law	BICE	FSI Alternative
• Anne can only discuss and recommend investments that the Firm, after a "new product" due diligence process, is authorized to make available to customers. • Both FINRA and state insurance law require Anne to have a reasonable belief, after reasonable diligence into the customer's profile, that she is recommending investments suitable for the customer.[33] • Predictions of future investment performance are prohibited. • The fees set by the Firm and the selling compensation paid by product providers must be "fair and reasonable." • FINRA rules permit non-cash incentive compensation for sales of certain investments, such as mutual funds and variable contracts, only if the	• Anne and the Firm are subject to all "Existing Law" requirements. • Anne's recommendation must meet a "best interest" standard without regard to the interest of herself, the Firm or any other person. • Anne may only recommend investments among the 13 asset classes permitted by BICE. • If the Firm's investment platform is not sufficiently broad with respect to all the asset classes reasonably necessary to service the best interests of a specific customer, it must provide certain disclosures to that customer. • Anne and the Firm may not recommend investments to the extent they would receive more than "reasonable compensation." • The Firm may not use quotas, appraisals, bonuses, awards,	• Anne's recommendation must meet a "best interest" standard that puts Carl's interest first. • Anne provides Carl with a short-form narrative disclosure focused on the issues most important for retail investors. • As explicitly stated in the short form disclosure, Anne provides Carl on request specific information about the compensation she would receive if her recommendations are implemented. **Conclusion** – FSI supports a best interest standard. Investors are provided with the information most relevant to their decision making in a short and digestible format.

[33] Both FINRA and the SEC also require firms to assess the appropriateness of account types. *See e.g.*, NASD Notice to Members 03-68; National Exam Program Risk Alert, Volume IV, Issue 6, Retirement-Targeted Industry Reviews and Examinations Initiative.

Existing Law	BICE	FSI Alternative
compensation is based on "total production" of such investments, with equal weighting given to all products. • Material information about securities and annuities must be delivered to the customer in prospectuses or other specified forms of documents. These include disclosures about product costs. Other required disclosures are integrated into the new account form. **Conclusion** – A financial advisor may only recommend suitable investments that have been authorized by the broker-dealer after due diligence. Compensation must be "fair and reasonable." The prospectus provides a comprehensive summary of the relevant information on the product, including its costs.	differential compensation or incentives that "tend to encourage" Anne to make recommendations not in the best interest of Carl, creating a potential conflict with the FINRA "total production" requirement. • Anne must provide Carl with a chart that shows for each asset recommended by Anne the total cost (acquisition, ongoing, disposition and other costs including operating expenses) for the retirement investor for one-year, five-year and ten-year periods expressed in a dollar amount, assuming an investment of the dollar amount recommended by Anne and reasonable assumptions about the investment performance are disclosed. **Conclusion** – In addition to the best interest standard, the BICE adds broad range, legal list and "reasonable compensation" requirements that are duplicative of or unnecessary in light of other regulatory requirements. The BICE supplements the product prospectus with complicated and costly disclosures. These complex and duplicative disclosures have the potential to overwhelm investors. Finally, compliance with the BICE requirement to project future costs will result in firm's violating FINRA rules.	

This stage in Anne's interaction with Carl brings in to play important investor protections under SEC, FINRA and state insurance requirements with respect to the substance of the recommendation Anne makes to Carl, the compensation received by Anne and the Firm, and the investment disclosures provided to Carl.

- In the case of securities that can be acquired only in the context of a securities offering (such as mutual funds or variable insurance contracts), Anne can discuss and recommend only those specific investments that the Firm is authorized by agreement to make available to its customers. In the securities industry, such investments generally are available only through broker-dealers that have entered into an agreement with the issuer of the investment or designated distributor to "participate" in the offering. A broker-dealer takes on certain responsibilities when entering into an agreement to participate in an offering, including a "due diligence" obligation with regard to the offering. In addition, for certain types of offerings, FINRA rules impose duties and restrictions on firms participating in the offering. The Firm has implemented appropriate policies and procedures designed to ensure that its participation in offerings complies with these rules.
- The Firm also has adopted a "new products" program for vetting offerings before deciding to enter into an agreement. This new products program was designed to comply with "best practices" recommended by FINRA for such programs.[34] Under the Firm's "new products" program, a team of designated senior management, operational, compliance and legal personnel follow a standardized process for evaluating an offering to determine if the Firm should participate in the offering. This process entails conducting due diligence on the offering and offering materials, ascertaining whether the offering can be supported operationally by the Firm, and determining whether any limits should be placed on the types of investors or the amounts that investors can invest in the offering. The Firm has adopted guidelines and standards specific to the features of different investments, such as mutual funds, variable annuities, structured notes, real estate investment trusts, and other investments. The Firm also analyzes the offering under the "reasonable-basis" component of the FINRA suitability rule. In this regard, FINRA has explained that the suitability obligation (discussed below) has three components: reasonable basis suitability (i.e., a recommendation is suitable for at least some investors), customer-specific suitability (i.e., the recommendation is suitable for a particular customer) and quantitative suitability (relevant to a series of recommendations). The Firm also considers the training or education needs of its representatives to ensure that they understand the features of the investments being offered. The Firm considers sales support and other information that the distributor for the offering may provide. Investment product sponsors may facilitate this training or help to underwrite its cost.
  - If the Firm decides to pursue participation in an offering, it then considers the terms of the selling agreement that it must enter into in order to participate. The terms of these agreements are regulated under SEC and FINRA rules and typically cover the conduct and conditions of the offering. Also, these agreements typically prohibit Anne and the Firm from furnishing information about the securities or offering other than information provided by the issuer or distributor for the offering. Any materials used in connection with the offering other than the prospectuses are likely to be subject to FINRA communication

[34] See NASD Notice to Members 05-26.

rules and may also be subject to FINRA filing requirements. Ordinarily, the distributor agrees to be responsible for filing these materials with FINRA; this responsibility is typically addressed in the selling agreement.

  - The Firm generally seeks to participate in a number of offerings at any point in time that will address an array of investors and investment situations and will provide diversification, both from the Firm's perspective, as well as customers' perspective. The Firm generally refers to the list of available offerings as its "menu."

- Anne's recommendations must comply with FINRA's suitability rule.[35] This rule requires a broker-dealer or associated person to have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the firm or broker to ascertain the customer's investment profile. This investment profile is to include the customer's age, other investments, financial situation and needs, tax status, investment objective, investment experience, investment time horizon, liquidity needs, risk tolerance and any other information the customer may disclose to the firm or associated person in connection with the recommendation. Further, as noted above, FINRA has explained that the suitability obligation has three components: reasonable-basis suitability, customer-specific suitability and quantitative suitability.[36] Anne's recommendations are limited to investments for which the Firm has already made a "reasonable basis" suitability determination under its "new products" program discussed above; given this, Anne's recommendation primarily implicates the "customer-specific" suitability component of the suitability obligation.
  - Anne's recommendations followed the process contemplated by FINRA's suitability rule. Anne first collected investment profile information for Carl through the completion of the new account form. The Firm's new account form has been designed to collect the "investment profile" information, as well as other information about the customer, the Firm considers relevant. Anne noted in particular Carl's concern about lifetime income.
  - Once Anne understood Carl's investment objectives and situation, Anne realized that no one investment would achieve Carl's overall objectives. Anne then developed an investment strategy, contemplating several coordinated investments. Anne's recommendations encompass both a recommendation to purchase specific securities (shares of mutual funds in the Northeast Fund Group) and an investment strategy recommendation (allocating the rollover balance among the annuity and specified mutual funds). FINRA's suitability rule applies to both types of recommendations.
  - In developing her recommendations regarding Northeast Fund Group mutual funds, Anne considered the investment objectives and historical performance of the funds available in the retirement plan offered by Carl's employer as well as the funds available on her Firm's menu. Anne also considered the fees and charges associated with long-term investment in these mutual funds, including the sales charges and other expenses associated with different classes of fund shares, as well as those associated with the mutual fund investment options in Carl's employer's retirement plan. Anne determined that the A share class, which pays a front-end sales load and ongoing 12b-1 fee, in the Northeast Fund Group would appear to be the most economical over the long term, assuming certain investment returns, particularly because the rollover amounts to the

[35] See FINRA Rule 2111.
[36] See id.

recommended funds combined would qualify for breakpoint reductions in the sales charges. Anne knows a FINRA rule prohibits the sale of mutual fund shares in dollar amounts just below the point that would qualify for sales charge discounts.[37] Anne looked into whether Carl was eligible for any sales charge waivers, given that his investments would be for a retirement account. Anne also considered the fees and charges associated with any changes over time in the amounts invested in the mutual funds, given that Carl's investment needs and objectives might change over the course of his retirement years. She decided to recommend funds from the same family of funds offering exchange privileges so that Carl could (i) reallocate his investments among multiple funds and corresponding asset classes over time without incurring additional sales charges and (ii) combine those investments in the same fund family to qualify for sales charge breakpoints. In making her recommendation to Carl, Anne presented each of the fund class options in a balanced manner.

- Anne also is attentive to state insurance suitability requirements, which apply to the recommendation to purchase a single premium immediate annuity. These rules impose suitability and supervision requirements for annuity recommendations similar to those imposed under FINRA rules.[38] Anne can sell an annuity to Carl only if she is appointed by the insurance company whose annuity she recommends. To qualify for appointment, Anne must satisfy, among other things, training requirements relevant to annuities.
- Anne was careful, though, to avoid making any predictions to Carl regarding investment performance. FINRA rules generally prohibit the use of any projections of future performance for an investment, and thus would prohibit the projection of fees and costs associated with an investment to the extent that the projection takes into account future performance.[39] This prohibition is emphasized in the training and compliance manuals provided by the Firm to its registered representatives.
- Anne gave Carl an information brochure regarding the Firm's fee schedules and other account-related charges, as well as disclosures regarding compensation arrangements with investment product providers and sponsors, in connection with account opening activities. This brochure describes the ways in which the Firm is compensated, depending on the type of transaction and service provided, and explains that some of the costs incurred by a customer are charged directly to the customer, whereas some of the costs associated with an investment are paid by the issuer or distributor of the investment (as is typical for investments distributed in an offering, such as mutual funds or variable annuities).
- In setting its fee schedule, the Firm is cognizant of FINRA rules and state securities rules imposing "fair and reasonable" standards on the various types of compensation paid in connection with securities transactions (e.g., commissions, markups, concessions and allowances), as well as account fees and charges. The "fair and reasonable" standards generally take into account "all relevant circumstances."[40] The Firm maintains policies and procedures for the review of the fairness of the fees and

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[37] See FINRA Rule 2342.
[38] See Suitability in Annuity Transactions Model Regulation developed by the National Association of Insurance Commissioners (NAIC) and adopted by a majority of states.
[39] See, e.g., FINRA Rule 2210.
[40] See, e.g., FINRA Rules 2121, 2122 and 5110 and NASD Rule 2830.

other charges the Firm assesses against customer accounts. In the case of offerings, where the selling compensation is set by the issuer or distributor, the Firm considers the reasonableness of the selling compensation arrangements as part of its "new products" program review, discussed above.

- Anne would receive transaction-based compensation from her Firm if Carl implements her recommendations. As annuities and mutual funds are different types of financial instruments, the compensation arrangements for each of them are different. The rate of compensation for the mutual fund shares would be modestly less than the rate of compensation on the annuity, in part due to the effect of the breakpoints. In the case of the annuity transaction, the ABC Insurance Company would pay the Firm. In the case of the Northeast Funds, the fund distributor would pay the Firm an agreed upon percentage of the sales charges and 12b-1 fees applicable to the fund shares purchased for Carl's account. In addition, both the Northeast Funds and the ABC Insurance Company pay Anne's firm marketing support payments that help to offset some of the cost of maintaining her firm's brokerage platform and for the ongoing due diligence of the products offered on its menu. Finally, the Northeast Funds pay Anne's firm sub-transfer agent fees to reflect shareholder accounting services provided by Anne's firm to the Northeast Funds. Specifically, Northeast Funds does not have to maintain separate account records for each of the firm's clients and does not have to send out prospectuses or other documents because these items are handled by Anne's firm. Under Anne's agreement with the Firm, Anne would receive a percentage of some of the amounts received by the Firm (Anne would not receive a portion of the marketing support payments or the sub-transfer agent fees).

  The transactions for Carl's account would also be taken into account by Anne's Firm in determining her eligibility under the Firm's incentive compensation programs. FINRA rules limit the use of non-cash compensation, gifts and entertainment, and training and education benefits in connection with certain securities offerings, including mutual funds. FINRA rules permit non-cash incentive compensation for sales of certain investments, such as mutual funds and variable contracts, only if the compensation is based on "total production" of such investments, with equal weighting given to all products (i.e., the same weighting for non-proprietary investments as for proprietary investments).[41] The Firm's non-cash incentive program is specifically designed to comply with the total production and equal weighting requirements of these rules.

- Anne's delivery of the investor kits is intended to satisfy information disclosure requirements imposed by applicable law. In the case of investments subject to the federal securities laws, the federal securities laws generally require the delivery of a prospectus if the investment recommendation involves a security offered by a prospectus.[42] In the case of insurance contracts, a number of states that impose disclosure requirements for annuity transactions, including the delivery of a "buyer's guide" for fixed annuities and equity indexed annuities. The investor kits are typically provided by the distributor (in the case of securities) or the insurer (in the case of annuity contracts). The application forms for the purchase of fund shares or an annuity policy typically request the applicant to indicate whether they received the materials in the investor kit.

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[41] See, e.g., FINRA Rules 2310, 2320 and 5110 and NASD Rule 2830.

[42] See Section 5 of the Securities Act of 1933. For clarity, we note that prospectuses are routinely available from public sources, and sometimes are formally delivered with the transaction confirmation rather than with the investment recommendation.

- Certain rules require the delivery of notices or disclosures at account opening, such as a notice regarding the firm's CIP program, privacy policy and business continuity policy.[43] The Firm has integrated these notices into the new account form/account agreement to make sure that the information is conveyed to the customer in a convenient, integrated form. Anne has been trained to point out these disclosures to customers when assisting them with completing the new account form.

BICE. Anne is providing Carl a recommendation in the FINRA sense, so she becomes an ERISA fiduciary under the Proposal and requires the relief provided by BICE because her compensation may differ with the investment choices Carl makes.[44] The BICE would impose a number of additional requirements on this interaction, some of which duplicates and/or does not comport with existing law.

In the customer experience, the BICE contract would most sensibly be introduced in the account opening process. Under the Proposal, however, that contract must be executed in advance of any recommendation, which functionally splits customer account opening documentation into two separate processes. This is both inefficient and customer-unfriendly.

In addition to complying with the suitability rule, Anne's recommendation must be in Carl's "best interest," reflecting the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor, without regard to the financial or other interests of the advisor, financial institution or any affiliate, related entity, or other party.

Anne's recommendation must be limited to an investment falling into one of the 13 asset classes described in BICE. For example, if it is in Carl's best interest to (i) structure his retirement investments as a brokerage account rather than an advisory account and (ii) include in his portfolio an interest in a non-traded REIT, the Proposal provides no means to effectuate that "best interest" transaction.

Also, the Firm would need to consider whether it is authorized to provide, and provides, most if not all of the 13 asset classes, as BICE requires a financial institution relying on the exemption to provide a range of options that is "broad enough" to enable its advisors to make recommendations with respect to all of the asset classes reasonably necessary to serve the "best interests" of the retirement investor. If a financial institution limits investments available to retirement investors based on whether the investments are proprietary products, generate "third-party payments" (defined to include sales charges, Rule 12b-1 fees and other payments by a third party) or for other reasons, the financial institution could still rely on the BICE, but only if four conditions are met:

- The financial institution makes a "specific written finding" that the limitations so imposed do not prevent the advisor from providing advice that is in the "best interest" of the retirement investor;
- Any compensation received in connection with an asset is reasonable in relation to the value of the specific services provided to the retirement investor in exchange for the payment and not in excess of the services' fair market value;

[43] See CIP Rule, Regulation SP and FINRA Rule 4370.

[44] We understand from statements made by representatives of the Department at the hearing that all of Anne's activities potentially affecting her compensation, including the advice to take a rollover and to utilize a commission-based rather than an advisory account, are intended to be within the scope of relief provided by the BICE.

- Before an investment recommendation is given, the retirement investor is given written notice of the limits placed on the assets; and
- The advisor notifies the retirement investor if the advisor (notably, not the financial institution) does not recommend a sufficiently broad range of assets to meet the retirement investor's needs.

If the Firm's investment platform would be considered to be limited under BICE, the Firm might be required to provide a notice of limitations to retirement investors when a recommendation is made.

Anne and the Firm may not recommend an asset if the total compensation anticipated to be received by them, affiliates and related entities in connection with the purchase, sale or holding of the asset would exceed reasonable compensation in relation to the total services provided to the retirement investor. The touchstone for this standard does not appear to align with the "fair and reasonable" standards under FINRA rules, which take into account all relevant circumstances, including market conditions with respect to the security at the time of the transaction, the expense involved and other considerations. Anne and the Firm intend to and believe they meet this requirement but, because of the absence of reliable benchmarks in the public domain and antitrust considerations, struggle to validate that determination.

The Firm may not use quotas, appraisals, bonuses, awards, differential compensation or incentives if they would "tend to encourage" Anne to make recommendations not in the best interest of Carl. This prohibition calls into question whether investments recommended to retirement investors must be excluded from conventional incentive programs maintained by broker-dealer firms, and whether the exclusion of those investments would cause a violation of "total production" requirements imposed by FINRA rules.

Anne must provide Carl with a chart that shows for each asset recommended by Anne the total cost (acquisition, ongoing, disposition and other costs including operating expenses) for the retirement investor for one-year, five-year and ten-year periods expressed in a dollar amount, assuming an investment of the dollar amount recommended by Anne and reasonable assumptions about the investment performance are disclosed.

- This chart would appear to violate FINRA rules prohibiting projections of performance for investments.[45]
- Even if allowable, the development of "reasonable" assumptions is a challenge for the Firm. The Firm is inclined to think that historical rates of return for asset classes make the most sense, but is concerned about a range of circumstances that in hindsight might make such an assumption appear "unreasonable," e.g. (i) particular investments that deviate significantly from the performance of the asset class, (ii) the effect of a change in a product's management or investment strategy on a projection of performance, and (iii) the consequences of a period of higher market volatility on projections as short as one and five years. The Firm also struggles with how frequently it must cause Anne to update Carl's chart to take account of daily changes in the market.

[45] FINRA Rule 2210.

The chart is also difficult and expensive to provide, given the Firm's existing systems capabilities and offerings available from vendors and the fact that the information being requested is largely outside of the Firm's control:

- It is not clear what the "total cost" of a mutual fund holding would be. Would the firm merely use the current operating expense or would the firm be required to take into account the trading costs of the mutual fund which are not included in the operating expense ratio? What should the Firm use for the operating expense ratio if the fund's investment manager is currently waiving a portion of its management fee?
- What would be the total cost of the fixed single premium annuity? The ABC Insurance Company is hoping that the premium it received will be less than the present value of the payments it makes to Carl over his lifetime plus the present value of any commissions paid to the Firm. Meanwhile the Firm knows how much it will receive from ABC Insurance Company and could disclose that amount but is concerned that this might not be the total cost. The Firm has no way of knowing what ABC Insurance Company might earn from the issuance of the contract yet will have engaged in a prohibited transaction if the Firm provides a chart that is not accurate.
- What would be the total cost of a variable annuity? In addition to the mutual fund and fixed annuity concerns raised above, variable annuities charge a mortality and expense fee and rider fees in exchange for valuable rights provided to the client. For instance, the mortality and expense fee would cover both the commission paid to the Firm plus the return of principal guarantee inherent in the variable annuity should Carl die prior to annuitizing and have suffered a market loss.

The Oxford Economics report attached to this letter projects the cost of implementation of the BICE contract requirement to average $4.5 million per broker-dealer, the cost of the BICE disclosure requirements to average $870,000 per broker-dealer, and the cost of the data collection required by BICE to average $570,000 per broker-dealer.

FSI Alternative. In contrast, our alternative is specifically designed to mesh with both the customer experience and other applicable bodies of law. Most importantly, in providing a recommendation, Anne and the Firm must:

- Act in Carl's best interest;
- Provide advice with skill, care, and diligence based upon information that is known, about Carl's investment objectives, risk tolerance, financial situation, and other needs; and
- Disclose and manage material conflicts of interest, avoid them when possible, and obtain Carl's informed consent to act when such conflicts cannot be reasonably avoided.

This formulation is intended to comport not only with Section 404(a) of ERISA, but also fiduciary standards applicable under federal securities laws. The cure for conflicts contemplated by this standard is provided through the "best interest" prohibited transaction exemption. Because of our concerns about the remedial aspects of the Proposal, the FSI alternative positions the "best interest" standard as a term of the exemption, rather than as a term of a tri-party written contract or other binding legal obligation to the retirement investor.

Instead of the BICE contract and the point-of-sale disclosure, the account opening documents Anne provides to Carl includes a short-form disclosure document that includes:

- A statement of the best interest standard of care owed by the Firm to the client;
- The nature and scope of the business relationship between the parties, the services to be provided, and the duration of the engagement;
- A general description of the nature and scope of compensation to be received by the Firm and financial advisor;
- A general description of any material conflicts of interest that may exist between the Firm, financial advisor and investor;
- An explanation of the investor's obligation to provide the Firm with information regarding the investor's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other relevant information the customer may choose to disclose, as well as an explanation of the investor's obligation to inform the Firm of any material changes in this information;
- A statement explaining that customers may research the Firm and its financial advisors through FINRA's BrokerCheck database or the IARD;
- A phone number and/or e-mail address the investor can use to contact the Financial Institution regarding any concerns about the advice or service they have received; and
- A description of the means by which a customer can obtain more detailed information regarding these issues, free of charge, including a link to the section of the Firm's website featuring the disclosures discussed above.

This short-form disclosure is focused on the issues that are of greatest importance to investors; functionally, it is the retail investor version of the disclosures required for plan fiduciaries under ERISA Reg. §2550.408(b)-2. It also constitutes an up-front commitment on the part of the Firm and the advisor to act in the best interest of the client, enforced through the exemption without the procedural complications of the BICE contract.

On request, Anne provides Carl specific information about the compensation she would receive if he acts on her recommendation. Under the FSI alternative, retirement advisers incur the cost of providing this information only to retirement investors who find it sufficiently material to request it. The short-form disclosure puts Carl on notice that this information is available from Anne.

The FSI alternative would not include a "legal list" of permissible investment types, but instead would rely on the best interest standard to police those concerns. If Anne recommends that Carl invest through a brokerage account in a non-traded REIT, relief would be available only if that investment is in Carl's best interest, e.g. because its returns are not correlated with the rest of the portfolio and thus provides important diversification, or because it generates income that fills out Carl's monthly needs in retirement. If the recommendation instead puts Anne's interest in receiving a commission first, the exemption would not be available.

4. Carl takes a few days to review the information and decides to move forward with the recommendations. Carl meets again with Anne to sign the account agreement and various forms (including retirement plan rollover forms). Anne submits the information to the Firm, which opens an IRA account for Carl and initiates the processes for the purchase of the annuity and fund shares with amounts rolled over from Carl's retirement plan.

Existing Law	BICE	FSI Alternative
• Firms must have review processes for customer accounts, including special processes for retirement accounts. • Account opening documentation, including pre-dispute arbitration provisions, must meet FINRA requirements. • Firms must retain and verify customer profile information. • Firms must have a processes for reviewing and approving transactions for customer accounts, including a review of suitability, rollover considerations and the other factors discussed above • Pursuant to FINRA guidance, firms are to maintain other policies for managing and mitigating compensation-related conflicts. • Firms must conduct periodic examinations of customer accounts to detect and prevent irregularities or abuses. **Conclusion** – Firms are obligated to supervise customer transactions and mitigate conflicts of interest, while	• Anne and the Firm are subject to all "Existing Law" requirements. • Statements made by Anne and the Firm about investments, fees, "material conflicts of interest" and other information relevant to Carl's decision may not be misleading. • The Firm must make a determination that a commission-based account structure aligns with the best interests of investors. • The Firm must warrant that it is in compliance with all applicable law relevant to this investment activity. • The Firm must warrant that it has adopted written policies and procedures designed to mitigate the impact of "material conflicts of interest" and "ensure that its individual advisers adhere to impartial conduct standards." **Conclusion** - The foregoing, which in some respects duplicate existing law, are "principles-based" conditions for which there is no definitive means to comply. Failure to comply opens firms to significant liability exposure.	• The Firm must adopt policies and procedures that meet specified criteria to mitigate the effect of potential conflicts of interest. **Conclusion** – This approach provides a reliable means to satisfy the exemption and promotes consistency between retirement and non-retirement accounts, improving the firm's ability to comply in operation.

Existing Law	BICE	FSI Alternative
observing high standards of commercial honor and just and equitable principles of trade.		

This step in the process triggers SEC and FINRA rules governing the acceptance of customer accounts, execution and supervision of transactions and transaction confirmations.

- FINRA rules require a member firm to have processes for the review and approval of each customer account.[46] In addition, a member firm must review account information to identify specially designated nationals under OFAC rules and any suspicious activity under anti-money laundering laws, rules and regulations. Anne's Firm has designated personnel responsible for reviewing and approving the opening of customer accounts pursuant to the Firm's procedures and standards. Designated personnel review the new account form and any other information collected to determine if the account and account owner meet the Firm's requirements. In this case, because Carl's account will be an IRA account, designated personnel review the account information under the standards adopted for retirement accounts, and "code" the account as a retirement account for purposes of monitoring future activity in the account.
- FINRA rules regulate any pre-dispute arbitration provision in an account agreement, and require that specified disclosures be provided to clients about arbitration procedures.[47] SEC rules require the firm to provide a copy of the account agreement to the client.[48] The Firm's account agreement is integrated into its new account form. As part of the Firm's account opening process, designated personnel confirm that Carl has signed an account agreement with the Firm (which also functions as an account agreement with its clearing firm) and that a copy has been provided to Carl. The Firm captures Carl's signature in its systems to use for verification of signatures on any written instructions that Carl may provide at a later date.
- The Firm enters Carl's "investment profile" information into its system, and sends Carl a notice with that information, requesting that he contact the Firm if there is an error in the information, consistent with SEC rules.[49] It is important that this information be entered correctly, as the Firm's supervision and surveillance programs will be based on the information so entered.
- Broker-dealers are required to have processes for reviewing and approving transactions for customer accounts, including a review of suitability and the other considerations discussed above.[50] In the rollover setting, this includes a review in accordance

[46] See FINRA Rules 3110 and 4512.
[47] See FINRA Rule 2268.
[48] See SEC Exchange Act 17a-3.
[49] See id.
[50] See FINRA Rule 3110.

with the principles of FINRA Regulatory Notice 13-45. The review must be conducted by a registered principal and documented. The Firm has designated personnel responsible for conducting a review of transactions effected for customer accounts. Under the Firm's review procedures, transaction(s) are compared to the account information to determine if the transaction(s) is(are) suitable for the customer account. The review procedures also take into account rules relevant to particular types of accounts or transactions. In the case of Carl's account, the review process would take into account applicable breakpoints, waivers and discounts relevant to Northeast Mutual Funds.

- The Firm recognizes that the compensation arrangements for mutual funds, which are based on long-standing practices in the securities industry, present potential conflicts of interest for the Firm and its registered representatives. In light of a report on conflicts of interest issued by FINRA in 2013, the Firm maintains written policies and procedures for identifying and managing compensation-related conflicts that:
    - Avoid creating compensation thresholds that enable a representative to increase his or her compensation disproportionately through an incremental increase in sales;
    - Maintain a supervisory program that employs specialized surveillance of a registered representative that is approaching a threshold that would (a) result in a higher payout percentage in a financial institution's compensation grid, (b) qualify an advisor to receive a back-end bonus, or (c) qualify an advisor to participate in a recognition club;
    - Maintain a neutral compensation grid that does not include higher payout percentages for products of a particular type;
    - Refrain from providing higher compensation to an advisor for the sale of proprietary products or products for which the firm has entered into revenue sharing arrangements;
    - Monitor recommendations around key liquidity events in an investor's lifecycle; and
    - Develop red flag processes that include compensation adjustments for employees who do not properly manage conflicts of interest.

These considerations are reflected in the Firm's review and supervision of Anne's recommendations.

- Broker-dealers are also required to conduct periodic examinations of customer accounts to detect and prevent irregularities or abuses, and to maintain written records of the date when such reviews are conducted.[51] Given this requirement, the Firm has implemented a number of integrated procedures and controls to monitor customer accounts, including the use of various activity and exception reports designed to identify potentially questionable transactions or patterns of transactions based on the sales practice risks presented by the types of transactions effected by the Firm. These reports include, with reference to Carl's account, activity and exception reports focused on IRA accounts and rollover transactions.

[51] See id.

BICE. The proposed BICE duplicates existing law by requiring that statements made by Anne and the Firm about investments, fees, "material conflicts of interest" and other relevant to Carl's decision may not be misleading. Otherwise, BICE introduces three additional regulatory requirements in a manner that leaves firms and advisors at material risk.

The Firm must make a determination that a commission-based account structure aligns with the best interests of investors. The Firm must also make a determination as to whether Anne's recommendation of the IRA rollover, the decision to purchase the single premium fixed annuity from ABC Insurance Company and the decision to purchase Northeast Funds was in Carl's best interest and without regard to either Anne's or the Firm's financial interests. This determination can be second-guessed by the Department or in a private action by a retirement investor.

The Firm must warrant that it is in compliance with all applicable law relevant to this investment activity. Even a de minimis violation of any of the other laws described in this letter – including laws which do not provide for any private right of action – potentially exposes Anne and the Firm to exposure under the BICE contract.

The Firm must warrant that it has adopted written policies and procedures designed to mitigate the impact of "material conflicts of interest" and "ensure that its individual advisers adhere to impartial conduct standards." The Firm is at risk whether its policies and procedures satisfy this requirement.

FSI Alternative. Our alternative avoids the risks created by the "principles based" approach of the BICE. Under the FSI alternative, the "best interest" exemption is predicated on a determination that variations in compensation to financial institutions and advisors among product types and product providers are not inconsistent with a best interest standard. It does not require separate (and contestable) determinations by each financial institution on that point.

In addition, adoption of the following policies and procedures by a financial institution would explicitly be sufficient to satisfy the exemption:

- Avoid creating compensation thresholds that enable a representative to increase his or her compensation disproportionately through an incremental increase in sales;[52]
- Maintain a supervisory program that employs specialized surveillance of a registered representative that is approaching a threshold that would (a) result in a higher payout percentage in a financial institution's compensation grid, (b) qualify an advisor to receive a back-end bonus, or (c) qualify an advisor to participate in a recognition club;
- Maintain a neutral compensation grid that does not include higher payout percentages for products of a particular type;
- Refrain from providing higher compensation to an advisor for the sale of proprietary products or products for which the firm has entered into revenue sharing arrangements;
- Monitor recommendations around key liquidity events in an investor's lifecycle; and

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[52] This is not to say that such thresholds are not allowable, but rather that they would be managed to minimize the risk that other than "best interest" advice is being provided.

- Develop red flag processes that include compensation adjustments for employees who do not properly manage conflicts of interest.

Finally, given the extensive regulation under other laws of the veracity and content of communications to investors, the FSI alternative imposes no additional requirements on this point. The FSI alternative also leaves the enforcement of other applicable laws to the remedies provided under those laws.

5. Carl receives confirmations and other disclosures about his transactions.

Existing Law	BICE	FSI Alternative
• Customers must receive confirmations of transactions. • Customers must receive quarterly account statements showing the values of securities held in their accounts and activity during the period covered by the statement. They may also receive periodic statements from product providers or insurance companies. • Firms are subject to substantial "books and records" requirements regarding customer accounts and transactions, and to make this information available to regulators on request. **Conclusion** – Investors are routinely provided information on their account holdings and transactions.	• Anne and the Firm are subject to all "Existing Law" requirements. • The Firm or advisor must send to retirement investors an annual statement listing each asset purchased or sold for the retirement investment and the related purchase or sale price – information that has already been included in the quarterly account statements – along with the total dollar amount of all fees and expenses paid directly or indirectly with respect to each asset sold, purchased or held by the account during the period and the total dollar amount of all compensation received by the adviser and financial institution directly or indirectly from any party as a result of each asset sold, purchased or held by the account during the period. • If the retirement investor decides to make additional investments or transfer between investments under the IRA, the point of sale disclosure chart must be	• To the extent not already provided, the total fees charged by the firm are reported on customers' annual account statements, which also include a narrative reminder that the compensation paid to the advisor is available on request. **Conclusion** – Low cost disclosures are provided to all investors. Those desiring greater detail may obtain it.

	reproduced (using the new investment amount or the transfer amount to develop the projections) if twelve months have passed between investments or if there has been a material change in costs. • Financial institutions must maintain, in a form that permits production to the Department on six months' notice, The Department can request a broker-dealer to provide information showing at the retirement investor level: (a) the name of the adviser; (b) the beginning-of-quarter value of the client's portfolio; (c) the end-of-quarter value of the client's portfolio; and (d) each external cash flow to or from the client's portfolio during the quarter and the date on which it occurred. The Department may publicly disclose any or all of this information so long as customer privacy is protected. **Conclusion** – Additional disclosure requirements are complex, costly, and likely to overwhelm and overload investors.	

Existing law regulates the information continue to receive about their accounts after transactions are effected.

Broker-dealers are required to furnish confirmations to customers to notify customers of the execution of orders and execution terms. Confirmations are also required to disclose information relating to commissions, fees, markups and other compensation received by the firms in connection with effecting the transactions. In the case of transactions in securities offered by a prospectus or other offering document, the broker-dealer generally can rely on disclosure of the distribution compensation arrangements in those documents.[53] Prospectuses would be delivered with the confirmation, if not previously provided.

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[53] SEC Exchange Act Rule 10b-10.

Broker-dealers generally must send quarterly account statements to their customers showing the values of securities held in the accounts and activity during the period covered by the statement.[54] Anne's Firm, like many broker-dealers, has arranged for its clearing firm to provide account statements. Knowing that the Firm remains responsible for the accuracy and timely delivery of the account statements, the Firm maintains a governance framework for the creation and distribution of account statements, as well as controls and audit protocols to confirm that the account statements are accurate and timely delivered. The Firm also permits its representatives to provide "consolidated" account statements to their customers that consolidate in one statement not only account information for the customer's account with the broker-dealer but also account information for other accounts that the client may maintain with other financial institutions, such as checking accounts, credit card accounts and advisory accounts. The Firm has adopted policies, procedures and controls in place to ensure that the information in the consolidated account statements is clear, accurate and not misleading consistent with FINRA guidance.[55]

Customers may also receive information periodically from the issuers of investments in their accounts. For example, a mutual fund investor receives updates to prospectuses and annual and semi-annual reports to shareholders and an investor in publicly traded equity securities may receive proxy statements and annual reports to shareholders. Depending on the circumstances, a broker-dealer may be responsible for the delivery of the prospectuses and statements on behalf of the issuer. Anne's Firm reviews updates to prospectuses and shareholder reports for securities that the Firm is continuing to offer to its clients.

State insurance regulations in various states require insurers to provide information periodically (typically annually) to contract owners regarding the status of their insurance contracts. As part of the process of becoming appointed by ABC Insurance Company to offer its annuity, the Firm confirmed that ABC Insurance Company sends these notices to contract owners, and requested that copies of the notices be sent to its representatives. In addition, the Firm arranged for ABC Insurance Company to transmit the account information to the Firm so that the Firm can include information in the consolidated account statements it provides to customers.

Broker-dealers are required to create and retain records relating to customer accounts and customer transactions, and to make this information available to regulators for review upon request.[56] The Firm maintains substantial books and records that satisfy these requirements and permit meaningful regulatory review by the Department pursuant to its ERISA Section 504 investigative authority. The Firm has designated a "books and records" principal who is responsible for the maintenance of all books and records, and is available to answer questions from regulators regarding the Firm's records.[57]

BICE. As proposed, BICE would materially increase the cost of post-transaction information collection and disclosure, in a manner that is unlikely to be of commensurate value to retirement investors.

Under BICE, the Firm or Anne must send to Carl an additional statement, within 45 days after the end of each year, listing each asset purchased or sold for the retirement investment and the related purchase or sale price – information that has already been

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[54] NASD Rule 2340.
[55] See FINRA Regulatory Notice 10-19.
[56] See Section 17 of the Securities Exchange Act of 1934 and FINRA Rule 8210.
[57] See SEC Exchange Act Rule 17a-3.

included in the quarterly account statements. The annual statement must include other information not ordinarily included in customer accounts statements, such as the total dollar amount of all fees and expenses paid directly or indirectly with respect to each asset sold, purchased or held by the account during the period and the total dollar amount of all compensation received by the adviser and financial institution directly or indirectly from any party as a result of each asset sold, purchased or held by the account during the period. As explained above, the Firm does not know what the total cost of mutual funds or annuity products are and would need to obtain this information from ABC Insurance Company and Northeast Funds. Neither company is currently obligated to provide this information so the Firm must amend its selling agreements to include this obligation. It is unclear whether most such product manufacturers will agree to provide this information given the cost and ambiguity related to what would be required. The Firm may have to greatly limit the products on its menu available to retirement accounts for this reason. Furthermore, even for the information related to the Firm's compensation and Anne's compensation, there is a material cost to capture, validate and report that additional information, and no process or tool currently available in the marketplace would automate that procedure. Carl very well may not appreciate receiving or value this report; studies find that investors are increasingly less desirous of this sort of disclosure.[58]

If Carl wants to make additional contributions to his IRA or transfer between investments under the IRA, the point of sale disclosure chart need not be provided with respect to subsequent recommendations of the same product if the chart was previously provided in the past twelve months and total costs have not materially changed. If more than twelve months have passed, the chart will need to be reproduced and redeveloped (using the new contribution amount or the transfer amount to develop the projections) even if there have been no material changes in costs.

The Department can request a broker-dealer to provide information showing at the retirement investor level: (a) the name of the adviser; (b) the beginning-of-quarter value of the client's portfolio; (c) the end-of-quarter value of the client's portfolio; and (d) each external cash flow to or from the client's portfolio during the quarter and the date on which it occurred. The BICE data request requirement compels the Firm to operationalize and maintain extensive account- and investment-level records beyond those required by FINRA and the SEC, also at a material cost and raise questions of data privacy.

The Firm must keep records of compliance with BICE for six years, at an average cost projected by Oxford Economics of $200,000.

FSI Alternative. Our alternative would reduce these incremental post-transaction requirements to the cost-effective essentials useful to retail investors. To the extent not already provided, the total fees charged by the Firm are reported on Carl's annual account statement, which also includes a narrative reminder that the compensation paid to Anne is available on request.

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[58] See, e.g., Final Rule: New Disclosure Option for Open-End Management Investment Companies, Exchange Act Release No. 33-7513 (March 13, 1998); Sandra West & Victoria Leonard-Chambers, Investment Company Institute, UNDERSTANDING INVESTOR PREFERENCES FOR MUTUAL FUND INFORMATION (2006), available at http://www.ici.org/pdf/rpt_06_inv_prefs_full.pdf; Karrie McMillan & Brian Reid, Comment Letter, Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, File No. S7-28-07 (August 29, 2008), available at http://www.ici.org/pdf/22836.pdf.

In sum, the FSI alternative implements a best interest standard supported by specifically targeted policies and disclosures that, as compared to the proposed BICE, are more workable, less costly, better leverage and integrate with existing law, and more effectively match the needs and capabilities of retail investors.