



August 6, 2020

*VIA E-RULEMAKING PORTAL*

Jeffrey J. Turner  
Deputy Director, Office of Regulations and Interpretations  
Department of Labor  
Employee Benefits Security Administration, Assistant Secretary  
200 Constitution Avenue NW  
Washington, DC 20210

RE: Improving Investment Advice for Workers & Retirees (EBSA-2020-0003)

Dear Mr. Turner,

MarketCounsel appreciates the opportunity to comment on the U.S. Department of Labor's ("the Department's") June 29, 2020 proposal to create a class exemption from certain prohibited transactions of the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code of 1986, as amended ("the Code"). Our comments pertain to the Department's proposed Improving Investment Advice for Workers & Retirees ("The Proposal") class exemption that grants fiduciary adviser status to financial professionals, who among other requirements, follow a best interest standard.<sup>1</sup>

For perspective, MarketCounsel Consulting ("MarketCounsel") is a New Jersey-based business and regulatory compliance consulting firm to some of the country's preeminent independent investment advisers. In addition, our affiliated law firm, the Hamburger Law Firm, renders legal counsel to entrepreneurial investment advisers, broker-dealers, hedge funds, family offices, and registered securities personnel. From its roots in 2000, MarketCounsel has been steadfast in its mission to deliver elegant solutions to the most substantial challenges faced by entrepreneurs in this fast-growing and highly-regulated industry.

The Proposal asked for public comment as to whether additional business models should be included in the Proposal's class exemption and whether any additional entities should be added to the Department's definition of financial institutions.<sup>2</sup> Rather than looking to expand those that are called fiduciaries, we respectfully submit that the Department should be looking to narrow the range of business models and entities to only those professionals and institutions who follow an actual fiduciary standard throughout the course of their customer relationships.

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<sup>1</sup> Improving Investment Advice for Workers & Retirees 85 Fed. Reg. 40,835 (July 7, 2020) <http://govinfo.gov/content/pkg/FR-2020-07-07/pdf/2020-14261.pdf> (hereafter "The Proposal")

<sup>2</sup> The Proposal at 40838.

As such, our comments are limited to highlight the differences in the standards of conduct that financial professionals follow and underline which financial professionals are held to a fiduciary standard. Our comments take into consideration the historical significance of the Proposal and how the Proposal can best address the looming retirement crisis facing this country by studying past regulatory proposals and the problems caused by investor confusion over fiduciary status.

### **THE ROOTS OF TODAY'S CONCERNS**

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As enacted in 1974, ERISA provides that a person is a fiduciary with respect to a plan to the extent that the person renders investment advice for a fee or for other compensation (direct or indirect) with respect to any moneys or property of the plan or has the authority to do so. The Code includes a parallel provision.<sup>3</sup>

In 1975, the Department established a five-part test to determine whether a person is a fiduciary if they did not meet the fiduciary definition under another provision of the statute.<sup>4</sup> To be an investment advice fiduciary, a person must meet all of the following five points:

- Renders advice to a plan as to the value of securities or other property or makes recommendations as to the advisability of investing in, purchasing or selling securities or other property;
- On a regular basis;
- Pursuant to a mutual agreement, arrangement or understanding with the plan or plan fiduciary;
- The advice serves as a primary basis for investment decisions with respect to such plan assets; and
- The advice will be individualized based on the particular needs of the plan.

Coincidentally, 1975 was a landmark year for the broker-dealer industry because the SEC ordered that fixed commissions be abolished in that year.<sup>5</sup> May 1, 1975 (“May Day”) and the technological innovations that followed cut the costs of trading and democratized investing.<sup>6</sup> Following May Day, commissions fell from an average of 80 cents per share in the early 1970s to four cents per share by the beginning of the 21<sup>st</sup> century.<sup>7</sup> Staring in the 1990s internet trading furthered this trend and today most major online brokers offer commission free trades on stocks and their options.<sup>8</sup> To offset the tremendous loss in commission revenue, broker-dealers created new business models and alternative ways to earn revenue. One of the most troubling of these alternatives has been the push by broker-dealers into the investment advice industry.

### **AN ERA OF CONVERGERNCE AND DISRUPTION**

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The push by broker-dealers into the investment advice industry has caused regulatory concern for over the last twenty-five years. The root cause of the concern is that broker-dealers, up through this year, followed a suitability standard designed for sales-based transactions. Investment advisers, however, follow a more stringent fiduciary standard.

In the 1990s, brokers-dealers started offering the same services that they traditionally provided (transaction-based securities sales) under a more enticing marketing package and charging an asset-based fee.<sup>9</sup> Their

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<sup>3</sup> The Proposal at 40834.

<sup>4</sup> *Ibid.*

<sup>5</sup> Zwiag, Jason. “How May Day Remade Wall Street.” *The Wall Street Journal*, May 1, 2015. <https://blogs.wsj.com/totalreturn/2015/05/01/remembering-how-may-day-remade-wall-street/>

<sup>6</sup> *Ibid.*

<sup>7</sup> Silber, Kenneth. “The Great Unfixing.” *ThinkAdvisor*, May 1, 2010 <https://www.thinkadvisor.com/2010/05/01/the-great-unfixing/>

<sup>8</sup> “As behemoth brokerage firms go zero-commission on trades, advisors are concerned”. *CNBC.com*, Nov 6, 2019 <https://www.cnbc.com/2019/11/06/as-brokerage-firms-go-to-zero-commission-on-trades-advisors-worry.html>

<sup>9</sup> Hershey, Robert D. “Investing; The Rise of the Fee-Based Account.” *The New York Times*, Jan. 27, 2002, [www.nytimes.com/2002/01/27/business/investing-the-rise-of-the-fee-based-account.html](http://www.nytimes.com/2002/01/27/business/investing-the-rise-of-the-fee-based-account.html)

entry into fee-based services along with a new emphasis on the advice they provided that was supposedly incidental to those transactions started to blur the lines between securities sales and investment advice.

By definition, any person who provides investment advice for a fee is an investment adviser and therefore should register as an investment adviser either with the U.S. Securities and Exchange Commission (“SEC”) or with state securities regulators.<sup>10</sup> Persons who register as investment advisers must follow a fiduciary standard that is applied to all conduct throughout the course of their advisory relationships.<sup>11</sup> Since this person stands in a place of trust and confidence to the investor, the fiduciary requirement is wholly necessary.

The Investment Advisors Act of 1940 (“Advisers Act”) offers an exemption to registration if the investment advice is “solely incidental” to the other services rendered.<sup>12</sup> While broker-dealers initially claimed this exemption when providing fee-based brokerage in the early 1990s and commission rates plummeted, it appeared less likely that their fees were for transactions and that their advice was solely incidental.

In 1994, these concerns led the SEC to form a broad-based committee on compensation practices. In what became known as the Tully Report, the committee found persistent conflicts of interest that could damage retail customers, including in fee-based brokerage accounts.<sup>13</sup>

In short, despite this landmark report, broker-dealers continued to avoid registering as investment advisers when providing fee-based brokerage. In addition, broker-dealers began calling their agents “advisors,” “consultants,” and “financial planners,” to name a few. Those titles clearly imply an advisory (rather than a sales) relationship with clients.<sup>14</sup>

In 2006, the RAND Corporation studied the effects of broker-dealers moving into the area of investment advice.<sup>15</sup> The report found that market participants had difficulty determining whether a financial professional was an investment adviser or a broker-dealer and that investors believed, erroneously, that investment advisers and broker-dealers offered the same services, subject to the same duties and the same standards of care.

In 2008, during the worst financial crisis since the Great Depression, investors needed objective advice. Too many were disappointed to learn that, although they had been paying an asset-based fee or otherwise believed that their broker-dealer was acting in their best interest, the advice that they had received was subject only to a suitability standard.<sup>16</sup> In other words, they learned that the advice was neither holistic, nor in their best interest at the moment they needed fiduciary advice the most.<sup>17 18</sup>

<sup>10</sup> “General Information on the Regulation of Investment Advisers” *US Securities and Exchange Commission*. March 11, 2011.

<https://www.sec.gov/divisions/investment/iaregulation/memoia.htm>

<sup>11</sup> “Commission Interpretation Regarding Standard of Conduct for Investment Advisers.” 84 Fed. Reg. 33669

<https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12208.pdf>

<sup>12</sup> 17 CFR § 275.202(a) (11)-1

<sup>13</sup> Report of the Committee on Compensation Practices.” *Sec.gov*, 10 Apr. 1995, <https://www.sec.gov/news/studies/bkrcomp.txt>

<sup>14</sup> Laby, Arthur B. “Reforming the Regulation of Broker-Dealers and Investment Advisers.” *The Business Lawyer*. February 2010.

<https://www.jstor.org/stable/41806629>

<sup>15</sup> “Investor and Industry Perspectives on Investment Advisers and Broker-Dealers.” *SEC.gov*, Jan 3, 2008,

[https://www.sec.gov/news/press/2008/2008-1\\_randiabdreport.pdf](https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf)

<sup>16</sup> *Welch v. TD Ameritrade Holding Corp.*, No. 07 Civ. 6904(RJS), 2009 WL 2356131 (S.D.N.Y. July 27, 2009). “Mere existence of a broker-customer relationship is not proof of its fiduciary character.”

<sup>17</sup> Browning, E.S. “Stock Investors Lose Faith, Pull Out Record Amounts.” *The Wall Street Journal*, Dec. 3, 2008, [www.wsj.com/articles/SB122990642933825357](http://www.wsj.com/articles/SB122990642933825357).

<sup>18</sup> Mincer, Jillian. “Insight: Mom and Pop Investors Miss out on Stock Market Gains.” *Thomson Reuters*, 30 Sept. 2012, [www.reuters.com/article/us-usa-stocks-retailinvestors/insight-mom-and-pop-investors-miss-out-on-stock-market-gains-idUSBRE88T0AE20120930](http://www.reuters.com/article/us-usa-stocks-retailinvestors/insight-mom-and-pop-investors-miss-out-on-stock-market-gains-idUSBRE88T0AE20120930)

## THE HISTORICAL SIGNIFIGANCE

The Department’s Proposal marks a decade of attempts to address the issue of which financial professionals should be considered an investment advice fiduciary. Understanding the historical significance of the moment and the likely long-term impact of the Proposal, we respectfully request that the Department methodically review public comments and study alternative solutions.

In 2010, following calls for reform of the investment advice industry in the wake 2008’s financial crisis, the Department published a proposed rule that would have amended the 1975 test for when a person becomes a fiduciary investment adviser. However, following considerable public comment, the proposal was withdrawn in 2011.<sup>19</sup>

In 2015, the Department announced a new proposal aimed at the types of advice that qualify as fiduciary in nature and offered exemptions to the rule. Under the Department’s 2016 Definition of the Term “Fiduciary”; Conflict of Interest Rule-Retirement Investment Advice (the Fiduciary Rule), broker- dealers were generally considered to be fiduciaries when they provide recommendations to participants in retirement plans and were subjected to additional requirements in order to charge commissions for their services.<sup>20</sup>

In 2017, the U.S. Fifth Circuit Court of Appeals struck down the Fiduciary Rule. The court explained its decision, “*When enacting ERISA, Congress was well aware of the distinction...between investment advisers, who were considered fiduciaries, and stockbrokers and insurance agents, who generally assumed no such status in selling products to their clients. The Fiduciary Rule improperly dispenses with this distinction.*”<sup>21</sup>

The court found that the Department had abused its power by ignoring the distinction between investment advisers who provide fiduciary investment advice and other financial professionals who perform a transactional, sales-based role. Following the court’s rationale, any subsequent fiduciary rule should respect the distinction between investment advisers and broker-dealers.

In determining who is a fiduciary, the Proposal seeks alignment with the standards of the SEC.<sup>22</sup> The SEC’s 2019 Regulation Best Interest (“Reg BI”) sets standards of conduct for broker-dealers and preserves the distinction between investment advisers and broker-dealers.

Reg BI preserves this distinction in large part by confirming fiduciary status to investment advisers while maintaining that broker-dealers do not follow a fiduciary rule. The SEC in its Reg BI commentary states, “*We have declined to subject broker-dealers to a wholesale and complete application of the existing fiduciary standard under the Advisers Act.*”<sup>23</sup>

We respectfully submit that, the Department should consider revising its Proposal so that its class exemption (1) respects the distinction between broker-dealers and investment advisers and (2) aligns with the SEC’s declination to subject broker-dealers to a fiduciary standard. The logical result is that broker-dealers should be prohibited from providing services that would require them to act as a fiduciary. Alternatively, should

<sup>19</sup> Conflict of Interest Rule—Retirement Investment Advice: Notice of Court Vacatur. *U.S. Department of Labor*. <https://www.dol.gov/sites/dolgov/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/investment-advice-fiduciaries/coi-retirement-investment-advice-notice-of-court-vacatur.pdf>

<sup>20</sup> “Definition of the Term “Fiduciary”; Conflict of Interest Rule-Retirement Investment Advice.” 81 Fed. Reg. 20945 <https://www.federalregister.gov/documents/2016/04/08/2016-07924/definition-of-the-term-fiduciary-conflict-of-interest-rule-retirement-investment-advice>

<sup>21</sup> *Chamber of Commerce v. U.S. Department of Labor*, No.17-10238, 2018 WL 1325019 (5th Cir. March 15, 2018). <https://cases.justia.com/federal/appellate-courts/ca5/17-10238/17-10238-2018-03-15.pdf?ts=1521156616>

<sup>22</sup> U.S. Department of Labor Proposes to Improve Investment Advice and Enhance Financial Choices for Workers and Retirees. *U.S. Department of Labor*, June 29, 2020. <https://www.dol.gov/newsroom/releases/ebsa/ebsa20200629> “*The standards in the Department’s proposed exemption announced today align with standards of other regulators, including the SEC.*”

<sup>23</sup> Regulation Best Interest: The Broker-Dealer Standard of Conduct. 84 Fed Reg. 33322. <https://www.govinfo.gov/content/pkg/FR-2019-07-12/pdf/2019-12164.pdf>.

the Department find a basis for broker-dealers to be referred to as fiduciaries, broker-dealers should then be held to a fiduciary standard.

### **THE IMPERATIVE FOR INVESTOR PROTECTION**

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America faces a retirement crisis. All three legs (social security, employer-provided pensions, and individual savings) of the retirement “stool” face a dire future.

The 2020 annual report of the Social Security Board of Trustees found that the trust funds that disburse retirement, disability, and other Social Security benefits will be depleted by 2035. That report encouraged lawmakers to address the issue as soon as possible and to take action using a broad range of policy options.<sup>24</sup>

Research by the Federal Reserve Bank of St. Louis found that, “for many American households, the total balances of their retirement accounts may not be sufficient to ensure a solid life in retirement.”<sup>25</sup> Research from the Economic Policy Institute finds that the gap between the retirement “haves” and “have nots” has grown since the 2008 financial crisis.

In the past, the U.S. could rely on a growing labor force for retiree support, but by the year 2030 all baby-boomers will be older than sixty-five and the number of older people is projected to outnumber children for the first time in U.S. history.<sup>26</sup> In the coming decade, it will be more burdensome for working-aged Americans to subsidize the retirement of older people.

Americans approaching retirement age need more protections. With the long decline of employer sponsored defined benefit plans and questions about the future of social security, individual savings in IRA accounts and defined contribution plans are forced to carry a much greater burden of providing for an aging population. COVID-19 has only made this looming crisis worse.

However, the Department has offered an admittedly deregulatory proposal that provides fewer protections.<sup>27</sup> The Proposal allows transactional insurance agents and broker-dealers to pose as fiduciaries at the moment would-be retirees need real fiduciary advice the most.

### **THE PROPOSAL WILL LEAD TO MORE CONFUSION**

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The Department’s new proposed class exemption would confer fiduciary investment advice status to broker-dealers who follow Reg BI.<sup>28</sup> Reg BI, however, is a far cry from a fiduciary standard. Therefore, Reg BI still leaves room for investor confusion.

Perhaps coincidentally, the Department released its proposal the day before Reg BI became effective. Up until that point, broker-dealers had always worked under a suitability standard. While Reg BI appears on its face to be a higher standard than suitability, it is unclear at the moment what kind of standard Reg BI will actually be. Reg BI avoids defining the term “best interest” and leaves the policies and procedures for implementing the standard up to the broker-dealers themselves.. One thing is for certain, however, we are sure it will not be a fiduciary standard.

The Proposal not only further blurs the distinction between investment advisers and broker-dealers by giving, at least in name, fiduciary status to broker-dealers, the proposal also relies on a brand new and

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<sup>24</sup> “A Summary of the Annual Reports.” Social Security Administration. <https://www.ssa.gov/oact/trsum/>

<sup>25</sup> “Many Americans Still Lack Retirement Savings.” *Federal Reserve Bank of St. Louis*. March 8, 2018

<https://www.stlouisfed.org/publications/regional-economist/first-quarter-2018/many-americans-still-lack-retirement-savings>

<sup>26</sup> “Older People Projected to Outnumber Children for First Time in U.S. History.” *The United States Census Bureau*. March 13, 2018, revised Oct. 8 2019. <https://www.census.gov/newsroom/press-releases/2018/cb18-41-population-projections.html>

<sup>27</sup> The Proposal at 40836.

<sup>28</sup> The Proposal at 40842 “*The standard is to be interpreted and applied consistent with the standard set forth in the SEC’s Regulation Best Interest.*”

largely undefined standard of care. Therefore, we urge the Department to take additional time to study Reg BI's impact on retail investors.

Further, broker-dealers who meet the Proposal's wide class-exemption, would be able to charge all types of fees that would otherwise violate the prohibited transactions rules, including but not limited to: commissions, 12b-1 fees, trailing commissions, sales loads, mark-ups and mark-downs, and revenue sharing payments from investment providers or third parties.<sup>29</sup> These compensation types lend themselves to retail investor confusion and abuse. These compensation types are not typically associated with the compensation of an advisor subject to a fiduciary standard.

The Department can resolve investor confusion and uncertainty around Reg BI by raising the first element of its Impartial Conduct Standards to require that the financial professional follow a fiduciary standard, rather than a best interest standard.

In addition to a best interest standard, the Proposal's Impartial Conduct Standards have two other requirements: (1) reasonable compensation and (2) no materially misleading statements.<sup>30</sup> Each of these requirements should be expected in any retail transaction. We submit Justice Cardoza's holding that a fiduciary should be held to higher standard than that of general marketplace.<sup>31</sup> Fiduciary requirements replace the general *caveat emptor*, with duties of loyalty and care. Therefore, we submit that Department also adopt the advertisement standards of the Advisers Act, specifically the standard of Rule 206(4)-1(a)5, which prohibits any untrue statement of a material fact, or which is otherwise false or misleading.<sup>32</sup>

In addition, the Proposal's disclosure requirement means that the financial professional must state in writing to the customer that the professional is a fiduciary under ERISA and the Code.<sup>33</sup> For broker-dealers and insurance agents who do not follow a fiduciary standard of care outside of ERISA or the Code, this statement will further confuse consumers as to the true nature of the financial professional.

## FINDING COMMON GROUND

We agree with the Proposal's rejection of the Department's prior position taken in its Deseret Letter.<sup>34</sup> Advice to take a distribution of assets from an employee benefit plan is advice that is often part of, or anticipation of, an ongoing relationship and represents one of the most critical decisions in an investor's financial lifetime.

We agree that the proposed class exemption should include other protective conditions. Disclosure to retirement investors, conflict mitigation, and a retrospective compliance review are all useful tools to ensure investor protection.<sup>35</sup> However, without being led by a fiduciary standard, those protections will prove inadequate.

<sup>29</sup> The Proposal at 80836.

<sup>30</sup> The Proposal at 808335.

<sup>31</sup> *Mienhard v Salmon*, 164 N.E. 454,546 (1928) "*Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place.*"

<sup>32</sup> 17 CFR § 275.206(4)-1.

<sup>33</sup> The Proposal at 40842.

<sup>34</sup> The Proposal at 40839.

<sup>35</sup> The Proposal at 40885.

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**CLOSING REMARKS**

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At MarketCounsel we admittedly champion the entrepreneurial independent investment adviser as the true bastion of objective investment advice. But we appreciate the utility that broker-dealers bring to the marketplace.

We support a real fiduciary standard for any investment professional who offers or appears to offer investment advice to retail investors, including advice to rollover assets from an employer sponsored plan into a retirement account. From our perspective, the Department's Proposal does not provide the protection of a fiduciary standard and will cause further investor confusion through its investment advice fiduciary terminology.

We respectfully submit that that the Proposal's Impartial Conduct Standards be raised to require that the financial professional: (1) follow a fiduciary standard of care rather than a best interest standard; and (2) is prohibited from making *any* untrue or otherwise misleading statement as that requirement is understood under the Advisers Act rather than adhering to a prohibition on *materially* misleading statements.

Even if these changes are not acceptable, since the Proposal aims to align with new standards of care by other regulators, most notably Reg BI, we request that the Department take significant to time to study the impact that these new standards will have on retail investors. Given the historical significance of the Proposal, we also think that the Department should explore alternative approaches to solving the long-standing issue of investor confusion caused by broker-dealers offering investment advice.

We are confident that these studies and changes would provide further protection to investors and improve the chances of avoiding a full-blown retirement crisis.

We hope that our comments made on behalf of us, and our independent investment adviser clients, who serve investors across the country, are beneficial to this process. Should you have any questions or require any additional information regarding any of the foregoing, we remain available at your convenience using any of the methods below.

Best regards,  
MARKETCOUNSEL, LLC



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Brian Hamburger, JD, CRCP  
President and CEO



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Daniel Bernstein  
Chief Regulatory Counsel