The Voice of Small Business.®

March 16, 2017

Edward Hugler
Acting Secretary of Labor
c/o Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

RE: Comments regarding the examination of the Fiduciary Duty Rule described in the President's Memorandum of February 3, 2017, RIN 1210–AB79 (82 *Fed. Reg* 12319)

Dear Mr. Acting Secretary:

The National Federation of Independent Business (NFIB) submits these comments for the record to the U.S. Department of Labor regarding the examination of the Fiduciary Duty Rule (the Rule) described in the President's Memorandum of February 3, 2017 (Memorandum).[1] These comments are submitted in response to the notice of proposed rulemaking regarding the "Definition of the Term 'Fiduciary;' Conflict of Interest Rule—Retirement Investment Advice," published in the March 2, 2017, edition of the *Federal Register* (NPRM of March 2, 2017).

NFIB is the nation's leading small business advocacy association, representing small and independent businesses in Washington, DC, and all 50 state capitals. A nonprofit, nonpartisan organization founded in 1943, NFIB's mission is to promote and protect the right of its members to own, operate, and grow their businesses. The membership of NFIB includes small and independent businesses in the financial services industry directly affected by the Rule, as well as small and independent businesses in virtually every industry sector likely to be indirectly affected by the Rule in its expected effect of limiting their ability to offer retirement benefits to employees.

Following the Memorandum that directed the Secretary of Labor to "examine the Fiduciary Duty Rule to determine whether it may adversely affect the ability of

[1] 82 Fed. Reg. 9675

Americans to gain access to retirement information and financial advice," the Department of Labor should find in the affirmative and rescind the rule. As explained below, the Department of Labor should make this finding because of the Rule's direct and indirect impacts on small and independent businesses.

This comment letter addresses the examination prescribed in the Memorandum. In an earlier comment letter on this notice of proposed rulemaking, NFIB strongly supported the Department of Labor's proposed delay of the applicability date by 60 days, and supported a longer delay if necessary to conduct a thorough review of the Rule's impact on retirement information and financial advice.[2]

President's Memorandum of February 3, 2017

As mentioned above, the Memorandum directed the Secretary of Labor to review the Rule and determine if it may adversely impact access to retirement information and financial advice. Specifically, the Memorandum issued the following direction:

> *(a) You are directed to examine the Fiduciary Duty Rule to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice. As part of this examination, you shall prepare an updated economic and legal analysis concerning the likely impact of the Fiduciary Duty Rule, which shall consider, among other things, the following:*
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> > *(i) Whether the anticipated applicability of the Fiduciary Duty Rule has harmed or is likely to harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice;*
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> > *(ii) Whether the anticipated applicability of the Fiduciary Duty Rule has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees; and*
> >
> > *(iii) Whether the Fiduciary Duty Rule is likely to cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services.*
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> *(b) If you make an affirmative determination as to any of the considerations identified in subsection (a)—or if you conclude for any other reason after appropriate review that the Fiduciary Duty Rule is inconsistent with the priority identified earlier in this memorandum—then you shall publish for notice and comment a proposed rule rescinding or revising the Rule, as appropriate and as consistent with law.*

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[2] NFIB Comments on the Proposed Delay of the Applicability Date of the Fiduciary Duty Rule. Filed March 3, 2017.

Fiduciary Duty Rule

The Department of Labor published the Rule on April 8, 2016.[3] The Rule broadened what is considered investment advice, which triggers fiduciary status. Under fiduciary status, an institution or individual that dispenses investment advice for a fee or other compensation is prohibited from transactions that may increase his or her compensation based on the investments made by the investor.

The Rule broadens the definition of investment advice by replacing the five-part test in place since 1975 with a description of the types of communications that make up investment advice. Under the five-part test:

> "*for advice to constitute 'investment advice,' an adviser who is not a fiduciary under another provision of the statute must (1) render advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary that (4) the advice will serve as a primary basis for investment decisions with respect to plan assets, and that (5) the advice will be individualized based on the particular needs of the plan or IRA.*"[4]

Under the Rule, a communication is considered investment advice if it makes a recommendation to a plan, plan fiduciary, plan participant or beneficiary, Individual Retirement Account (IRA), or IRA owner for compensation concerning the acquisition holding, disposing, or exchange of securities or investment property, or concerning how much property should be invested after a rollover or distribution from a plan or IRA, or the management of securities or other investment property including investment policies or strategies, portfolio composition, the selection of investment advisors, and whether and how to take a transfer, distribution, or rollover from a plan or IRA; and the person providing the advice either acknowledges his or her fiduciary status, gives the advice pursuant to an agreement that the advice is individualized for the recipient or directs the advice to a specific investor concerning a particular investment or management decision.[5]

In addition to a broader definition, the Rule, for the first time, expands coverage beyond plans covered by the Employee Retirement Income Security Act (ERISA) to non-ERISA

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[3] 81 Fed. Reg. 20946. The Employee Retirement Income Security Act (ERISA) (29 U.S.C. 1002(21)) and the Internal Revenue Code (IRC) (26 U.S.C. 4975(e)(3)) define the term "fiduciary" with respect to an employee benefit plan to include a person who ". . . renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so . . . ." On April 8, 2016, the U.S. Department of Labor's Employee Benefits Security Administration published the final Fiduciary Rule construing the ERISA/IRC definition.

[4] 80 Fed. Reg. 21933

[5] Ash, Greg. *Who's a Fiduciary Now?* pp. 7-8. SpencerFane LLC. 2016.

plans like IRAs. The cumulative effect of these changes is to increase the number of investment advice fiduciaries substantially.

Investment advice fiduciaries can only engage in otherwise prohibited transactions through the use of prohibited transaction exemptions. The Department of Labor introduced two new exemptions and amended many existing exemptions at the same time it issued the Rule. Of the new exemptions, the most notable for small businesses is the Best Interest Contract (BIC) Exemption. The BIC Exemption “allows entities such as registered investment advisers, broker-dealers and insurance companies, and their agents and representatives, that are ERISA or (Internal Revenue) Code fiduciaries by reason of the provision of investment advice, to receive compensation that may otherwise give rise to prohibited transactions as a result of their advice to plan participants and beneficiaries.”[6]

As the name implies, to take advantage of the BIC Exemption, the financial institution and its advisors enter into a contract with the investor. This contract must acknowledge that the institution is a fiduciary, explain the institution’s policies and procedures “reasonably designed to mitigate any harmful impact of conflicts of interest,”[7] and impose conduct standards that Congress chose not to impose outside ERISA, for the investor in court against the institution, among other requirements.

The Rule became effective on June 7, 2016. The Rule and associated exemptions are due to become applicable on April 10, 2017, notwithstanding the current proposed rule to delay these dates at least 60 days. While the standards of the BIC Exemption apply on April 10, 2017, the contract provision of the BIC Exemption does not apply until January 1, 2018.

Impact of the Rule on Small and Independent Businesses

NFIB believes the Rule, if allowed to proceed as finalized, will have a substantial impact on small and independent businesses. In comments filed for the record in response to the notice of proposed rulemaking published in the *Federal Register* on April 20, 2015,[8] NFIB expressed concern about the impact of the rule on small businesses seeking to offer retirement benefits to employees, as well as those in the financial services industry.[9]

A January 2016 survey conducted by the NFIB Research Foundation found 38 percent of small employers with 250 employees or fewer offer retirement benefits to their

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[6] 81 Fed. Reg. 21002
[7] *Ibid.*
[8] 80 Fed. Reg. 27928
[9] Docket ID: EBSA-2010-0050-0830

employees.[10] NFIB remains concerned that the Rule could substantially transform the way in which financial service providers deliver services to small businesses and their employees. This could result in providers no longer being able to offer these services to small businesses in an affordable manner. It is the employees of these small businesses – the very individuals the Rule purports to benefit – that stand to lose access to retirement benefits. The inability of small businesses to offer retirement benefits to employees will make them less competitive with larger businesses – hurting innovation and job opportunities for everyone.

Further, the Department of Labor underestimated the impact of the Rule on small and independent businesses by insufficiently fulfilling its obligations under the Regulatory Flexibility Act (RFA). The RFA requires agencies to consider the impact of their regulatory proposals on small entities, to analyze effective alternatives that minimize small entity impacts, and to make their analyses available for public comment. It is the role of the U.S. Small Business Administration's Office of Advocacy to advance the views, concerns, and interests of small business before Congress, the White House, federal agencies, federal courts, and state policy makers. The Office of Advocacy is the government's expert on the RFA. In this role, the Office of Advocacy comments to federal agencies regarding the impact of proposed regulations on small business and provides feedback on agency analyses of the regulatory impact.

Under the RFA, an agency is required to examine whether its proposed rule will have a significant economic impact on a substantial number of small entities. If the agency determines that its proposed rule will have such an impact, it is required to prepare an initial regulatory flexibility analysis (IRFA). The IRFA must meet several requirements spelled out by section 603 of the RFA, including what small businesses are expected to be directly impacted, the major cost factors, and consideration of all significant regulatory alternatives.[11] The RFA requires agencies to publish the IRFA, or a summary, in the *Federal Register* at the same time it publishes the proposed rulemaking.

In its public comment letter to the Department of Labor of July 17, 2015, the Office of Advocacy wrote that it had found the IRFA for the Rule deficient. The Office of Advocacy found the IRFA deficient because "the public has not been adequately informed about the possible impact of the proposal on small entities, and (DOL) has not effectively weighed less burdensome significant alternatives to the proposed rule that would meet the (DOL)'s objectives."[12]

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[10] Wade, Holly S., Chow, Michael J. *Employee Compensation and Small Business*. NFIB Research Foundation. January 2016.

[11] *The RFA in a Nutshell: A Condensed Guide to the Regulatory Flexibility Act*. pp. 9-13. U.S. Small Business Administration Office of Advocacy. October 2010.

[12] Docket ID: EBSA-2010-0050-0608

The failure of the Department of Labor to address these concerns in the final version of the Rule illustrates the need for it to be rescinded in accordance with the Memorandum.

Responses to the Review Considerations in the President's Memorandum

The following section further explains NFIB's concerns about the Rule in the context of the three considerations for analysis under subsection (a) in the Memorandum and the NPRM of March 2, 2017.

> Presidential Consideration 1: *Whether the anticipated applicability of the Fiduciary Duty Rule has harmed or is likely to harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice.*

The Rule is likely to harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice. Accordingly, the Department of Labor should find in the affirmative on this consideration of review.

The Rule, as explained above, prohibits certain transactions that could increase the compensation of a financial advisor or creates several new obligations that financial advisors must meet in order to continue offering services. These new requirements increase costs to advisors. In turn, the costs likely will be passed along to investors and raise the cost of accessing retirement investment planning. Even worse, these requirements make it more likely that financial advisors will abandon servicing small accounts altogether.

According the *2016 Global Survey of Financial Advisors* published by Natixis Global Asset Management, more than three-quarters of advisors surveyed believe increased regulations could lead to higher costs for their clients.[13] The Rule is specifically mentioned as being one of the primary drivers of increased regulatory costs. More alarming to small businesses, 38 percent of respondents said they were likely to "disengage from smaller clients." Because retirement plans sponsored by small businesses often pale in comparison to larger corporate retirement plans in terms of assets invested, small businesses face a greater likelihood of being dropped by their financial advisors. The costs to the advisor, in part due to the Rule, may become too great to justify continued servicing of smaller plans.

The new regulatory costs associated with the Rule will disproportionately impact small and independent businesses in the financial services industry. Research indicates that federal regulation of all types disproportionately affect small businesses. As one

[13] *2016 Global Survey of Financial Advisors*. Natixis Global Asset Management. 2016.

example, a 2014 study by two Lafayette College professors found that businesses with 50 or fewer employees spend 30 percent more per employee, per year, complying with federal rules.[14] This finding reflects a trend from similar surveys performed for the U.S. Small Business Administration's Office of Advocacy in 1995, 2001, 2005, and 2010.[15]

As noted in our comment letter of March 3, 2017, supporting a 60-day delay in the applicability date of the Rule, small and independent businesses lack the resources to easily absorb the regulatory costs associated with the Rule. This fact increases the likelihood that small and independent businesses in the financial services industry will lose competitiveness with larger counterparts. A decreased ability to compete will lead to fewer small businesses in the industry. Consequently, retirement investors will have less access to the services listed in the Memorandum and the NPRM of March 2, 2017.

> Presidential Consideration 2: *Whether the anticipated applicability of the Fiduciary Duty Rule has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees.*

The anticipated applicability of the Rule has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees. Accordingly, the Department of Labor should find in the affirmative on this consideration of review.

Since finalization of the Rule, information continues to emerge illustrating that companies are making changes that will limit the options of small businesses wanting to offer retirement benefits to their employees.

Merrill Lynch announced in October 2016 that to comply with the Rule, it would no longer provide advice from advisors on new, commission-based IRAs beginning on the applicability date, April 10, 2017.[16] Instead, new customers would either pay a level fee – which for infrequent traders can be more expensive than commission based models – or utilize the firm's "roboadvisory product." The same article cited sources familiar with Merrill Lynch's decision explaining that the firm chose not to use the BIC Exemption for these accounts because "the documentation requirements were still labor-intensive and presented a litigation risk."

Edward Jones announced in August 2016 that it would stop offering mutual funds and exchange traded funds to commission-based accounts.[17] The article covering the

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[14] Crain, W. Mark, and Crain, Nicole V. *The Cost of Federal Regulation to the U.S. Economy, Manufacturing and Small Business*. National Association of Manufacturers. 2014.
[15] *Ibid.* p. 5. (See note 6).
[16] Wursthorn, Michael. *Merrill Lynch to End Commission-Based Options for Retirement Savers*. Wall Street Journal. October 6, 2016.
[17] Wursthorn, Michael. *Watch Out, Retirement Savers, Your Choices Are Poised to Shrink*. Wall Street Journal. August 18, 2016.

announcement explained the ramifications: "many will have to weigh whether they want to remain in a commission-based account without access to mutual funds and exchange-traded funds or move to an individual retirement account that charges a fee based on a percentage of invested assets. The fee-based option could be more costly for some investors, such as those who don't trade much."

LPL Financial announced in August 2016 that it was implementing a fee-based compensation structure on common products like mutual funds and annuities.[18] In November 2016, when explaining a further transition into fee-based products by eliminating more commission-based products, the company's chief executive said "[t]he world is going to get more narrow, meaning there is going to be a smaller set of products that one can support."[19]

The product-offering decisions above demonstrate the reduction of investment options for retirement investors, and the disruptions taking place in the financial services industry as a direct result of the Rule.

> <u>Presidential Consideration 3:</u> *Whether the Fiduciary Duty Rule is likely to cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services.*

The Rule is likely to cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services. Accordingly, the Department of Labor should find in the affirmative on this consideration of review. It should be noted that the Fiduciary Rule already has generated a substantial amount of litigation, even before the Rule becomes applicable.[20]

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[18] Kelly, Bruce. *DOL fiduciary rule sparks LPL to standardize fees on mutual funds: CEO*. Investment News. August 24, 2016.

[19] Britton, Diana. *LPL Makes More Changes to Prepare for DOL Rule*. WealthManagement.com. November 3, 2016. LPL Financial Holdings, Inc. describes itself as follows: "We are a leader in the retail financial advice market, the nation's largest independent broker-dealer (based on total revenues, Financial Planning magazine June 1996-2016), a top custodian for registered investment advisors ('RIAs'), and a leading independent consultant to retirement plans. We provide an integrated platform of brokerage and investment advisory services to more than 14,000 independent financial advisors (our 'advisors'), including financial advisors at more than 700 financial institutions across the country, enabling them to provide their retail investors ('clients') with objective financial advice through a lower conflict model. We also support approximately 4,000 financial advisors who are affiliated and licensed with insurance companies that use our customized clearing, advisory platforms, and technology solutions." *Annual Report* (SEC Form 10-K), filed February 24, 2017, Item 1 (General Corporate Overview). LPL Financial has stated that "because qualified retirement accounts and IRAs make up a significant portion of our business, we expect that implementation of the DOL Rule and related exemptions will negatively impact our results, including the impact of increased expenditures related to legal, compliance, information technology and other costs" and that "these changes have also affected (and will likely continue to affect) the products and services we provide to accounts and the compensation that we and our advisors receive in connection with such products and services." *Id*., Item 1A (Risks Related to Our Regulatory Environment).

[20] Chamber of Commerce of the United States, et al. v. Hugler, No 3:16-cv-1476-M, 2017 WL 514424 (N.D. Tex. February 8, 2017) (holding Fiduciary Rule lawful), appeal pending, No. 17-10238 (5th Cir., appeal filed March 1, 2017); National Association for Fixed Annuities v. Perez, Civ. A. No. 16-1035 (RDM), 2016 WL 6573480 (D.D.C. November 4, 2016) (holding Fiduciary Rule lawful), appeal pending, No. 16-5345 (D.C. Cir. appeal filed November 28, 2016); Market Synergy Group, Inc. v. U.S. Department of Labor, No. 16-CV-4083-DDC-KGS, 2016 WL 6948061 (D. Kansas November 28, 2016) (denying preliminary injunction against Fiduciary Rule), id. 2017 WL 661592 (granting government motion for summary

The Rule includes a requirement in the BIC Exemption for a contract between the investor and the financial services institution that includes government-mandated conduct standards enforceable in court against the institution. The inclusion of this provision makes it more likely that litigation will increase. As noted previously, Merrill Lynch noted the anticipated increase in litigation risk as one reason why it was switching to level-fee IRA products.

Legal analysis of the Rule indicates that litigation is expected to increase.[21] The expected increase in costs would add to the fees investors must pay, and add to the risks for small and independent financial advisors. As one lawyer explained, "whatever the cost, it will be passed onto the customer. That's just how capitalism works. With any increased litigation risk, there is an increased litigation expense. And if you're adding a big expense like that into the system, then it's going to make it more expensive for customers to get the advice they need."[22]

The Department of Labor Should Rescind the Rule

Subsection (b) of the Memorandum directs the Department of Labor to publish for notice and comment a proposed rule rescinding or revising the Rule, as appropriate and as consistent with law, if the Department makes an affirmative determination as to any of the considerations identified in subsection (a), or if the Department concludes for any other reason after appropriate review that the Fiduciary Duty Rule is inconsistent with Administration priorities spelled out in the Memorandum.

The Department of Labor should find in the affirmative on all three considerations. Accordingly, the Department of Labor should publish for notice and comment a proposed rule rescinding the Rule. Based on the discussion above, the Rule will have clear negative impacts warranting rescission.

The Rule has harmed, or is likely to harm, small businesses and their employees – as retirement investors – by reducing access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice. The Rule has resulted in disruptions among small and independent businesses in the financial services industry as well as adversely affected small businesses and their employees as retirement investors. Finally, the Rule is likely to cause an increase in expected litigation, both among small businesses in the financial services industry, and for small businesses sponsoring retirement plans for their employees.

judgment)(February 17, 2017), appeal pending, No 17-3038 (Tenth Cir. appeal filed February 23, 2017); and Thrivent Financial for Lutherans v. Perez, No 16-CV-03289-SRN-HB (D. Minn. February 21, 2017) (denying government motion to stay proceedings pending presidentially-directed review).

[21] *The US Department of Labor's Final "Fiduciary" Rule Incorporates Concessions to Financial Service Industry but Still Poses Key Challenges*. Pp. 17. Shearman & Sterling LLP. April 14, 2016.

[22] Karmasek, Jessica. *Class actions will test DOL's new fiduciary rule, attorney says*. Legal News Line. May 2, 2016.

Conclusion

For the reasons set forth above, the NFIB urges the U.S. Department of Labor to publish promptly for notice and comment a proposed rule rescinding the Fiduciary Duty Rule. Thank you for the opportunity to comment of the Department's examination of the Rule described the President's Memorandum of February 3, 2017.

Sincerely,

Daniel Bosch
Senior Manager, Regulatory Policy