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

Attention: Fiduciary Rule Examination.

Subject: RIN 1210-AB79
Proposed Rule, Definition of the Term "Fiduciary"; Conflict of Interest Rule- Retirement Investment Advice; Best Interest Contract Exemption (Prohibited Transaction Exemption 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Prohibited Transaction Exemption 2016-02); Prohibited Transaction Exemptions 75-1, 77-4, 80-83, 83-1, 84-24 and 86-128

Ladies and Gentlemen:

I appreciate the opportunity to comment¹ on the proposal² by the Department of Labor, Employee Benefits Security Administration (hereinafter referred to as "the Department") for a 60-day delay to the applicability date for the definition of the term "fiduciary" under the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (IRC) (hereinafter referred to as the "Delay Rule").

¹ These comments are submitted personally and are not on behalf of any institution or

² Definition of the Term "Fiduciary" - Delay of Applicability Date, 82 Fed. Reg. 12319 (Mar. 2, 2017) (to be codified at 29 C.F.R. pt. 2510)

Re: Proposal to Delay Applicability Date – Comment Letter by Asst. Professor Ron A. Rhoades, JD, CFP®

For many years I have researched and written about the application of fiduciary standards of conduct in the delivery of financial and investment advice to individual consumers in the United States. As a long-standing attorney-at-law (estate planning, taxation, and retirement plan distribution planning), investment adviser, Certified Financial Planner™, and more recently as a professor of finance and financial planning with a focus on investments and retirement planning, my comments oppose any delay in the applicability date. I would also note that I have provided extensive comments to the Department throughout the DOL rulemaking process, have provided testimony to the Department, and I have spoken frequently at national and regional conferences over the past several years regarding the Proposed Rule and Final Rule³ and their applicability. I have further consulted with brokerage firms and compliance consulting firms regarding the implementation of the Final Rule, and over the past year I have provided extensive written guidance regarding compliance with the final rule to practitioners through various white papers and other media.

The major points in my comments can be summarized as follows:

1. The U.S. Department of Labor lacks the authority to delay the applicability date of the rule, as the requirements of the Administrative Procedures Act have not been followed.
2. Not all regulation on business conduct should be withdrawn by the current administration. Proper regulation is necessary for the conduct of certain business.
3. Substantial benefits have already resulted, and will continue to result, to U.S. business, from the application of the Final Rule.
4. Substantial benefits have already resulted, and will continue to result, as to retirement savers, from the application of the Final Rule.
5. Substantial benefits have already resulted, and will continue to result, to U.S. business, from the application of the Final Rule.
6. A substantial public policy rationale supports the application of the fiduciary standard and the implementation of the Final Rule.

³ Definition of the Term “Fiduciary,” 81 Fed. Reg. 20,846 (Apr. 6, 2016) (to be codified at 29 C.F.R. pt. 2510), and related exemptions, referred to herein collectively as the “Final Rule.”

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Accordingly, the Department should proceed to implement the Final Rule without any delay.

There are times when the staff of a government agency need to respond to the President, and to the newly appointed leaders of an agency, that their inclination to gut a rule (or delay it, with a view toward unwinding it) is just clearly wrong.

This is one of those times.

There are times when the staff of a government agency must stand up and say, “This is too important. This would impose too much harm on our friends, our neighbors, and indeed on all individual Americans.”

This is one of those times.

There are times when the staff of a government agency must pull out all the stakes to provide education to its new leadership on the profound negative implications of a suggested new direction.

This is one of those times.

There is a time when the staff of a government agency must, indeed, jeopardize their own future within a government agency, to seek to protect hundreds of millions of their fellow Americans.

This is one of those times.

Please permit me to now explore, in the pages following, the compelling rationale as to why the Delay Proposal cannot be justified.

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The U.S. Department of Labor lacks the authority to delay the applicability date of the rule, as the requirements of the Administrative Procedures Act have not been followed.

The Department has not taken into account, in the formulation of the Delay Rule, both the short-term and the long-term harm to American business, the U.S. economy, and individual retirement savers and investors from the delay.

Lacking a cogent economic analysis, and in the face of substantial economic evidence that immense harm would result from even a temporary delay, the Department has not met the requirements of the Administrative Procedures Act for the issuance of any rule that delays the applicability date of the Final Rule.

(A) THE SHORT-TERM AND LONG-TERM HARMS TO AMERICAN BUSINESS ENTITIES CANNOT BE UNDERESTIMATED, AND THESE ADVERSE IMPACTS ON AMERICAN BUSINESS OWNERS (PLAN SPONSORS) HAVE NOT BEEN PROPERLY TAKEN INTO ACCOUNT BY THE DEPARTMENT IN CONNECTION WITH THE DELAY PROPOSAL.

American business owners act prudently to provide retirement plans for their employees. These plan sponsors often receive advice from "retirement consultants" (Wall Street firms, insurance companies) on what funds to choose. Later, when plan sponsors are sued for including expensive mutual funds in their plans, the "retirement consultants" are often relieved of liability (hiding behind the low standard of "suitability"), while the business owner remains on the hook.

Yet, every business owner (plan sponsor) will tell you, in these cases (which often lead to the imposition of tens of millions of dollars of liability on American businesses), that they relied upon the advice provided to them by their "retirement consultants." And that they believed that they were provided advice that was in the best interests of the retirement plan and its participants.

This situation should not continue unabated. Educational efforts to plan sponsors, who are busy running their businesses and who nearly always lack substantial knowledge and expertise to navigate today's complex financial markets, are wholly insufficient. Only the application of the fiduciary standard can save plan sponsors from the huge liability to which so many are currently exposed.

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Government has long imposed thoughtful regulation to protect American business from harm by other American business. This is not favoritism. Rather, it is the imposition of standards of business conduct which our society, in an age of increasing specialization and complexity, must adopt for the safety of those engaged in commerce.

Government has a role to play here, in the regulation of the business conduct of those who profess to provide “advice” and “consulting services” to plan sponsors. As related in the Federalist Papers #51, James Madison famously wrote: “[W]hat is government itself, but the greatest of all reflections on human nature? If men were angels, no government would be necessary.”

Yet, history has shown that many Wall Street broker-dealer firms and the insurance companies have shown that they are no angels. They continue to tout their role, in commercials and other advertisements, as trusted “financial advisors” and “wealth managers.” Yet, in reality, much of Wall Street just uses these masks to deceive and to sell highly expensive, often inappropriate investments to plan sponsors who are working hard to improve the profits of their businesses and to benefit their shareholders and other stakeholders.

Yet, there is a solution.

The 237 words that form the U.S. Department of Labor's (DOL's) “impartial conduct standards” lie at the heart of the DOL's “Conflict of Interest” (Fiduciary) Rule. Like Madison, the DOL recognizes that some government is necessary. And the Final Rule imposes upon financial advisers to retirement accounts a simple, elegant solution - adhere to the fiduciary principle, and act in the best interests of your clients. (The remaining parts of the rule just serve to accommodate some of Wall Street's business practices, at Wall Street's request; hence the length of the rule releases.)

The harm imposed by Wall Street's current “sell expensive investment products to everyone” is hugely detrimental to American business owners, in their capacity as retirement plan sponsors, plain and simple.

The harm results in a shifting of profits away from American businesses (as a result of liability due to reliance on non-fiduciary advisers), and from the participants in ERISA-covered retirement plans, to Wall Street firms and insurance companies. Yet, inexplicably, the Department has failed to address the substantial economic impact on American business in its Delay Proposal. Through this failure, the Department has failed to comply with the economic analysis requirements of the Administrative Procedures Act.

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All Americans, including plan sponsors, deserve expert fiduciary financial investment advice, delivered for reasonable, professional-level compensation. But American business does not deserve to continue to be victimized by conflict-ridden, deceptive sales practices. Similar to Wells Fargo's recent egregious practices for which they received so much public disdain, Wall Street does not need to continue to use the perverse incentives within their firms that drive the sale of high-cost, inappropriate investment products to plan sponsors. The Final Rule acts to prohibit such perverse economic incentives, via its application of the fiduciary standard of conduct. As a result, plan sponsors – American business owners – will benefit tremendously from the implementation of the Final Rule.

(B) THE SHORT-TERM AND LONG-TERM HARM TO INDIVIDUAL CONSUMERS WILL BE HUGE WITH ANY DELAY IN THE APPLICABILITY DATE.

1. The Department's Extensive Prior Economic Analysis Indicates the Harm to Individual Investors Resulting from Any Delay.

In its economic analysis associated with the Final Rule, the Department concluded less than one year ago that the underperformance associated with conflicts of interest – in the mutual fund segment alone – could cost IRA investors between \$95 billion and \$189 billion over the next 10 years and between \$202 billion and \$404 billion over the next 20 years.

In other words, IRA investors will lose a *minimum* of \$26 million dollars a day with any delay in the applicability of the Final Rule. These losses dwarf, by far, any of the cost estimates the Department has set forth (which number only several million or so, in total, for the entire delay period) as rationale for the delay of the applicability date.

I personally view these estimates as very conservative. In my capacity as an investment adviser, I have personally reviewed hundreds and hundreds of the investment portfolios of retirement portfolios, including those served by fiduciary advisers and those served by non-fiduciary advisers. In these reviews I have seen the average total fees and costs incurred by investors using non-fiduciary investors be two percent (2%) or more each year, and at times I have seen individual investors paying total fees and costs exceeding four percent (4%) a year. In contrast, I have seen individual investors receive better and more comprehensive financial and investment advice from fiduciaries for an average of half (or less) of the total fees and costs incurred with non-fiduciary advisers. Think about it – half the fees and costs, or less – for more comprehensive advice – result from the application of fiduciary duties upon financial advisers. These huge benefits to individual investors cannot be ignored during the regulatory process!

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2. How About This Interesting Position? “Government Should Not Regulate FA’s Conduct by Imposing Fiduciary Duties”!

I'm a lawyer, and I'm upset. Because the government has these rules in place. I can't, for example, represent the buyer of a business when the seller of the business interest gives me a commission to assist with its sale. How awful! Why shouldn't I be permitted to profit from such an endeavor?

I'm also the trustee of a private trust, and I'm saddened. Because, again, the government has these darn laws and regulations in place. For example, I can't sell my stamp collection to the trust, for a tidy profit for myself, even though it would be a "good" investment (at least, so I say). I have to invest trust funds "prudently" – I can't just have fun and speculate with the trust investments, or be cavalier as I shoot darts to select stocks.

I also provide advice to consumers as a registered investment adviser. Imagine, again, my total dismay when I was informed by securities regulators that I was a fiduciary. I cannot accept commissions from selling hedge funds, non-publicly traded REITs, oil and gas limited partnerships, and all manner of other kinds of illiquid investments. I can't receive expensive trips and other awards for meeting sales quotas. I can't receive additional compensation through casually disclosed payments for shelf space and other revenue-sharing arrangements. Even though I would receive much more personal compensation as a result.

Imagine, those government regulators even want me to exercise "due care" when providing investment advice! Oh, my, the plaintiff's attorneys are clamoring ... they are parked outside my door, even!

Oh, woe to me. The federal government is so intrusive! In fact, it must be a communist conspiracy, hatched by some liberal academics in some ivory tower in cohorts with evil government bureaucrats.

Of course, I jest.

Over the past several weeks I have seen many communications advancing the view that the government has no right to interfere in their business as a financial advisor. These communications sometime propose that those in business should be free of all government restraint. *Hogwash*. Again, as James Madison so famously wrote, "If men were angels, no government would be necessary."

The fact of the matter is ... fiduciary duties are not imposed lightly, but are imposed when other legal constraints are ineffective - such as disclosures (not read, if read not understood, by consumers, in the complex and ever-changing world of investments).

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The fact of the matter is ... fiduciary duties serve to restrain greed.

The fact of the matter is ... some government regulation of certain business conduct is justified. And the U.S. Department of Labor's Fiduciary ("Conflict of Interest") Rule is perhaps the most necessary, thoughtful, and elegant regulation to emerge in the last few years.

The fact of the matter is ... I truly am an attorney. I do serve as the trustee of a private trust. And I am a registered investment adviser. As such, I accept the restraints on my conduct that come with my fiduciary status. I accept the responsibility to avoid conflicts of interest and to act with a high degree of expertise and care.

Yet, even though I am "burdened" with such fiduciary obligations as an attorney (subject to fiduciary duties under the rules of professional conduct governing attorneys, given the force of law through statutory law, as trustee of a private trust (subject to the dictates of both common law fiduciary duties and statutory prudent investor rule), and as an investment adviser (subject to the fiduciary duties imposed by the Investment Advisers Act of 1940, state investment adviser statutes, and state common law). Yet, despite these "burdens":

- I earn reasonable, professional-level compensation for my expertise.
- I serve clients both large and small.
- I provide holistic advice to my clients, often changing their lives dramatically for the better.
- I look forward to going to work each and every day.
- I look forward to serving my clients as a trusted professional.
- I know I add value, through my expertise and through my stewardship of my client's hopes and dreams.
- Lastly, I don't ever think about potential liability as a fiduciary. Because by avoiding conflicts of interest, and by maintaining and applying my expertise, I have nothing to fear.

I have been for 30 years an attorney, and I have served for over 15 as an investment adviser, and for nearly a decade as a private trustee. In these roles, I have operated as a fiduciary willingly, and happily.

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3. Current Standards of Conduct Imposed Upon Broker-Dealers and Insurance Agents are Wholly Inadequate to Protect Retirement Investors.

It must be recognized that the “suitability” standard relieves broker-dealer firms and their representatives of the standard of care that virtually every other provider of services must adhere to. It must also be recognized that the suitability standard (which was designed originally to relieve brokers from the failures of individual stock recommendations, when brokers were acting only as the executors of trades) is an inherently weak and ambiguous standard. Moreover, the suitability standard has been inexplicably extended to the selection of other advisers – such as mutual fund managers – even though the selection of mutual funds is an advisory function that should be undertaken only by a fiduciary.

I've seen the huge extraction of rents by Wall Street and the insurance companies from the investment portfolios of my fellow citizens.

I've seen the failures by FINRA to raise the standards of conduct for brokers (as contemplated by Senator Maloney, for which The Maloney Act was named, which Maloney Act led to the creation of FINRA in 1940, formerly and more properly known as the National Association of Securities Dealers).

The fact of the matter, I've seen the harm done to my fellow Americans by non-fiduciaries providing financial and investment advice. Hundreds of times. Perhaps thousands of time. I've lost count. I've seen Americans' retirement hopes and dreams crushed through investment advice that hides behind the low standard of "suitability."

FINRA has opposed (and continues to oppose) a bona fide fiduciary standard of conduct. In its place FINRA has offered to the Department a new “best interests” standard that, upon close examination, is merely a version of suitability augmented with “casual disclosures” that would be largely ineffective. In fact, the naming of FINRA’s new standard as a “best interests” standard shows, itself, the depths of the problem facing individual investors today, as those who prey upon individual investors (and their “self-regulatory organization”) continue through the use of inappropriate titles (“financial advisor,” “financial consultant,” “wealth manager,” etc., that denote a relationship of trust and confidence where none exists) and now an attempt to re-define the legal terminology used so often by the courts to indicate the existence of a fiduciary standard of conduct.

I have a saying about those non-fiduciary financial advisers who continue to impose harm on American consumers of investment advice: "Either they don't know, or they don't care."

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Don't become a Department that either "does not know" or "does not care" about your fellow Americans, American business, or the U.S. economy. Do not delay the huge benefits that have already resulted, and will continue to result, for hundreds of millions of Americans.

By failing to properly address the harm to American consumers that will result from any delay, however short, of the proposed rule, the Department has failed to comply with the economic analysis requirements of the Administrative Procedures Act.

(C) LONG-TERM HARM TO THE U.S. ECONOMY WILL RESULT FROM ANY DELAY.

As the returns of the capital markets are diverted away from individual Americans - the owners of capital - to Wall Street, the accumulation of capital falls. This results in less accumulated capital for investment purposes - an effect that compounds over time with severe negative consequences for the long-term health of the U.S. economy. The cost of capital to American business increases, impairing economic growth. And innovation, without capital, equates to missed opportunities for economic growth.

Indeed, Wall Street hurts itself, in the long run. If Wall Street's greed - in the form of high fees and costs from expensive products pushed upon our fellow Americans - was constrained, much greater capital would exist in later years to manage. In essence, Wall Street extracts high fees today, preventing greater accumulations of savings and investment accounts. If the fiduciary standard were imposed and Wall Street's fees had to be simply "reasonable," greater accumulations would occur in investment accounts. Within years Wall Street would have much more to manage, albeit at and far more reasonable lower fees. Yet, Wall Street firms, operating under a fiduciary standard, would be making just as much money in future years! And America would be far better off!

Moreover, many economic studies have demonstrated that Wall Street's excesses impair U.S. economic growth and the formation of new businesses and jobs. As just one example: "[F]inancialization depresses entrepreneurship. Paul Kedrosky and Dane Stangler of the Kauffman Foundation find that as financialization increases, startups per capita decrease, in part because the growth in the financial sector has distorted the allocation of talent. They estimate that if the sector were to shrink as a share of GDP back to the levels of the 1980s, *new business formation would increase by two to three percentage points*. We have substantial circumstantial evidence to show that these trends have had negative consequences at the macro level: *'the influence of finance sector size on economic growth turns negative when financial services become too large a share of an economy and that high levels of financial activity crowd out investment and R&D in the non-finance sector.'*"

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(Emphasis added.) From a Brookings Institute report by William A. Galston and Elaine C. Kamarck.

By failing to consider the long-term harm that will result to the U.S. economy from the compounding effects of lower accumulations of capital by retirement investors, the Department has failed to comply with the economic analysis requirements of the Administrative Procedures Act.

(D) THE DEPARTMENT PROVIDES NO COGENT RATIONAL FOR WHY ITS PREVIOUS ECONOMIC ANALYSIS, UNDERTAKEN OVER SEVERAL YEARS AND WITH THE AID OF BOTH ECONOMISTS BOTH INTERNAL TO THE DEPARTMENT AND EXTERNAL, AND WHICH STRONGLY SUPPORTED THE RATIONALE FOR THE APPLICATION OF THE RULE, SHOULD BE IGNORED.

The Department's Final Rule was the result of one of the most extensive economic analysis ever taken by a government agency. As the Department is well aware, the Department relied upon extensive work performed over several years by economists and many others, including both those who work for the Department as well as outside experts.

A proper Regulatory Impact Analysis must include an estimate of the costs and benefits of the proposed regulatory action and its alternatives, and should be based on the best available scientific, technical, and economic information.

Yet, there is no evidence that the Department, in ignoring the comprehensive, thoughtful, and extensive economic analysis so recently provided, has sought out "the best available scientific, technical and economic information" in its Delay Proposal.

The cogent analysis of this issue by the recently submitted comment letter (March 2017) from the Financial Planning Coalition deserves to be repeated:

First, the Department has not provided an adequate statement of the need for the delay. The Department states that a delay is necessary so that "advisers, investors and other stakeholders would be spared the risk and expenses of facing two major changes in the regulatory environment."

However, the Department admits in the Delay Rule proposal that "[t]he nature and magnitude of any such delay ... is highly uncertain." The Supreme Court has held that it is not sufficient for an agency to merely recite the terms "substantial uncertainty" as a justification for its actions.

The Department's statement that it is delaying applicability of the Final Rule to address questions raised by the Presidential Memorandum is also not adequate. The Presidential Memorandum directs the Department to modify

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the Final Rule if it concludes the Final Rule, among other things, is inconsistent with the new administration's priorities. However, a statement concerning a change in priorities, without additional explanation, is not an adequate statement of need for the delay.

The Presidential Memorandum also states "it shall be implemented consistent with applicable law." Under a settled principle of federal administrative law, a federal agency may not announce a position that abruptly changes direction from prior agency pronouncements without providing a reasoned explanation for the change. Courts have held that "an agency must explain why the original reasons for adopting the rule or policy are no longer dispositive" and that "[w]hen an agency departs from its own prior precedent without explanation ... its judgment cannot be upheld."

Specifically, the Department has not adequately explained what environmental changes, if any, led the Department to believe that the Final Rule and Regulatory Impact Analysis completed less than a year ago are now inadequate or defective. To the contrary, the limited evidence provided by the Department directly contradicts the rationale for the proposed delay. In the Delay Rule proposal, the Department found that investor gains would be reduced by \$104 million, using a three percent discount rate and \$87 million, using a seven percent discount rate. Compliance costs for the industry would only be \$8 million, using a three percent discount rate and \$9 million, using a seven percent discount rate. The Department needs to address why it believes a delay is warranted when, under its own analysis, investor harm greatly outweighs any cost savings for the industry.

(Citations omitted.)

(E) The Department has not addressed the substantial public policy considerations that underlies the application of fiduciary standards of conduct upon those who provide investment advice.

The rationale for the imposition of fiduciary standards of conduct, as a matter of public policy, are often overlooked during consideration of the application of such standards. In this section I explore the central question: "Why is a transformation from an arms-length relationship to a fiduciary relationship justified?"

It is because trust is not an absolute, in that it either exists or does not exist. Rather, trust falls along a continuum. In many commercial relationships the purchaser is aware of the need to exercise his or her own due diligence prior to entering into, or consummating, the transaction; in such instances the need for trust is minimal. But, in this increased era of

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specialization in society, and vast disparities in knowledge and expertise when dealing with complex matters, a much higher degree of trust must be present in order to protect consumers who receive certain types of services, such as investment advice.

THE VAST DISPARITY IN EXPERTISE

During the provision of specialized goods and services (including advice) that society treasures and where a vast imbalance of knowledge and expertise is present, the purchaser of goods or services is at such a disadvantage the purchaser's own due diligence cannot guard against the potential for abuse by the service provider. In these situations the law rightly and justly goes further and imposes *fiduciary status* upon the provider of such goods or services.

The consumer of investment products and services today is simply overwhelmed by information. Our fellow Americans are thrust into a highly complex financial environment in which a high degree of expertise is required to properly undertake portfolio design and management, and investment product selection. To prosper in today's modern financial world requires not just the ability to understand often-complex financial products, but also a knowledge of Modern Portfolio Theory (MPT), concepts intertwined with MPT (such as variance, correlation, and the benefits of diversification), strategic vs. tactical asset allocation, multi-factor models of risks and returns, tax and risk characteristics of various asset classes and particular investments, the extent of regulation (or non-regulation) of various types of investment managers, and much, much more.

Where such information disparity and complexity exists, "the traditional tools for supervising counterparties, available through the law of contract, cannot guarantee the effective delivery of specialized services. Individuals simply do not have the resources or the expertise to determine on their own whether these specialized services are actually serving their interests. Instead, these individuals need to *trust* that the specialists they rely upon will keep their best interests at heart."⁴

Accordingly, by necessity our consumers justly rely upon specialists. Just as they do in medicine, law, and other disciplines, consumers rely on financial and investment advisers to help them take advantage of the many advances in understanding of how the capital markets function and how the returns of the capital markets can be brought to bear to achieve the individual's lifetime financial goals.

⁴ Edward J. Waitzer and Douglas Sarr, *Fiduciary Society Unleashed: The Road Ahead for the Financial Sector*, 69 *Bus. Lawyer* 1081, 1090 (Aug. 2014).

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As Professor Tamar Frankel, long the leading scholar in the area of fiduciary law as applied to securities regulation, once observed:

[A] prosperous economy develops specialization. Specialization requires interdependence. And interdependence cannot exist without a measure of trusting. In an entirely non-trusting relationship interaction would be too expensive and too risky to maintain. Studies have shown a correlation between the level of trusting relationships on which members of a society operate and the level of that society's trade and economic prosperity.⁵

Fiduciary duties are imposed by law when public policy encourages specialization in particular services, such as investment management or law, in recognition of the value such services provide to our society. For example, the provision of investment consulting services under fiduciary duties of loyalty and due care encourages participation by investors in our capital markets system. Hence, in order to promote public policy goals, the law requires the imposition of fiduciary status upon the party in the dominant position. Through the imposition of such fiduciary status the client is thereby afforded various protections. These protections serve to reduce the risks to the client that relate to the service, and encourage the client to utilize the service. Accordingly, the imposition of fiduciary status thereby furthers the public interest.

Some might opine that financial literacy efforts can fulfill this role. Yet, the body of academic research, and my own experience in dealing with thousands of clients, reveals that financial literacy efforts only significantly assist consumers with basic personal finance training, such as in expenditures budgeting and saving for future needs. However, the complexity of the financial markets, and the limits of time each consumer possesses to devote to training in finance, renders the vast majority of consumers unable to become investment experts or to understand the many terms and concepts required, even with the aid of a multitude of disclosures. We are just as likely to turn a consumer of financial services into a highly knowledgeable designer and manager of her or his investment portfolio as we are to turn a patient needing a brain operation into a neurosurgeon.

We must recognize that the combination of specialization and interdependence found today is essential to the progress of our society. This combination fosters both the development of new knowledge and expertise. It provides great benefits to consumers, provided the advice is delivered with a high degree of due care and in the consumers' best interests. It enables consumers to place the fruits of their hard-earned labor to work in the

⁵ Tamar Frankel, *Trusting And Non-Trusting: Comparing Benefits, Cost And Risk*, Working Paper 99-12, Boston University School of Law.

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capital markets, with the expectation that the returns offered by the markets will be returned to the consumer, less only a reasonable amount for professional-level compensation to the specialist and the carefully scrutinized fees and costs of any investment product.

THE IMPORTANCE OF TRUST TO ECONOMIC GROWTH

In this section, we must first ask, “What is ‘trust’?” I submit that there exists “at least implicitly accepted a definition of trust as a belief, attitude, or expectation concerning the likelihood that the actions or outcomes of another individual, group or organization will be acceptable . . . or will serve the actor’s interests.”⁶

How important is trust to commerce, generally? Aristotle once observed that the doctrine of good faith is so fundamental to the making and performance of contracts that, “[i]f good faith has been taken away, all intercourse among men ceases to exist.”

Trust itself is also crucial to a society’s economic success. Nobel laureate economist Kenneth Arrow has stated that “[v]irtually every commercial transaction has within itself an element of trust,” and that “much of the economic backwardness in the world can be explained by the lack of mutual confidence.”⁷

Several studies have documented the positive relationship between trust in society and economic growth. Increased trust between actors in commercial transactions has a direct positive and significant effect on income per capita growth.⁸

Individuals need to trust that the specialists they rely upon will keep their best interests at heart. The imposition of broad fiduciary duties of due care, loyalty, and utmost good faith promotes this essential relationship of trust. It permits entry into the capital markets by those without the knowledge and skill to navigate their complex waters. As stated by Luhmann:

Trust is necessary in order to face the unknown, whether that unknown is another human being, or simply the future and its contingent events. Seldom, if ever, can we obtain all the information we would need in order to take

⁶ Sim B. Sitkin & Nancy L. Roth, Explaining the Limited Effectiveness of Legalistic “Remedies” for Trust/Distrust, 4 ORG. SCI. 367, 368 (1993).

⁷ Kenneth Arrow, Gifts and Exchanges, 1 Philosophy & Pub. Affairs 343, 357 (1972).

⁸ See, e.g., Tatsi, Eirini and Zafar, Tasneem, Social Capital and Economic Growth: Evidence from OECD Countries (May 1, 2011).

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decisions in a completely rational manner. At a certain point in our 'intelligence-gathering' about the world we have to call a halt, say 'enough is enough' and take a decision based on what we know and the way we feel. That decision will inevitably partly be based on trust. Trust is thus a way of reducing uncertainty. It lies somewhere between hope and confidence, and involves an element of semi-calculated risk-taking. Trust, by the reduction of complexity, discloses possibilities for action which would have remained unattractive and improbable without trust - which would not, in other words, have been pursued.⁹

I have personally seen the trust of consumers betrayed, over and over again, by providers of financial and investment advice who act out of their own self-interest, not bound by a fiduciary standard. Immense personal harm results, involving the destruction of the hopes and dreams of the consumer.

For society the cost of abuse of trust in the provision of investment advice is even greater. I have personally seen consumers, burned and unwilling to trust any other financial or investment adviser, flee from the capital markets – likely for all time. Like most of the Greeks, such consumers resort to placement of their savings in commercial banks. As a result, the costs of capital increase, for the capital markets are deprived of direct funding and the provision of available equity capital, in particular, is diminished.

Investment advisory services rendered in a relationship of trust and confidence, as a fiduciary, encourage participation by investors in our capital markets system, which in turn promotes economic growth. The first and overriding responsibility any financial professional has is to all of the participants of the market. This primary obligation is required in order to maintain the perception¹⁰ and reality that the market is a fair game and thus encourage the widest possible participation in the capital allocation process. The premise of the U.S. capital market is that the widest possible participation in the market will result in the most efficient allocation of financial resources and, therefore, will lead to the best operation of the U.S. and worldwide economy. Indeed, academic research has

⁹ Niklas Luhmann, *Trust and Power* (John Wiley & Sons; Chichester, 1979), p. 4.

¹⁰ “Applying the Advisers Act and its fiduciary protections is essential to preserve the participation of individual investors in our capital markets. NAPFA members have personally observed individual investors who have withdrawn from investing in stocks and mutual funds due to bad experiences with registered representatives and insurance agents in which the customer inadvertently placed his or her trust into the arms-length relationship.” Letter of National Association of Investment advisers (NAPFA) dated March 12, 2008 to David Blass, Assistant Director, Division of Investment Management, SEC re: Rand Study.

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revealed that individual investors who are unable to trust their financial advisors are less likely to participate in the capital markets.¹¹

OTHER COMPELLING REASONS FOR IMPOSITION OF FIDUCIARY STATUS

The key to understanding fiduciary principles, and why and how they are applied, rests in discerning the foregoing public policy objectives the fiduciary standard of conduct is designed to meet, as well as the other public policy objectives set forth in this section.

FIDUCIARY STATUS ADDRESS “OVERREACHING” WHEN PERSON-TO-PERSON ADVICE IS PROVIDED

The Investment Advisers Act of 1940 “recognizes that, with respect to a certain class of investment advisers, a type of personalized relationship may exist with their clients ... The essential purpose of [the Advisers Act] is to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard the honest investment adviser against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful.”¹² “The Act was designed to apply to those persons engaged in the investment-advisory profession -- those who provide personalized advice attuned to a client's concerns, whether by written or verbal communication¹³ ... The dangers of fraud, deception, or overreaching that motivated the enactment of the statute are present in personalized communications....”¹⁴

¹¹ “We find that trusting individuals are significantly more likely to buy stocks and risky assets and, conditional on investing in stock, they invest a larger share of their wealth in it. This effect is economically very important: trusting others increases the probability of buying stock by 50% of the average sample probability and raises the share invested in stock by 3.4 percentage points ... lack of trust can explain why individuals do not participate in the stock market even in the absence of any other friction ... [W]e also show that, in practice, differences in trust across individuals and countries help explain why some invest in stocks, while others do not. Our simulations also suggest that this problem can be sufficiently severe to explain the percentage of wealthy people who do not invest in the stock market in the United States and the wide variation in this percentage across countries.” Guiso, Luigi, Sapienza, Paola and Zingales, Luigi. “Trusting the Stock Market” (May 2007); ECGI - Finance Working Paper No. 170/2007; CFS Working Paper No. 2005/27; CRSP Working Paper No. 602. Available at SSRN: <http://ssrn.com/abstract=811545>.

¹² *Lowe v. SEC*, 472 U.S. 181, 200, 201 (1985).

¹³ *Id.* at 208.

¹⁴ *Id.* at 210.

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CONSUMERS' LACK OF DESIRE TO EXPEND TIME AND RESOURCES ON MONITORING

The inability of clients to protect themselves while receiving guidance from a fiduciary does not arise solely due to a significant knowledge gap or due to the inability to expend funds for monitoring of the fiduciary. Even highly knowledgeable and sophisticated clients (including many financial institutions) rely upon fiduciaries. While they may possess the financial resources to engage in stringent monitoring, and may even possess the requisite knowledge and skill to undertake monitoring themselves, the expenditure of time and money to undertake monitoring would deprive the investors of time to engage in other activities. Indeed, since sophisticated and wealthy investors have the ability to protect themselves, one might argue they might as well manage their investments themselves and save the fees. Yet, reliance upon fiduciaries is undertaken by wealthy and highly knowledgeable investors and without expenditures of time and money for monitoring of the fiduciary. In this manner, “fiduciary duties are linked to a social structure that values specialization of talents and functions.”¹⁵

THE SHIFTING OF MONITORING COSTS TO GOVERNMENT

In service provider relationships which arise to the level of fiduciary relations, it is highly costly for the client to monitor, verify and ensure that the fiduciary will abide by the fiduciary's promise and deal with the entrusted power only for the benefit of the client. Indeed, if a client could easily protect himself or herself from an abuse of the fiduciary advisor's power, authority, or delegation of trust, then there would be no need for imposition of fiduciary duties. Hence, fiduciary status is imposed as a means of aiding consumers in navigating the complex financial world, by enabling trust to be placed in the advisor by the client.

Fiduciary relationships are relationships in which the fiduciary provides to the client a service that public policy encourages. When such services are provided, the law recognizes that the client does not possess the ability, except at great cost, to monitor the exercise of the fiduciary's powers. Usually the client cannot afford the expense of engaging separate counsel or experts to monitor the conflicts of interest the person in the superior position will possess, as such costs might outweigh the benefits the client receives from the relationship with the fiduciary. Enforcement of the protections thereby afforded to the

¹⁵ Tamar Frankel, Ch. 12, *United States Mutual Fund Investors, Their Managers and Distributors*, in *CONFLICTS OF INTEREST: CORPORATE GOVERNANCE AND FINANCIAL MARKETS* (Kluwer Law International, The Netherlands, 2007), edited by Luc Thévenoz and Rashid Barhar.

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client by the presence of fiduciary duties is shifted to the courts and/or to regulatory bodies. Accordingly, a significant portion of the cost of enforcement of fiduciary duties is shifted from individual clients to the taxpayers, although licensing and related fees, as well as fines, may shift monitoring costs back to all of the fiduciaries that are regulated.

CONSUMERS' DIFFICULTY IN TYING PERFORMANCE TO RESULTS

The results of the services provided by a fiduciary advisor are not always related to the honesty of the fiduciary or the quality of the services. For example, an investment adviser may be both honest and diligent, but the value of the client's portfolio may fall as the result of market events. Indeed, rare is the instance in which an investment adviser provides substantial positive returns for each incremental period over long periods of time – and in such instances the honesty of the investment adviser should be suspect.

CONSUMERS' DIFFICULTY IN IDENTIFYING AND UNDERSTANDING CONFLICTS OF INTEREST

Most individual consumers of financial services in America today are unable to identify and understand the many conflicts of interest that can exist in financial services. For example, a customer of a broker-dealer firm might be aware of the existence of a commission for the sale of a mutual fund, but possess no understanding that there are many mutual funds available that are available without commissions (i.e., sales loads). Moreover, brokerage firms have evolved into successful disguisers of conflicts of interest arising from third-party payments, including payments through such mechanisms as contingent deferred sales charges, 12b-1 fees, payment for order flow, payment for shelf space, and soft dollar compensation.

Survey after survey (including the Rand Report) has concluded that consumers place a very high degree of trust and confidence in their investment adviser, stockbroker, or financial planner. These consumers deal with their advisors on unequal terms, and often are unable to identify the conflicts of interest their “financial consultants” possess.

Transparency is important, but even when compensation is fully disclosed, few individual investors realize the impact high fees and costs can possess on their long-term investment returns; often individual investors believe that a more expensive product will possess higher returns.¹⁶ Nor will competition, even with transparency, serve to substantially lower costs due to the economic incentives advisers possess to sell higher-cost funds.¹⁷

¹⁶ In a 2005 study, Professors “Madrian, Choi and Laibson recruited two groups of students in the summer of 2005 -- MBA students about to begin their first semester at Wharton, and

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FOR FIDUCIARIES, THE COST OF PROVING TRUSTWORTHINESS IS QUITE HIGH

How does one prove oneself to be “honest” and “loyal”? The cost to a fiduciary in proving that the advisor is trustworthy could be extremely high – so high as to exceed the compensation gained from the relationships with the advisors’ clients.

In his influential article discussing the creation of the federal securities acts, and in particular their moral purpose, John Walsh (formerly of the SEC’s OCIE) reviewed the legislative history underlying the creation of the Investment Advisers Act:

As part of a congressionally mandated review of investment trusts the agency also studied investment advisers. The Advisers Act was based on that

undergraduates (freshmen through seniors) at Harvard. All participants were asked to make hypothetical investments of \$10,000, choosing from among four S&P 500 index funds. They could put all their money into one fund or divide it among two or more. ‘We chose the index funds because they are all tracking the same index, and there is no variation in the objective of the funds,’ Madrian says ... ‘Participants received the prospectuses that fund companies provide real investors ... the students ‘overwhelmingly fail to minimize index fund fees,’ the researchers write. ‘When we make fund fees salient and transparent, subjects’ portfolios shift towards lower-fee index funds, but over 80% still do not invest everything in the lowest-fee fund’ ... [Said Professor Madrian,] ‘What our study suggests is that people do not know how to use information well.... My guess is it has to do with the general level of financial literacy, but also because the prospectus is so long.’ Knowledge@Wharton, “Today's Research Question: Why Do Investors Choose High-fee Mutual Funds Despite the Lower Returns?” citing Choi, James J., Laibson, David I. and Madrian, Brigitte C., “Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds” (March 6, 2008). Yale ICF Working Paper No. 08-14. Available at SSRN: <http://ssrn.com/abstract=1125023>.

¹⁷ See Choi, James, David Laibson, and Brigitte Madrian. 2010. Why does the law of one price fail? An experiment on index mutual funds. *Review of Financial Studies* 23(4): 1405-1432. [“[Subjects overwhelmingly failed to minimize index fund fees. Instead, they placed heavy weight on irrelevant attributes such as funds’ annualized returns since inception. Highlighting these misleading historical returns caused student subjects (in one of our randomized experimental treatments) to chase those returns even more intensely, despite the negative future return consequences such behavior had. Even subjects who claimed to prioritize fees in their portfolio decision showed minimal sensitivity to the fee information in the prospectus. Subjects apparently do not understand that S&P 500 index funds are commodities ... *In the real world, this problem is likely to be exacerbated by the financial advisors whose compensation is increasing in the fees of the mutual funds they sell to their clients. When consumers in a commodity market observe prices and quality with noise, a high degree of competition will not drive markups to zero*” [Emphasis added.]

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study. By the time it passed, it was a consensus measure having the support of virtually all advisers.

Investment advisers' professionalism, and particularly their professional ethics, dominated the SEC study and the legislative history of the Act. Industry spokespersons emphasized their professionalism. The "function of the profession of investment counsel," they said, "was to render to clients on a personal basis competent, unbiased and continuous advice regarding the sound management of their investments." In terms of their professionalism they compared themselves to physicians and lawyers. However, industry spokespersons indicated that their efforts to maintain professional standards had encountered a serious problem. The industry, they said, covered "the entire range from the fellow without competence and without conscience at one end of the scale, to the capable, well-trained, utterly unbiased man or firm, trying to render a purely professional service, at the other end." Recognizing this range, "a group of people in the forefront of the profession realized that if professional standards were to be maintained, there must be some kind of public formulation of a standard or a code of ethics." As a result, the Investment Counsel Association of America was organized and issued a Code of Ethics. Nonetheless, the problem remained that the Association could not police the conduct of those who were not members nor did it have any punitive power.

The SEC Study noted that it had been the unanimous opinion of all who had testified at its public examination, both members and nonmembers of the Association, that the industry's voluntary efforts could not cope with the "most elemental and fundamental problem of the investment counsel industry—the investment counsel 'fringe' which includes those incompetent and unethical individuals or organizations who represent themselves as bona fide investment counselors." Advisers of that type would not voluntarily submit to supervision or policing. Yet, all counselors suffered from the stigma placed on the activities of the individuals on the fringe. Thus, an agency was needed with compulsory and national power that could compel the fringe to conform to ethical standards.

As a result of the Commission's report to Congress, the Senate Committee on Banking and Currency determined that a solution to the problems of investment advisory services could not be affected without federal legislation. In addition, both the Senate and House Committees considering the legislation determined that it was needed not only to protect the public, but also to protect bona fide investment counselors from the stigma attached to the activities of unscrupulous tipsters and touts. During the debate in Congress, the special professional relationship between advisers and their

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clients was recognized. It is, said one representative, “somewhat [like that] of a physician to his patient.” The same Congressman continued that members of the profession were “to be complimented for their desire to improve the status of their profession and to improve its quality.”¹⁸

This is why it is important to fiduciary advisors to be able to distinguish themselves from non-fiduciaries. A recent example of the problems faced by investment advisers was the “fee-based brokerage accounts” final rule adopted by the SEC in 2005, which would have permitted brokers to provide the same functional investment advisory services as investment advisers but without application of fiduciary standards of conduct. This would have negated to a large degree economic incentives¹⁹ for persons to become investment advisers and be subject to the higher standard of conduct. The SEC’s fee-based accounts rule was overturned in *Financial Planning Ass’n v. S.E.C.*, 482 F.3d 481 (D.C. Cir., 2007).

MONITORING AND REPUTATIONAL THREATS ARE LARGELY INEFFECTIVE

¹⁸ John H. Walsh, “A Simple Code Of Ethics: A History of the Moral Purpose Inspiring Federal Regulation of the Securities Industry,” 29 Hofstra L.Rev. 1015, 1066-8 (2001), *citing* SEC, REPORT ON INVESTMENT COUNSEL, INVESTMENT MANAGEMENT, INVESTMENT SUPERVISORY, AND INVESTMENT ADVISORY SERVICES (1939).

¹⁹ One might reasonably ask why “honest investment advisers” (to use the language of the U.S. Supreme Court in *SEC vs. Capital Gains*) had to be protected by the Advisers Act. Was it not enough to just protect consumers? The answer can be found in economic principles, as set forth in the classic thesis for which George Akerlof won a Nobel Prize:

There are many markets in which buyers use some market statistic to judge the quality of prospective purchases. In this case there is incentive for sellers to market poor quality merchandise, since the returns for good quality accrue mainly to the entire group whose statistic is affected rather than to the individual seller. As a result there tends to be a reduction in the average quality of goods and also in the size of the market.

George A. Akerloff, The Market for "Lemons": Quality Uncertainty and the Market Mechanism, *The Quarterly Journal of Economics*, Vol. 84, No. 3. (Aug., 1970), p.488.

George Akerloff demonstrated “how in situations of asymmetric information (where the seller has information about product quality unavailable to the buyer), ‘dishonest dealings tend to drive honest dealings out of the market.’ Beyond the unfairness of the dishonesty that can occur, this process results in less overall dealing and less efficient market transactions.” Frank B. Cross and Robert A. Prentice, *The Economic Value of Securities Regulation*, 28 *Cardoza L.Rev.* 334, 366 (2006). As George Akerloff explained: “[T]he presence of people who wish to pawn bad wares as good wares tends to drive out the legitimate business. The cost of dishonesty, therefore, lies not only in the amount by which the purchaser is cheated; the cost also must include the loss incurred from driving legitimate business out of existence.” Akerloff at p. 495.

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The ability of “the market” to monitor and enforce a fiduciary’s obligations, such as through the compulsion to preserve a firm’s reputation, is often ineffective in fiduciary relationships. This is because revelations about abuses of trust by fiduciaries can be well hidden (such as through mandatory arbitration clauses and secrecy agreements regarding settlements), or because marketing efforts by fiduciary firms are so strong and pervasive that they overwhelm the reported instances of breaches of fiduciary duties.

RETIREMENT ACCOUNTS ARE AFFORDED SPECIAL STATUS

Not only does ERISA impose upon certain qualified retirement accounts significant protections for participants in those plans, but the Internal Revenue Code provides significant tax advantages to those who invest through qualified retirement accounts and individual retirement accounts (IRAs). These advantages should not be negated by the non-application of fiduciary standards, which serve to negate to a large degree the tax advantages otherwise afforded to investors in such accounts.

Because the Department has failed to consider the significant and overwhelming justifications, based upon public policy considerations, for the imposition of the fiduciary standard in its Delay Proposal, the Department has failed to follow the requirements of the Administrative Procedures Act.

(F) The Department has failed to consider the recent federal court cases that in fact confirmed the adequacy of the Final Rule’s Regulatory Impact Analysis and in so doing upheld the Final Rule, as well as such courts’ support for the strong public policy objectives apparent in the Final Rule.

In a recent opinion from the District Court for the Northern District of Texas, Chief Judge Barbara Lynn upheld each component of the Final Rule. The Court noted the Department’s comprehensive and inclusive rulemaking process, as well as the rigorous and thorough cost-benefit analysis that concludes the benefits to consumers substantially outweigh the costs to industry.

In the District of Columbia case, the judge (known to be an expert in the application of the Administrative Procedures Act) upheld the Department’s economic analysis. And, in the In the Kansas case, the Court found Market Synergy’s claim of irreparable harm unpersuasive

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and held that any delay in the implementation of the rule “will produce a public harm that outweighs any harm that plaintiff may sustain from the rule change.”²⁰

By going against its own substantial economic evidence in support of the Final Rule, and in going against court findings that substantial public harm would result from a delay in the application of the Final Rule, and doing so without any cogent rationale or change in circumstances, the Department has again failed to comply with the requirements of the Administrative Procedures Act in its Delay Proposal.

(G) The Department has not adequately set forth how “marketplace confusion” would result, does not analyze the negative impact on investment firms that have already implemented systems and procedures under the Final Rule.

The Department’s “marketplace confusion” argument is so distorted that evidence of a rational argument behind the existence of “marketplace confusion,” prior to the Department’s consideration of a delay, is wholly lacking.

Any “marketplace confusion” has arisen not from the Final Rule, but rather from the wholly inappropriate directives provided by the Delay Proposal itself. The Department should not be in the position of creating marketplace confusion, and then attempting to use the very confusion it has created for a profound change of direction in policy.

It is the Department’s eleventh-hour proposal to delay the rule that has caused marketplace confusion, not developments in the marketplace itself. Many firms publicly announced, months ago, how they intend to comply with the Final Rule. Many firms have already implemented the policies and procedures necessary to adequately comply with the Final Rule.

Moreover, the Department’s Field Assistance Bulletin No. 2017-01 (March 10, 2017) risks further marketplace confusion. While the Department set forth that the Department will not enforce the provisions of the Final Rule for a period of time, the Department has long recognized that the primary means of enforcement of the Final Rule is through consumer actions (via court or arbitration) for breach of contract (and other causes of action, where applicable). The Department’s Field Assistance Bulletin No. 2017-01 could well lead some firms to possess a false sense of security regarding their need to comply with the Final Rule.

²⁰ Mkt. Synergy Grp., 2016 U.S. Dist. LEXIS at *98.

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Again, the Department's economic analysis on this issue is wholly inadequate. The Department, by its Delay Proposal, is the source of any marketplace confusion, not the Final Rule. Accordingly, the requirements of the Administrative Procedures Act, and in particular the requirement for a well-reasoned economic analysis, have not been satisfied.

In Conclusion.

There is a time when each of us is called upon to exercise personal leadership.

There is a time when the greater good is so overwhelming that we must consider personal self-sacrifice.

There is a time when we must follow the dictates of the law, not the dictates of those leaders who propose to us that we not follow the law.

This is such a time.

This is a time to announce, promptly and without delay, that the Final Rule's applicability date will not be delayed.

The Department is well aware of the substantial, compelling, and even overwhelming economic evidence and public policy considerations that support the implementation of the Final Rule. The Department clearly lacks the authority, under the law, in the absence of a cogent and thorough economic analysis setting forth a change in the marketplace (which has not occurred), to proceed with its Delay Proposal.

I urge the Department to implement the Final Rule, and to withdraw its Delay Proposal, for the substantial benefits so apparent to the owners of American businesses large and small, to the tens of millions of individual investors in retirement accounts, and to the U.S. economy itself.

Sincerely,

Ron A. Rhoades, JD, CFP®