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August 7, 2017

Filed Electronically

Office of Exemption Determinations
Employee Benefits Security Administration
Attention: D-11933
US Department of Labor
200 Constitution Avenue N.W., Suite 400
Washington, DC 20210

Re: RIN 1210-AB82; Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions

Dear Sir or Madam:

The Investment Company Institute¹ supports the Department of Labor (the “Department”) reexamining its fiduciary rulemaking in response to the President’s directive,² and welcomes the

¹ The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s members manage total assets of US\$20.0 trillion in the United States, serving more than 95 million US shareholders, and US\$6.0 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

² See White House memorandum to the Secretary of Labor, dated February 3, 2017 and published at 82 Fed. Reg. 9675 (February 7, 2017), available at <https://www.gpo.gov/fdsys/pkg/FR-2017-02-07/pdf/2017-02656.pdf> (President’s Memorandum”).

opportunity to express our views on the Department's request for information (RFI) identifying several possible changes to the fiduciary rule and prohibited transaction exemptions.³

We believe that advice providers should act in their clients' best interest, a position we have stated consistently in our prior commentary.⁴ The Department, however, must critically reexamine and modify its fiduciary rulemaking. The fiduciary definition is overbroad and convoluted—turning commonplace interactions into fiduciary relationships and severely reducing exchanges of information currently provided at no cost to millions of retirement savers through call centers, walk-in centers, and websites. Many financial professionals serving retirement investors find that the Best Interest Contract or “BIC” exemption is unworkable or too burdensome to continue to offer certain products and services. They simply cannot justify assuming the potential risk and liability, including the substantial threat of unwarranted litigation, for certain accounts.⁵

The fiduciary rulemaking consequently is causing dislocations and disruption within the financial services industry and limiting the ability of retirement savers to obtain the guidance, products, and services they need to meet their retirement goals.

We appreciate, therefore, that the RFI's questions implicitly recognize the need to modify significantly the fiduciary rulemaking. Particularly encouraging is that the RFI requests commenters to consider the impact that a potential new Securities and Exchange Commission (SEC) standard of conduct would

³ 82 Fed. Reg. 31278 (Jul. 6, 2017), available at <https://www.gpo.gov/fdsys/pkg/FR-2017-07-06/pdf/2017-14101.pdf>.

⁴ *See e.g.*, letter from Paul Schott Stevens, to Office of Regulations and Interpretations, Employee Benefits Security Administration, US Department of Labor (July 21, 2015), available at https://www.ici.org/pdf/15_ici_dol_fiduciary_overview_ltr.pdf.

⁵ The Department issued the BIC exemption, published at 81 Fed. Reg. 21002 (April 8, 2016), at the same time as the final rule with the stated intent—subject to its many conditions—of permitting the payment of commissions and other compensation that ERISA and the Internal Revenue Code (“Code”) otherwise would prohibit. The failure of the BIC exemption to meet its intended purpose of allowing commission-based models to continue has been well-documented in reports of intermediary actions regarding the rule. *See, for example*, “Edward Jones Shakes Up Retirement Offerings Ahead of Fiduciary Rule,” *Wall Street Journal*, August 17, 2016, available at <https://www.wsj.com/articles/edward-jones-shakes-up-retirement-offerings-ahead-of-fiduciary-rule-1471469692>; “Fiduciary ready: Edward Jones Unveils Compliance Plans,” *On Wall Street*, August 19, 2016, available at <http://www.onwallstreet.com/news/fiduciary-ready-edward-jones-unveils-compliance-plans>; and “JPMorgan Chase to Drop Commissions-Paying Retirement Accounts,” Reuters, November 10, 2016, available at <http://www.reuters.com/article/us-jpmorgan-wealth-compliance-idUSKBN1343LK>.

have on the fiduciary rulemaking.⁶ This follows Secretary of Labor Acosta⁷ and SEC Chairman Clayton⁸ publicly expressing a willingness to cooperate as they further review the standards of conduct that apply to broker-dealers and investment advisers across retirement and non-retirement accounts.

Developing consistent standards that apply to retirement and non-retirement accounts presents a very clear path for reforming and modifying the Department's fiduciary rulemaking. A consistent approach will help all investors achieve better financial outcomes, increase efficiency, and preserve investor choice and access to advice. It ultimately will better enable financial services providers to deliver holistic investment advice and financial planning services to retail investors.

Our letter explains how the SEC and Department can accomplish these important objectives. We summarize below the letter's key points.

Summary of Key Points

- The SEC developing an enhanced standard of conduct for SEC-registered broker-dealers will allow the Department to adopt a corollary prohibited transaction exemption for financial services providers that are subject to an SEC-governed standard of conduct.⁹ The SEC, working with the Department, should develop a best interest standard of conduct for

⁶ The RFI requests comment on whether, if the SEC were to “adopt updated standards of conduct applicable to the provision of investment advice to retail investors . . . a streamlined exemption or other change [could] be developed for advisers that comply with or are subject to those standards . . .” 82 Fed. Reg. 31278, at 31280. The RFI asks further “[t]o what extent does the existing regulatory regime for IRAs by the Securities and Exchange Commission, self-regulatory bodies (SROs) or other regulators provide consumer protections that could be incorporated into the Department's exemptions or that could serve as a basis for additional relief from the prohibited transaction rules?” *Id.*

⁷ Secretary Acosta stressed the Department's need for the SEC's expertise in this area in both his May 22, 2017 op-ed in the Wall Street Journal and in the June 27, 2017 hearing of the Senate Subcommittee on Labor, Health and Human Services, Education, and Related Agencies (“Previously the SEC did not work jointly with the Department of Labor; as I indicated quite publicly, I think that the SEC has important expertise and that they need to be part of the conversation. And I asked the chairman of the SEC if the SEC would be willing to work with us. The chairman indicated his willingness to do so. It is my hope as the SEC also receives a full complement of commissioners, that the SEC will continue to work with the Department of Labor on this issue.”).

⁸ At the June 27, 2017 hearing of the Senate Subcommittee on Financial Services and General Government, Chairman Clayton said “Look, it's not separate; what's happening at the Department of Labor is going to affect the markets we [the SEC] regulate and vice versa. It's my intent as chairman to try and move forward and effectively deal with that, in a way that is coordinated so that our Main Street investors have access to investment advice and access to investment products.” <http://www.thinkadvisor.com/2017/06/27/sec-moving-forward-on-fiduciary-rule-clayton-says>.

⁹ This prohibited transaction exemption also should be available to SEC-registered investment advisers, which would remain subject to their existing SEC-governed fiduciary duty.

broker-dealers that would apply when they make recommendations to retail investors in non-discretionary accounts, whether those investors are saving for retirement or other important goals.¹⁰ This standard should have clearly defined obligations, reflecting a duty of care and a duty of loyalty. We explain these points further below and in more detail in comments¹¹ submitted in response to SEC Chairman Clayton's request for comment on standards of conduct that apply to investment advisers and broker-dealers.¹²

- A coordinated approach presents distinct advantages over the dueling approaches in place today.
 - It is consistent with the Administration's regulatory policy directives,¹³ and reflects the reality that individuals who seek financial guidance commonly have both retirement accounts and retail accounts. It would permit these individuals to receive guidance that reflects consistent and compatible regulatory requirements.
 - Retirement investors will benefit from the SEC's and FINRA's regulatory protections,¹⁴ examination programs and enforcement mechanisms, and financial professionals serving retirement investors will not be saddled with unnecessary burdens and unwarranted legal risk.

¹⁰ For ease of reference, throughout this letter we refer to our recommended standard of conduct as the "best interest standard of conduct," and to the SEC-registered brokers and dealers to which it would apply simply as "broker-dealers."

¹¹ See letter from Dorothy M. Donohue, Acting General Counsel, to Jay Clayton, SEC Chairman (August 7, 2017), available at https://www.ici.org/pdf/17_ici_rfiresponse_ltr.pdf and attached as Appendix A ("ICI's Letter to Chairman Clayton").

¹² Chairman Jay Clayton, Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers (June 1, 2017), available at <https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31>.

¹³ See Presidential Executive Order on Enforcing the Regulatory Reform Agenda, issued on February 24, 2017 (stating that "[i]t is the policy of the United States to alleviate unnecessary regulatory burdens placed on the American people" and encouraging Agencies to eliminate regulations that "create a serious inconsistency or otherwise interfere with regulatory reform initiatives and policies"), available at <https://www.whitehouse.gov/the-press-office/2017/02/24/presidential-executive-order-enforcing-regulatory-reform-agenda>; and Presidential Executive Order on Reducing Regulation and Controlling Regulatory Costs, issued on January 30, 2017 (directing agencies to identify at least two existing regulations to be repealed for every new regulation proposed), available at <https://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling>.

¹⁴ As discussed further below in Section II.A.1, the SEC and FINRA have regulatory oversight over broker-dealers, and the SEC has oversight over investment advisers.

- The SEC's and FINRA's examination and enforcement programs appropriately protect investors, including retirement investors, and would serve to enforce compliance with the SEC's conduct standards, making the BIC exemption's contractual warranties, private right of action, and the Department's reliance on the plaintiff's bar as means of enforcement all unnecessary. The Department's bootstrap approach was put in place solely because it has no enforcement authority over IRAs.
- A coordinated approach would obviate the need for numerous, complex exemptions and exceptions required for the current rule. The current fiduciary rulemaking depends on numerous exceptions and exemptions in an attempt to allow for commonplace interactions. Such an approach serves only to add complexity with no corresponding benefit to investors. In addition to the significant number of exceptions and special exemptions that are part of the current fiduciary rulemaking, the RFI identifies several new potential exemptions which are presumably needed to make the rule work.¹⁵ The coordinated approach outlined above would eliminate the need for such special exemptions and thereby significantly reduce complexity.
- The Department must limit the scope of the **rule's fiduciary definition**. Although the coordinated approach we recommend would eliminate the need for many of the special new exemptions that the RFI mentions, it would not obviate the need for changes to the Department's overly broad definition of fiduciary investment advice. The Department must narrow the definition to avoid turning commonplace interactions into fiduciary relationships. The Department must (1) clarify that recommendations to make or increase contributions to a plan or IRA are not fiduciary investment advice, (2) provide unambiguous thresholds for determining when fiduciary advice is being provided, (3) simplify the exception for transactions with independent fiduciaries with financial expertise, (4) include a **broad seller's carve-out**, and (5) broaden the education exception.¹⁶
- An updated impact analysis will lead the Department to conclude that a more principles-based rule—consistent with the coordinated approach we recommend above—will better protect investors. The weaknesses in the fiduciary rulemaking to date stem from a flawed impact analysis. Rather than serving as a tool to understand a problem and determine the best solution, the Department started with a predetermined agenda of eliminating perceived

¹⁵ The RFI includes 18 questions (each with multiple sub-questions) regarding potential new exemptions and changes to the fiduciary definition and existing exemptions.

¹⁶ See text accompanying footnotes 72 through 87, *infra*.

“conflicts” in the retirement marketplace and used the 2016 RIA¹⁷ to justify that effort. The result is an impact analysis that focuses on claims that support the Department’s narrative and that readily dismisses facts that raise contrary conclusions regarding that narrative. Most significantly, the 2016 RIA (1) fails to address adequately the harms of the rule—a topic of **primary importance in the President’s Memorandum**;¹⁸ and (2) bases its conclusions on a limited review of the marketplace, and then misapplies the academic studies on which it relies, causing it to overstate by a factor of 15 to 50 times any potential benefits of the rule.¹⁹

Structure of the Comment Letter

- Part I describes how the SEC developing an enhanced standard of conduct for SEC-registered broker-dealers will allow the Department to adopt a streamlined prohibited transaction exemption for financial services providers that are subject to an SEC-governed standard of conduct.
- Part II discusses our responses to the RFI’s questions regarding potential changes to the rule and related exemptions. More specifically, we discuss why the changes discussed in the RFI regarding the BIC exemption are unnecessary if the Department adopts the coordinated approach discussed in Part I. We also explain the need to narrow the scope of the fiduciary definition.
- Appendix A is a copy of ICI’s Letter to SEC Chairman Clayton recommending that the SEC develop a best interest standard of conduct for broker-dealers that would apply when they make recommendations to retail investors in non-discretionary accounts, whether those investors are saving for retirement or other important goals.

¹⁷ US Department of Labor, Employee Benefits Security Administration, Regulating Advice Markets, Definition of the Term “Fiduciary” Conflicts of Interest—Retirement Investment Advice Regulatory Impact Analysis for Final Rule and Exemptions (April 2016) (“2016 RIA”), available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>.

¹⁸ See the President’s Memorandum. The initial question raised for examination pursuant to the President’s Memorandum is whether the 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.”

¹⁹ For a detailed discussion of the 2016 RIA’s flaws that underlie the Department’s unsupportable exaggeration of the potential harm to investors if the rule was not made effective, see pages 18 through 28 of letter from Brian Reid and David Blass, to Office of Regulations and Interpretations, Employee Benefits Security Administration, US Department of Labor (April 17, 2017), available at https://www.ici.org/pdf/17_ici_dol_fiduciary_reexamination_ltr.pdf (“ICI’s April 17 Letter”). See also Appendix B.

- Appendix B summarizes the flaws in the Department’s impact analysis supporting its fiduciary rulemaking and how the rulemaking will cause an “advice gap.”
- Appendix C summarizes recent SEC and FINRA examination and enforcement statistics that demonstrate the existence of robust examination and enforcement mechanisms that protect all investors, including retirement investors, from the types of theoretical abuses the Department’s fiduciary rulemaking was intended to address.

I. The SEC and the Department Should Take a Consistent Approach to Standards of Conduct.

The RFI requests comments on whether the Department should create a streamlined exemption for financial services providers who are subject to an SEC-governed standard of conduct. As recommended in ICI’s Letter to Chairman Clayton, we strongly support the Department coordinating its approach to these crucial issues with the SEC.²⁰ Financial professionals who use the BIC exemption find themselves subject to a best interest standard of conduct that, as the Department has applied it, is consistent with neither the fiduciary standard applicable to investment advisers nor the suitability standard applicable to broker-dealers. This results in a financial professional being subject to different standards of conduct **with respect to the same customer’s retirement and non-retirement accounts**. This not only burdens the regulated community with multiple inconsistent rules, but also naturally leads to investor confusion. It therefore is critical that the SEC and Department take a consistent approach to identifying and implementing a standard of conduct for broker-dealers that applies uniformly across retirement and non-retirement accounts.

As an initial step, the SEC should establish a clearly articulated best interest standard of conduct that would apply to broker-dealers providing recommendations to retail investors in non-discretionary accounts, regardless of whether those recommendations are made with respect to retirement accounts.²¹ The best interest standard of conduct that ICI recommends for broker-dealers, which is described in more detail below, would be intended to enhance, and not replace, the existing suitability requirements and other obligations that currently apply to broker-dealers under the Securities Exchange Act of 1934 (“Exchange Act”), the rules thereunder, and FINRA rules.

The Department, for its part, should provide a new streamlined prohibited transaction exemption for recommendations made by financial services providers who are subject to an SEC-governed standard of conduct. This exemption also would cover recommendations by SEC-registered investment advisers

²⁰ The discussion in this part of the letter is consistent with ICI’s Letter to Chairman Clayton.

²¹ When a financial professional has discretionary authority over customer accounts, it would be deemed a fiduciary. Therefore, a fiduciary duty standard, rather than a best interest standard would apply in that situation.

subject to an SEC-governed fiduciary standard of conduct.²² Application of one of these standards of conduct should be sufficient to meet a prohibited transaction exemption for advice under ERISA and the Code.²³ For financial services providers who are not subject to an SEC-governed standard, the Department should provide an exemption that includes conditions comparable in scope and intent to any new SEC best interest standard for broker-dealers.

To provide time for the agencies to coordinate in this manner, we urged the Department in our July 21, 2017 letter, to immediately—by August 15, 2017—issue an interim final rule delaying the January 1, 2018 applicability date for one year.²⁴ In conjunction with this postponement, we recommended that the Department announce that it expects to finalize modifications to the fiduciary rule and related prohibited transaction exemptions prior to January 1, 2019 and that the applicability date of the modified rule and exemptions will become effective no sooner than January 1, 2020. The SEC should issue the new best interest standard of conduct for broker-dealers within this same timeframe, so that our recommended new prohibited transaction exemption for SEC-regulated entities can be operational.

A. The SEC Should Establish a New Best Interest Standard of Conduct for Broker-Dealers.

Our recommended best interest standard would require that a broker-dealer’s “recommendation” to a retail customer in a non-discretionary account be in that customer’s best interest at the time the recommendation is made, incorporating an explicit duty of loyalty and a duty of care, with the following affirmative obligations:

Duty of Loyalty

- **Client’s Interest First.** The standard would require that a broker-dealer’s recommendation to a retail customer not put the broker-dealer’s interests (or the interests of anyone else) above the client’s interests.

²² Under our recommended approach, SEC-registered investment advisers would remain subject to the long-standing fiduciary duty that already governs their conduct.

²³ For brevity, throughout this letter, we refer to this recommended approach as the “SEC-governed standards of conduct.”

²⁴ See letter from Dorothy M. Donohue and David M. Abbey to Office of Exemption Determinations, Employee Benefits Security Administration, US Department of Labor (July 21, 2017), available at <https://www.ici.org/pdf/30795a.pdf> (“ICI’s July 21 Letter”).

Duty of Care

- Diligence, Care, Skill, and Prudence. The standard would require a broker-dealer's recommendation to a retail customer to reflect (1) reasonable diligence;²⁵ and (2) reasonable care, skill, and prudence based on the customer's investment profile.²⁶

Fair and Reasonable Compensation. A broker-dealer would be required to charge no more than reasonable compensation for services to its customer.²⁷

Disclosure. The best interest standard would require that the broker-dealer disclose to the customer certain key aspects of its relationship with the customer—such as the type and scope of services provided, the applicable standard of conduct, the types of compensation it or its associated persons receive, and any material conflict of interest.

No Misleading Statements. A broker-dealer would be prohibited from making any misleading statements about the transaction, compensation or conflicts of interest.

Policies and Procedures. Broker-dealers would be subject to existing regulation requiring them to adopt policies and procedures reasonably designed to prevent violations of the applicable standard of conduct.²⁸ FINRA already requires a broker's written procedures and supervisory system to be reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules. The recommended policies and procedures would fall within the scope of this FINRA requirement.

Application of Standard. The standard would be triggered whenever a broker-dealer makes a recommendation to any customer having a non-discretionary account. For this purpose, FINRA's definition of "recommendation" would apply.²⁹

Scope of Standard. A best interest standard of conduct for broker-dealers also would permit the broker-dealer to limit the scope, nature, and anticipated duration of the relationship with the customer.

²⁵ See FINRA Rule 2111.

²⁶ See FINRA Rule 2111.04.

²⁷ See FINRA Rules 2121 and 2122.

²⁸ See FINRA Rule 3110.

²⁹ See FINRA Rule 2111.

It is significant that the best interest standard of conduct for broker-dealers described above is generally analogous to the standard of conduct required of financial professionals who wish to utilize the BIC exemption during the “Transition Period” from June 9, 2017 through January 1, 2018. Compliance with the “Impartial Conduct Standards” requires that advisors provide advice in retirement investors’ best interest; charge no more than reasonable compensation; and avoid misleading statements.³⁰ The Department determined that adherence to these “fundamental fiduciary norms” helps ensure that advisor conflicts do not drive investment recommendations. Like the Impartial Conduct Standards, our suggested standard would be triggered when a “recommendation” is made. The standard goes beyond the Impartial Conduct Standards because it requires disclosure³¹ and implicitly requires (under already-applicable FINRA rules) broker-dealers to adopt policies and procedures designed to prevent violations of the standard.

The BIC exemption also requires both extensive disclosures and the adoption of policies and procedures (separate from the Impartial Conduct Standards). But its conditions are now widely understood to be so prescriptive that many broker-dealers are choosing to forego providing advice and other services rather than operationalizing the BIC exemption. For example, the policies and procedures currently required under the BIC exemption impose stringent requirements with respect to financial institutions’ and professionals’ compensation. The requirement to level a financial professional’s compensation where there is not an objective and memorialized “neutral factor” to evidence the difference has proven to be the greatest obstacle in operationalizing the BIC exemption, along with the significant class action risk.

The BIC exemption also requires financial professionals to provide contractual warranties and subjects them to private rights of action. As discussed in detail below,³² the SEC’s and FINRA’s examination and enforcement programs adequately protect investors, including retirement investors, and would serve as a sufficient incentive motivating compliance with the SEC’s conduct standards, making the BIC exemption’s contractual warranties and private right of action unnecessary.

³⁰ As described by the Department, “the basic Impartial Conduct Standards . . . require advisers to make recommendations that are in the customer’s best interest (*i.e.*, advice that is prudent and loyal), avoid misleading statements, and charge no more than reasonable compensation for services (which is already an obligation under ERISA and the Code, irrespective of this rulemaking) . . .” 82 Fed. Reg. 16905 (April 7, 2017).

³¹ See text accompanying footnotes 70 and 71, *infra*.

³² See text accompanying footnotes 37 through 47 and Appendix C, *infra*.

B. The Department Should Create a New Streamlined Prohibited Transaction Exemption.

The Department should provide a new streamlined prohibited transaction exemption for financial services providers who are subject to an SEC-governed standard of conduct. The exemption would cover recommendations made by broker-dealers who would be subject to any new best interest standard. The exemption also would cover SEC-registered investment advisers that already are subject to an SEC-governed fiduciary standard of conduct. Application of one of these standards of conduct should be sufficient to meet a prohibited transaction exemption for advice under ERISA and the Code. Because the SEC and FINRA will oversee compliance with the standards of conduct, the Department will no longer need to rely on a newly created private right of action to compensate for its own lack of enforcement authority with respect to IRAs.³³

We note that FINRA requires compliance training and monitoring designed to manage and mitigate conflicts, consistent with its report on conflicts (“**Report**”).³⁴ With respect to potential conflicts of interest in compensation arrangements, focusing particularly on brokerage and other compensation for associated persons, the Report highlights various examples of effective practices used by firms to mitigate instances where the compensation structure may potentially affect the behavior of registered representatives. FINRA acknowledges in the Report, as should the Department, that actual practices used to appropriately mitigate conflicts will vary from firm to firm.³⁵ This approach best enables financial services providers to tailor their compliance programs to their businesses and relationships with customers, thereby increasing the effectiveness of those programs.

For financial services providers who are not subject to an SEC-governed standard, the Department should provide an exemption that includes conditions comparable in scope and intent to the new best interest standard for broker-dealers.³⁶ For example, the exemption would condition relief on having comparable duties of loyalty and care; receiving only fair and reasonable compensation; providing

³³ *Id.*

³⁴ See FINRA Report on Conflicts of Interest (October 2013), *available at* <https://www.finra.org/sites/default/files/Industry/p359971.pdf>. We previously made these suggestions in our comment letter on the proposed fiduciary rule. See text accompanying footnotes 38 through 42 of letter from David M. Abbey and David W. Blass to Office of Exemption Determinations, Employee Benefits Security Administration, US Department of Labor (July 21, 2015), available at https://www.ici.org/pdf/15_ici_dol_fiduciary_best_interest_ltr.pdf.

³⁵ Report at p. 36.

³⁶ To the extent that these other financial services providers are (or become) subject to a comparable best interest standard of care through their applicable state or federal regulatory scheme, the Department could structure the exemption to rely on application of that regulatory scheme.

disclosures regarding the services provided, the applicable standard of conduct, types of compensation to be received, and any material conflicts of interest; and not making misleading statements.

C. **The SEC's and FINRA's Examination Programs and Enforcement Mechanisms Can Effectively Protect Retirement Investors, Supporting the Use of a Streamlined Exemption.** (Question 11)

The RFI asks several questions about how the Department could incorporate the SEC's **regulation of investment advice**, including, as discussed above, suggesting a streamlined exemption for advisors that are subject to updated SEC standards of conduct. As discussed above, the Department should provide a new streamlined prohibited transaction exemption for financial services providers that already are subject to an SEC-governed best interest standard.

The RFI also asks whether the SEC's or FINRA's **existing regulatory regime covering IRAs could provide a basis for relief from the Code's prohibited transaction rules**. We believe that the SEC's and FINRA's **robust examination program and enforcement mechanisms** provide strong incentives for broker-dealers to comply with any new best interest standard. They negate the need for the alternate enforcement mechanism the Department created **through the BIC exemption's written contract and warranty requirements**. The SEC and FINRA examination and enforcement programs described below, along with **firms' own compliance programs** and incentive to comply with applicable laws and regulations,³⁷ offer sufficient motivation to justify a prohibited transaction exemption under ERISA and the Code.

In particular, the SEC and FINRA both regularly examine and, as warranted, bring enforcement actions against registered representatives, broker-dealers, and investment advisers. Both organizations pursue remedies including disgorgement and restitution on behalf of such investors. Not only have examination and enforcement activities increased over time, but also these efforts have increasingly focused on issues with respect to retirement investors. As outlined below, the SEC can leverage further those mechanisms to **help address the Department's enforcement concerns**. This will eliminate the need for the BIC exemption's **contract requirement and private right of action**. Relying on current enforcement mechanisms would allay industry concerns about increased exposure to class action risks, thereby allowing the industry to continue to offer, and bring to market, a fulsome suite of services to retirement investors.

³⁷ We note that applicable law and regulation in this context includes the excise taxes triggered by violations of the Code's prohibited transaction rules. The penalties under Code section 4975 automatically apply when a violation occurs, and the disqualified person must report and pay the penalty regardless of any enforcement action by the IRS.

The SEC and FINRA have been active in pursuing enforcement actions against registered representatives, broker-dealers, and investment advisers who allegedly have harmed investors in connection with their retirement accounts and retirement assets. In the past year,³⁸ the types of issues that the SEC has settled in numerous enforcement actions against broker-dealers and investment advisers are particularly pertinent to retail investors (including retirement investors) and address issues including failures to disclose conflicts of interest,³⁹ suitability of investments,⁴⁰ misrepresentations to customers,⁴¹ and overcharging fees and commissions.⁴² FINRA likewise settled enforcement actions relating to unsuitable investment recommendations⁴³ **and firms' failures to supervise associated persons.**⁴⁴

These actions demonstrate that the SEC and FINRA already protect investors, including with respect to their retirement accounts and retirement assets. They also are consistent with the SEC's and FINRA's stated regulatory and examination priorities for 2017, in which they reaffirmed their continuing focus on retail investors, including senior investors and individuals investing for their retirement.⁴⁵ With regard to senior investors and retirement investors, the SEC recognized that "[a]s

³⁸ See Appendix C for a summary of SEC and FINRA examination and enforcement statistics.

³⁹ See, e.g., *In re Biscayne Capital Int'l, LLC*, Investment Advisers Act Release No. 4399, 2016 SEC LEXIS 3275 (May 27, 2016) (settlement with investment advisory firm and principals for disgorgement, civil penalties for failure to disclose personal and institutional conflicts of interest).

⁴⁰ See, e.g., *In re Fortius Fin. Advisors, LLC*, Investment Advisers Act Release No. 4483, 2016 SEC LEXIS 3294 (Aug. 15, 2016) (settlement with registered investment adviser for disgorgement and civil penalties over allegations including investment in unsuitable, illiquid investments in which respondents had an undisclosed financial interest).

⁴¹ See, e.g., News Release, FINRA, FINRA Bars Registered Representative for Unauthorized and Unsuitable Trading in Elderly Customer's Retirement Account (March 1, 2017) (representative permanently barred from association with any FINRA member for making unauthorized and unsuitable trades totaling approximately \$15 million in a 73-year-old retiree's account, and for misrepresenting the reasons for the trades to the customer).

⁴² See, e.g., *In the Matter of Barclays Capital, Inc.*, SEC Release No. 10355 (May 10, 2017) (settlement for \$97 million over three sets of alleged violations resulting in over 20,000 customer accounts being overcharged for services that respondent did not actually perform and for the misrepresentation of those services in respondent's brochures).

⁴³ See, e.g., *In re J.J.B. Hilliard, W.L. Lyons, LLC*, FINRA AWC No. 2015048307001 (Sept. 9, 2016) (finding that certain retirement plan and charitable organization customers were disadvantaged by selling classes of mutual fund shares with either front-end or back-end sales charges and higher ongoing fees and expenses).

⁴⁴ See, e.g., *In re Newport Coast Sec., Inc.*, FINRA Disc. Proc. No. 2012030564701 (Oct. 17, 2016) (finding by panel that respondent failed to supervise five registered representatives and made unsuitable trades and recommendations).

⁴⁵ Unless otherwise noted, descriptions of SEC's Office of Compliance Inspections and Examinations' priorities are from: SEC Press Release No. 2017-7, SEC Announces 2017 Examination Priorities (Jan. 12, 2017), available at <https://www.sec.gov/news/pressrelease/2017-7.html>.

the U.S. population ages and investors become more dependent than ever on their own investments for retirement income, we are devoting increased attention to issues affecting senior investors and those investing for retirement.” Components of that priority include:

- The ReTIRE initiative, which focuses on services investment advisers and broker-dealers provide to investors with retirement accounts, including, for 2017, a particular focus on recommendations and sales of variable insurance products, sales and management of target date funds, and controls relating to cross-transactions, particularly for fixed income securities;
- Examinations of investment advisers to pension plans of states, municipalities, and other government entities, focusing on a variety of topics such as conflicts of interest; and
- Evaluating how firms manage their interactions with senior investors, focusing on the adequacy of disclosures relating to certain products and the mechanisms in place to detect the financial exploitation of seniors, such as supervisory programs and controls relating to products and services aimed at senior investors.⁴⁶

FINRA’s guidance and activities related to IRA rollovers offer more evidence of its interest in and intent to protect retirement investors and their assets. In this regard, FINRA Notice 13-45 provides guidance on suitability obligations with respect to rollovers, indicating that broker-dealers should consider fees, available services and investments, distribution options, and tax considerations when making a rollover recommendation. FINRA’s notice further requires broker-dealers to review and assess conflicts of interest and to supervise “to reasonably ensure that conflicts of interest do not impair the judgment of a registered representative . . . about what is in the customer’s interest.” FINRA also has provided investors with specific guidance related to IRA rollovers, as part of its investor education alerts.⁴⁷

⁴⁶ Similarly, FINRA has stated that “protecting senior investors will remain a top priority in 2017,” including focusing on firms’ controls for protecting senior investors from fraud, abuse, and improper advice. Part of that focus is aimed at determining whether recommendations to purchase speculative or complex products are suitable given the investor’s profile and risk tolerance. FINRA also maintains its Securities Helpline for Seniors® (HELPS™), which has received more than 9,900 calls from seniors and their families seeking help, resulting in the return of \$4.5 million to customers “with no lawyers and no arbitration.” Susan F. Axelrod, FINRA, Remarks at IRI Government, Legal and Regulatory Conference (June 12, 2017), available at <http://www.finra.org/newsroom/speeches/061217-remarks-iri-government-legal-and-regulatory-conference>. Unless otherwise noted, descriptions of FINRA’s priorities are from: FINRA, 2017 Regulatory and Examination Priorities Letter (Jan. 4, 2017), available at <http://www.finra.org/industry/2017-regulatory-and-examination-priorities-letter>.

⁴⁷ See FINRA Investor Alert, “The IRA Rollover: 10 Tips to Making a Sound Decision” (January 23, 2014), available at <https://www.finra.org/investors/alerts/ira-rollover-10-tips-making-sound-decision>.

II. The Fiduciary Rule and Exemptions are Harming Investors Without Any Corresponding Benefit and Should Be Significantly Modified.

The RFI asks several specific questions regarding potential changes to the fiduciary rule and related exemptions. As discussed above, we urge the Department to provide a new streamlined prohibited transaction exemption for financial services providers who are subject to an SEC-governed standard of conduct. If the Department follows our recommendation, many of the changes to the rulemaking described in the RFI, including the need for additional streamlined exemptions, would be unnecessary. In fact, this path forward would eliminate the need for the BIC and Principal Transactions exemptions.

Our recommended approach, however, would not obviate the need for changes to the overly broad definition of fiduciary investment advice. Such changes are crucial to avoid turning commonplace interactions into fiduciary relationships. The Department should modify the fiduciary rule to (1) clarify that recommendations to make or increase contributions to a plan or IRA are not fiduciary investment advice, (2) provide unambiguous thresholds for determining when fiduciary advice is being provided, (3) simplify the exception for transactions with independent fiduciaries with financial expertise, (4) include a broad seller's carve-out, and (5) broaden the education exception.

A. Adoption of a Streamlined Exemption for Brokers Subject to an SEC Best Interest Standard Would Eliminate the Need for the BIC and Principal Transactions Exemptions.

The Department asks several “general questions” about the efficacy of its fiduciary rulemaking.⁴⁸ It is now clear that the BIC and related exemptions are not working as intended.⁴⁹ As has been widely reported, several large intermediaries have announced a variety of changes to service offerings, including no longer offering mutual funds in IRA brokerage accounts; no longer offering any IRA brokerage accounts at all; reducing web-based financial education tools; and raising account minimums or discontinuing advisory services for lower-balance accounts.

Simply put, faced with the Hobson's choice of using the BIC exemption and assuming unmanageable compliance obligations and liability, many intermediaries instead are deciding to significantly change

⁴⁸ More specifically, the Department asks what the industry has done to date to comply with the rulemaking (in particular since June 9, 2017); whether the rulemaking balances the interests of consumers and effectively allows advisers to provide a wide range of products to meet their needs; whether the cost of the not-yet-applicable BIC exemption conditions outweigh the benefits; and whether there are more appropriate alternatives to the remaining BIC exemption conditions.

⁴⁹ The Department amended other pre-existing exemptions to require compliance with the Impartial Conduct Standards that are part of the BIC exemption. These exemptions are Prohibited Transaction Exemptions (PTEs) 75-1, 77-4, 80-83, 83-1, and 86-128. Our concerns with respect to the BIC exemption apply to these exemptions as well.

their business models. This demonstrates that the rule and related exemptions do not appropriately balance the interests of investors. Rather, the rulemaking has limited **retirement savers' choices**, restricted their access to information they need for retirement planning, and increased costs, particularly for those savers who can least afford it.⁵⁰ The incremental costs of imposing the additional exemption conditions would greatly exceed any benefits.

The Department announcing the phased implementation approach has slowed some of this intermediary activity. Consequently, the full impact of the rulemaking is not fully manifest in the retirement marketplace. It is understood that intermediary activity will increase if the Department fails to delay the January 1, 2018 compliance date and propose significantly modifying the rulemaking.⁵¹

There is no evidence that the Department deciding to eliminate the additional exemption conditions (beyond the Impartial Conduct Standards) will negatively impact investors. To the contrary, the Department recognizes that any gains to investors from the rulemaking almost entirely come from imposing the Impartial Conduct Standards. As the Department explains, its current bifurcated approach, which delays imposing the additional BIC **exemption requirements**, **does not give** “short shrift to the competing interest of retirement investors in receiving advice that adheres to basic fiduciary norms. Because the Impartial Conduct Standards apply [as of June 9, 2017], retirement investors will benefit from higher advice standards, while the Department takes the additional time necessary to perform the examination required by the President’s **Memorandum**.”⁵²

The clear path forward is for the Department to adopt our recommended approach of coordinating with the SEC on a best interest standard of conduct for broker-dealers and providing a new streamlined exemption for financial services providers subject to an SEC-governed standard of conduct. Maintaining the BIC exemption and making changes around the edges simply will not work and is incompatible with **Secretary Acosta’s and Chairman Clayton’s promise** of a coordinated, principles-based approach. Notwithstanding that reality, our comments below respond to specific questions the Department raises in the RFI regarding potential modifications to the BIC and other exemptions.

⁵⁰ See Appendix B for a detailed discussion of the “advice gap” that will result from these market disruptions.

⁵¹ As we described in ICI’s July 21 Letter, at pp. 13-15, the abbreviated timeline required by the January 1, 2018 applicability date, as well as the resultant uncertainty, is creating inefficiency and sub-optimal implementation decisions.

⁵² While the Department suggests that it is possible that “some lapses in compliance may result in investor losses,” it also clarifies that such a possibility is clearly negligible and unsubstantiated. 82 Fed. Reg. 16902, at 16906.

1. SEC and FINRA examination and enforcement programs present an effective approach to protecting retail investors, including retirement investors, making the **BIC exemption's contract requirement and private right of action unnecessary.** (Questions 5 and 6)

Questions 5 and 6 of the RFI request information on the contract and contractual warranties⁵³ requirements of the BIC and Principal Transaction exemptions.⁵⁴ The Department asks if financial services providers will be incentivized to comply with the Impartial Conduct Standards in the absence of either the contract or warranty requirements. As discussed above, the Department already has concluded that not moving forward with the additional exemption conditions beyond the Impartial Conduct Standards will not negatively impact investors.

An SEC-governed best interest standard of conduct for broker-dealers would serve as an overlay to, and enhance, the already robust consumer protections enshrined in existing SEC and FINRA requirements.⁵⁵ The standard also is (as discussed above) generally analogous to the Impartial Conduct Standards. The SEC and FINRA would oversee compliance with the standard—both of which, as discussed in detail above, have well established enforcement programs. If the SEC adopts a standard of conduct modeled after our recommended approach, there would be no need for a private right of action under the BIC exemption, given that both the SEC and FINRA have jurisdiction over policies, procedures, and client disclosures.

Similarly, the existing fiduciary duty standard of conduct applicable to SEC-registered investment advisers is generally analogous to the Impartial Conduct Standards. The SEC effectively oversees

⁵³ While not specifically referenced in the RFI, we note that given the Department's position in *Chamber of Commerce v. U.S. Dep't of Labor*, No. 17-10238 (5th Cir. July 3, 2017) and *Thrivent Financial for Lutherans v. R. Alexander Acosta*, Secretary of Labor and U.S. Department of Labor, Court File No. 0:16-cv-03289-SRN-DTS, the Department must promptly act to formally remove the prohibition on class arbitration found in section II(f)(2) of both PTE 2016-01 and 2016-02. As we discussed in our previous letter, the significant costs of increased litigation either will be passed on to consumers through higher fees or result in a loss of access to advice by some investors, particularly smaller accounts. Because the Department has recognized that the Federal Arbitration Act, properly construed, precludes this provision, the exemptions should be modified immediately.

⁵⁴ See ICI's April 17 Letter at pp. 34 to 37, for a detailed discussion of the increase in litigation and the resultant increase in prices for investors as a result of the contract and contractual warranties requirements.

⁵⁵ The Exchange Act requires that investment recommendations provided by broker-dealers meet certain standards of conduct analogous to those required under the Impartial Conduct Standards. If the SEC, as we have suggested, adopts a standard of conduct that substantially overlaps with the Impartial Conduct Standards, SEC required policies and procedures for broker-dealers may be expanded or enhanced to help meet the enhanced standard of conduct. Thus, they will offer sufficient protections supporting coverage by the Department's new exemption, making the prescriptive and unworkable additional policies and procedures requirements under the BIC exemption unnecessary.

compliance with this standard, through its disclosure, examination, and enforcement programs.⁵⁶ The SEC's jurisdiction over investment advisers' policies, procedures, and client disclosures makes a private right of action under the BIC exemption unnecessary for advisers, as well as broker-dealers.

Even if the Department does not adopt a streamlined exemption for SEC-governed standards of conduct, the private right of action under the BIC exemption still would be unnecessary. The SEC and FINRA do not have explicit jurisdiction over the implementation and enforcement of the Department's rules from a substantive perspective. Yet, there are three ways the SEC and FINRA (for broker-dealers) effectively can review the activities of SEC-registered financial services professionals as they relate to compliance with the BIC exemption.

- First, the SEC and FINRA examine the policies and procedures of the entities they regulate to ensure compliance. Registered investment advisers and broker-dealers are required to adopt and implement written policies and procedures reasonably designed to address compliance with certain legal standards.⁵⁷ Such regulated entities must tailor their policies and procedures to the particular firm's business, including providing advice to retirement accounts. As part of SEC and FINRA examinations, both agencies review firms' written policies and procedures to ensure compliance. The SEC staff already regularly considers the policies and procedures that address compliance with ERISA and IRS requirements. Although the SEC and FINRA will not be in a position to opine on whether the procedures a firm adopts in response to the BIC exemption are substantively compliant, such agencies *will* be in a position to police whether a firm is complying with the procedures it has adopted.

⁵⁶ The Investment Advisers Act of 1940 ("Advisers Act") requires that an investment adviser's advice to clients be consistent with the adviser's fiduciary duty, which encompasses a duty of care and a duty of loyalty. The Supreme Court has described the Advisers Act as reflecting "a congressional recognition of the delicate fiduciary nature of an investment advisory relationship as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested." *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 190-192 (1963). An adviser's obligations to satisfy its fiduciary duty are analogous to those required under the Impartial Conduct Standards, and investment advisers have adopted policies and procedures addressing these obligations.

⁵⁷ Rule 206(4)-7 under the Advisers Act provides that registered investment advisers must "adopt and implement written policies and procedures reasonably designed to prevent violation, by [the adviser] and [its] supervised persons" of the Advisers Act and the rules thereunder. This rule requires advisers to consider their fiduciary and regulatory obligations under the Advisers Act and to formalize policies and procedures to address them including with respect to, among other issues, portfolio management processes, conflicts of interest, and the accuracy of disclosures. See *Compliance Programs of Investment Companies and Investment Advisers*, 68 Fed. Reg. 74714, 74715 (Dec. 24, 2003). FINRA Rule 3110 requires broker-dealers to "establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with applicable securities laws and regulations, and with applicable FINRA rules..., including through "the establishment and maintenance of written procedures..."

- **Second, as part of the SEC’s and FINRA’s examination authority**, both agencies also review firm disclosures to ensure that such disclosures actually match firm practice. Similar to the discussion of policies and procedures above, both agencies *will* have the authority to ensure that any disclosures a firm may make to investors, including those relating to the BIC exemption, are accurate. The SEC staff also reviews the adequacy of conflict of interest disclosure as part of their routine examination programs and the SEC and FINRA bring enforcement actions relating to the failure of a firm to enforce its written policies and procedures or the accuracy of its disclosures.⁵⁸
 - Finally, both examination staffs could refer any matters relating to inconsistencies in policies, procedures, or disclosures or other potential issues to the Department or IRS for the relevant **agency’s substantive review**. The agencies could formally address this in an interagency memoranda of understanding.
2. A coordinated approach with the SEC would obviate the need for a clean shares exemption. (Questions 7 and 9)

The Department asks for input on possible additional and more streamlined exemption approaches that would better address marketplace innovations that may mitigate or even eliminate some kinds of potential advisory conflicts. The RFI specifically mentions so-called “clean shares” as one such innovation that could provide the basis for a new streamlined exemption.

Clean shares are a mutual fund share class described in an SEC Division of Investment Management interpretive letter,⁵⁹ as having no front-end load, deferred sales charge, or other asset-based fee for sales or distribution. The SEC staff interpretive letter expresses the view that, under the circumstances

⁵⁸ See, e.g., *In re Everhart Financial Group, Inc.*, Investment Advisers Act Release No. 4314, 2016 SEC LEXIS 185 (Jan. 14, 2016) (regarding investments in share classes that paid 12b-1 fees that were not adequately disclosed to clients); *In re Biscayne Capital Int’l, LLC*, Investment Advisers Act Release No. 4399, 2016 SEC LEXIS 3275 (May 27, 2016) (regarding failure to disclose material information and failure to implement policies and procedures to prevent violations of the Advisers Act); *In re Stephens Inc.*, FINRA AWC No. 2014041823201 (May 11, 2016) (regarding alleged inadequate supervision of the content and dissemination of firm-wide “flash” emails under inadequate policies and procedures); *In re Deutsche Bank Sec., Inc.*, FINRA AWC No. 2012035003201 (Aug. 8, 2016) (regarding failure to maintain adequate supervisory systems, policies, and procedures reasonably designed to supervise certain registered representatives’ access to internal broadcast transmissions or related communications with customers).

⁵⁹ SEC Interpretive Letter (publicly available Jan. 11, 2017), available at <https://www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d.htm>.

described in the letter, the restrictions of section 22(d) of the Investment Company Act of 1940⁶⁰ do not apply to a broker, when the broker acts as agent on behalf of its customers and charges its customers commissions for effecting transactions in clean shares. Clean shares were developed as a potential compliance approach under the BIC exemption by allowing brokerage firms to implement a consistent commission schedule for all mutual funds offered for sale by the broker, thereby eliminating conflicts associated with recommending funds that pay different compensation to the intermediary.

One of ICI's **major concerns about the rule and** related exemptions is that they effectively put the Department in the role of prescribing the products, services, and compensation structures that should be available in the retirement services marketplace. ICI supports innovations that satisfy the needs of our partner distributors, including clean and T shares,⁶¹ but we do not support a one-size-fits-all regulatory approach, which effectively favors one particular product over another. No one share class will be optimal for all investors. There are many situations where any given investor could derive benefits more responsive to his or her individual preferences and circumstances with other share classes in use today, depending on the fee structure, transaction frequency, and any rights of accumulation, breakpoints, or other features.

Accordingly, instead of an exemption encouraging the use of particular share classes, we strongly urge the Department to provide a streamlined exemption for financial services providers who are subject to SEC-governed standards of conduct and an exemption for non-SEC regulated financial advisors with conditions that are comparable to the new best interest standard that we are recommending for broker-dealers. Of course, if the BIC exemption were revised as described in Section II.A.1, 4 and 5, the Department would not have to resort to special streamlined exemptions that promote certain products over others.

3. The Principal Transactions exemption should be revised to better serve investor interests and provide market flexibility. (Question 12)

The RFI asks if there are ways in which the Principal Transactions exemption could be revised or expanded to better serve investor interests and provide market flexibility. As the Department noted, the Principal Transactions exemption provides relief for selling only a limited set of investments—certain

⁶⁰ Section 22(d) of the 1940 Act, often referred to as the retail price maintenance rule, prohibits a mutual fund, the fund's principal underwriter, and dealers in the fund's shares from selling the fund's shares at a price other than a current public offering price described in the fund's prospectus. The letter explains that, while section 22(d) does not apply to brokers, there is uncertainty about the application of section 22(d), and many firms are unsure whether charging a commission for effecting transactions in clean shares could cause them to be treated as dealers under section 22(d).

⁶¹ T shares are another share class developed as a potential compliance approach under the BIC exemption. They generally have a uniform front-end load, similar to an A share, but with a lower commission, generally around 2.5 percent.

debt securities, CDs, and unit investment trusts. We recommend expanding the types of investments covered by the Principal Transactions exemption to include closed-end fund (CEF)⁶² initial public offerings (IPOs).

Because CEFs are often designed and managed to offer strong income and cash flow, they are an important investment option for long-term investors in IRAs and other tax-deferred accounts. Of the total \$176 billion in assets held in CEFs composed of taxable bond or equity funds, it is estimated that about 25 percent (\$44 billion) is in IRAs and tax-deferred accounts.⁶³ But unlike continuously offered funds, CEFs generally have a limited opportunity to raise investment capital through a brief IPO offering period—typically around 20 business days.

Excluding 25 percent of the CEF universe’s investor base from an initial offering could significantly reduce the scale of future CEFs. Smaller-scale CEFs could translate into higher fund expense ratios, reduced efficiency and investment choice in managing a fund’s portfolio which may lead to less diversification, reduced or absent CEF analyst coverage (CEF analysts generally do not evaluate or publish information about smaller funds), and lower secondary market volume, leading to potentially wider bid/ask spreads.

We note that CEFs offer important investment features to retirement investors. In particular, retail investors choose CEFs for access to less liquid and more institutional-like asset classes—such as real assets, energy master limited partnerships, senior loans, preferred securities, Build America Bonds, and even investments in the Public-Private Investment Program under the Troubled Asset Relief Program. All these strategies have allowed CEF investors—including those investing for retirement in IRAs—to

⁶² Like an open-end mutual fund, a CEF is a pooled investment vehicle that offers shares almost exclusively through a public offering registered under the Securities Act of 1933, with all applicable fees, expenses, and offering costs fully disclosed in an initial prospectus. CEFs differ from open-end mutual funds in that they are generally not offered continuously and typically have a fixed number of shares issued during the IPO. Notably, CEFs generally do not issue redeemable shares; after the IPO, investors buy and sell shares on the secondary market at prices established through market trading. The exchange and market participants provide investors with price transparency and liquidity throughout the trading day. The non-redeemable nature of CEF shares allows full investment of all capital (rather than reserving significant amounts of cash to meet redemptions), especially in funds with less liquid investments.

⁶³ As of December 31, 2016, the CEF universe included 530 funds with \$262 billion in assets, of which approximately \$176 billion represent taxable bond funds or equity funds (municipal bond funds comprise the remainder). Antoniewicz and Saenz, “The Closed-End Fund Market, 2016.” ICI Research Perspective 23, no. 2 (April 2017), available at www.ici.org/pdf/per23-02.pdf. ICI does not publish the proportion of CEF assets held in tax-deferred retirement savings plans. However, financial intermediaries that offer CEFs suggest that IRAs and other tax-deferred retirement plans hold approximately 25 percent of the taxable bond and equity CEF universe, which translates into roughly \$44 billion of CEF assets held in retirement accounts.

diversify their income portfolios away from more traditional sources while using diversified, professionally managed investment portfolios.

In summary, the Principal Transactions exemption's **failure to accommodate IPOs in the CEF setting** may harm the product for *all* investors, including retirement investors.⁶⁴ We therefore urge the Department to modify the Principal Transactions exemption so IRA owners and other tax-deferred retirement savers can have the opportunity to participate in CEF IPOs.

4. Expanding the existing grandfathering provision would simplify operations and benefit investors and advisers. (Question 16)

The BIC exemption includes an exemption for **pre-existing transactions (the "grandfather rule")** "to facilitate ongoing advice with respect to investments that predated the Rule, and to enable financial advisers to continue to receive compensation for those investments" **under existing agreements**.⁶⁵ The grandfather rule allows financial services providers to continue receiving compensation that relates to assets that were invested before the applicability date of the rule (June 9, 2017). To be treated as grandfathered, the amount of compensation must be "reasonable" within the meaning of ERISA section 408(b)(2). The provider may make recommendations regarding grandfathered investments after the applicability date, but those recommendations will be subject to the best interest standard. Generally, financial services providers may not treat as grandfathered additional amounts that are invested on or after the applicability date.⁶⁶

⁶⁴ To the extent that the Department has concerns about the risk of underwriters "dumping" shares on investors during the IPO process, we believe the concern is not relevant here given differences in the IPO process for CEFs as compared to operating companies. In a typical operating company equity IPO, the issuer consults with its underwriters and sets a specific capital target the offering must raise at a valuation determined by a negotiation between the issuer and the underwriters. That capital goal is prominently featured on the front of the offering's preliminary prospectus. In contrast, the assets raised in a CEF IPO depend solely upon investor demand discerned during the initial offering period, not a pre-determined capital goal. In addition, no valuation concerns are present as the CEF holds only cash proceeds immediately following the offering that are then promptly invested in a pool of securities in accordance with the fund's investment mandate. For the CEF IPO, the underwriting syndicate members are committing only to the shares needed to fill their clients' indications of interest—rather than issuer and syndicate goals. Beyond that, the underwriters hold little or no additional inventory. Additionally, for CEF IPOs, pricing is known at the outset and high transparency and liquidity opportunities continue after launch.

⁶⁵ 82 Fed Reg. 31278, at 31281.

⁶⁶ However, certain exchanges within mutual fund families will be covered by the grandfather rule (as long as they do not result in more compensation to the service provider or an affiliate than they were entitled to before the applicability date), as well as systematic purchase programs that were in place before the applicability date.

Mutual funds and their distribution partners widely use the grandfather rule. This has benefited retirement investors. Without the grandfather rule, retirement investors would lose certain advantageous rights flowing from existing compensation agreements, with millions of retirement investors forfeiting their right to ongoing advice at a very modest cost. For example, in many cases, the customer already has paid for continuing guidance on whether to hold, sell, or exchange the investment, such as through a front-end sales load coupled with a small trailing fee. Without the grandfather rule, financial services providers would be reluctant even to make a recommendation to retain an investment and stay the course during a period of market turmoil or to exchange to a different fund within a fund family to reflect changing needs of the investor—even though new commissions typically are not generated in those circumstances. To ensure that retirement savers continue to receive the benefits of services and features owed under pre-existing arrangements, the Department should expand the grandfather rule as described below.

The Department should extend the grandfather rule cut-off date to the end of the Transition Period. When the Department announced the 60-day delay to the rule's applicability date and modified the obligations applicable under the BIC exemption during the Transition Period, the cut-off date for grandfathering treatment correspondingly was extended to the new June 9, 2017 applicability date. We urge the Department to extend the grandfather rule period by moving the cut-off date to the end of the Transition Period (currently scheduled for January 1, 2018, with the potential for further delay). This would streamline operations and benefit both investors and advisors. We understand the Department may want to specify that, in such circumstances, any new recommendations made after June 9, 2017 will be subject to the Impartial Conduct Standards.

There is no practical difference between the standard of care that applies to new recommendations made regarding grandfathered amounts and the standard of care that applies to other recommendations made during the Transition Period.⁶⁷ The best interest standard and reasonable compensation requirement apply to recommendations made with respect to both grandfathered amounts and amounts invested during the Transition Period. Therefore, moving the grandfather rule's cut-off date makes sense.

Furthermore, when the BIC exemption originally was published, there was a practical difference between the treatment of recommendations on grandfathered amounts and recommendations on other amounts during the Transition Period. The original implementation schedule required financial professionals (and their financial institutions) relying on the BIC exemption during the Transition

⁶⁷ Recommendations made during the Transition Period are subject to the Impartial Conduct Standards. Recommendations regarding grandfathered amounts are subject to two prongs of the Impartial Conduct Standards, but not the third—the requirement that advisors avoid making misleading statements. *See* footnote 30, *supra*.

Period to not only meet the Impartial Conduct Standards, but also to (1) provide significant disclosures to the investor, (2) comply with certain recordkeeping requirements, and (3) identify a person responsible for addressing material conflicts of interest and monitoring adherence to the Impartial Conduct Standards. In April 2017, the Department announced that the requirements described in (1), (2) and (3) above would not apply during the Transition Period. Now there seems to be little reason for applying separate rules to recommendations on grandfathered amounts and Transition Period investments.

Without this change, it is unclear what status will attach to recommendations (regarding non-grandfathered amounts) made during the Transition Period, once the Transition Period ends. For example, to continue receiving trailing compensation on those recommendations after the Transition Period ends, it may be necessary retroactively to adhere to the additional BIC exemption conditions. This would be both burdensome to financial institutions and confusing for investors. But, absent clarifying guidance, it could be viewed as the result if the Department does not extend the grandfather rule out through the end of the Transition Period. It would be unreasonable to impose retroactively the additional BIC exemption requirements, such as entering into a retroactive written contract, on advice during the Transition Period—particularly given that it is far from clear what those requirements ultimately will be. Financial institutions and financial advisers need certainty about the rules that govern their conduct; retroactivity is fundamentally unfair. This necessarily leads to the conclusion that any recommendations during the Transition Period should receive the same grandfather treatment currently only applicable to new recommendations on amounts invested prior to June 9.

This approach would simplify operation of the grandfather rule significantly by allowing all amounts invested by January 1, 2018 (or later, if this applicability date is delayed), to be treated as grandfathered (albeit with recommendations after June 9 subject to the Impartial Conduct Standards).

Under the current phased implementation structure, an investor may have one account that includes grandfathered amounts, a separate account that includes amounts invested during the Transition Period, and a third account that is subject to the full BIC exemption requirements. Under our recommended change, this investor would have just two accounts—one grandfathered account, to which the Impartial Conduct Standards would apply, and one account subject to the full BIC exemption conditions. This change would lead to fewer separate accounts and reduce investor confusion.

The Department should permit additional investments into grandfathered accounts. Under the current grandfather rule, the only situation in which new assets invested after June 9, 2017 may be treated as grandfathered is an investment made pursuant to a systematic purchase program that was

established before June 9.⁶⁸ New contributions (even if made to the same investment) are not eligible for grandfathering. While the Department's guidance indicates that new contributions to an account do not cause compensation attributable to grandfathered assets to become ineligible for grandfathering⁶⁹ (*i.e.*, an account could contain both grandfathered assets and non-grandfathered assets), as a practical matter, operational constraints prevent many funds and intermediaries that service mutual fund accounts from maintaining one account with both grandfathered and non-grandfathered assets. Instead, they must segregate grandfathered and non-grandfathered assets in separate accounts to monitor the restrictions applicable to each.

As a result, if an IRA owner makes a one-time contribution after June 9, 2017 to an existing IRA resulting in compensation to the financial adviser, that IRA may be segregated into two accounts (or else treated as non-grandfathered in its entirety). We note that many investors maintain their IRAs with a mutual fund group that is a completely separate entity from the financial adviser's firm, and, therefore, the financial adviser would need to proactively and specifically notify the client to not make any further investments into the grandfathered account serviced by the mutual fund company. However, even if the client follows such instructions, contributions could still make their way into the grandfathered account by way of a third-party contributor, such as an employer in the case of SEP-IRAs and SIMPLE-IRAs, or a relative in the case of Coverdell Education Savings Accounts. This understandably results in confusion for investors and increased administrative challenges and costs for mutual funds.

The Department should treat adding to existing investments as grandfathered. In other words, for an investor invested in Fund A prior to June 9, 2017, the grandfather rule should permit financial advisers to recommend (subject to the Impartial Conduct Standards) that the investor continue to make additional grandfathered purchases of Fund A. This change would alleviate the need to establish separate non-grandfathered accounts with the same investments, potentially in different share classes, while still protecting investors by ensuring that recommendations are made in their best interests.

In addition, this expanded grandfather approach would have other advantages, including preserving existing rights of accumulation—rights the investor acquired prior to the implementation date of the new rule—and avoiding having to move existing assets into an advisory program, which in many cases

⁶⁸ Grandfathered amounts also may be exchanged within a mutual fund family or variable annuity contract without losing their grandfathered status.

⁶⁹ See Question 29 of Conflict of Interest FAQs (Part I – Exemptions), issued October 2016, available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-1.pdf>.

could happen upon establishment of a new non-grandfathered account. Finally, the expanded grandfather rule we recommend is not substantially different from the current rule allowing ongoing hold recommendations. We believe this approach strikes an appropriate balance between minimizing disruption and ensuring the consumer protections of the rule. It does not make sense to force investors into two programs or accounts for the same investment product.

5. The Department should simplify the content and timing of the disclosure requirements. (Question 13)

The RFI asks whether the BIC exemption disclosure requirements should be simplified and should focus the investor on a few key issues. In our view, the existing timing rules for disclosures under the BIC exemption are overly complex and create confusion.⁷⁰ While far from clear, current conditions appear to require that a new transaction-based disclosure be provided to an investor if another recommendation is made that (a) involves a different product or (b) is more than one year after the last disclosure was made. Such a requirement does not account for difficulties associated with tracking disclosures and interactions with investors, and it is not clear that repeated disclosures would benefit the investor when the information has not changed.

We also support simplifying the disclosure requirements to allow for greater flexibility. Rather than the current overly prescriptive requirements, the Department should provide for principles-based rules on disclosure. Under such a principles-based approach, the first time or prior to the first time a financial services provider executes a transaction based on a recommendation to a retail customer, the financial services provider would be required to disclose to the customer, in a clear and concise manner, the following:

- The type and scope of services the financial services provider will provide;
- The standard of conduct that applies to the relationship;

⁷⁰ The “contract” disclosures described in Section II(e) of the BIC exemption must be provided once, prior to or at the same time as the execution of the recommended transaction. A transaction-based disclosure described in Section III of the BIC exemption must be made prior to or at the same time as the execution of the recommended investment. The transaction disclosure does not have to be repeated for subsequent recommendations of the same investment product within one year of a prior disclosure, unless there are material changes in the subject of the disclosure. Therefore, a new transaction-based disclosure appears to be needed if another recommendation is made that (a) involves a different product or (b) is more than one year after the last disclosure was made. Because it may be difficult to keep track of when the latest disclosure was provided to each individual, it may be easier to provide a new disclosure each year, for example along with the comparative chart provided under 29 CFR 2550.404a-5.

- The types of compensation the financial services provider (and its registered representatives and associated persons) may receive and the customer may pay; and
- Any “material conflict of interest.”⁷¹

The financial services provider should retain flexibility to elect the timing and content, form (whether paper, electronic, web-based, or otherwise), and manner of delivery (whether hard copy or electronic delivery or access), including any updates to disclosure and notices thereof, based on the financial services provider’s **particular business model**. Specifically, we urge the Department to reconsider the pitfalls of its overly prescriptive disclosure rules that have proven to impose a heavy financial burden on the industry with an attendant increase in cost to investors.

B. The **Rule’s** Scope is Overly Broad and Must Be Narrowed.

Question 18 of the RFI asks for suggestions for changes the Department should make to the rule’s exclusion for “transactions with independent fiduciaries with financial expertise.” In addition to our concerns about this exclusion as currently drafted, we are more generally concerned with the overly broad scope of the rule’s **fiduciary definition**.

Regardless of whether the Department adopts our recommended approach regarding the adoption of an exemption for financial services providers who are subject to an SEC-governed standard of conduct, changes are needed to the rule beyond those discussed in the RFI.

The Department must modify the rule to (1) clarify that recommendations to make or increase contributions to a plan or IRA are not fiduciary investment advice, (2) provide unambiguous thresholds for determining when fiduciary advice is being provided, (3) simplify the exception for transactions with independent fiduciaries with financial expertise, (4) include a **broad seller’s carve-out**, and (5) broaden the education exception. Our recommendations would be consistent with Congressional intent and would ensure that retirement investors are not unnecessarily impeded from access to services and information.

⁷¹ “Material conflict of interest” means a financial interest of a financial services provider that a reasonable person would expect to affect the impartiality of a recommendation.

1. Recommendations to make or increase contributions to a plan or IRA should not be fiduciary advice. (Question 14)

Question 14 of the RFI asks if recommendations to make or increase contributions to a plan or IRA should be expressly excluded from the definition of investment advice. Related to this question, the RFI asks if there should be an amendment to the rule or a streamlined exemption focused on such communications and, if so, what conditions should apply. Question 14 undoubtedly responds to the confusion resulting from several Department FAQs issued earlier in the year, providing interpretive guidance on the fiduciary rulemaking.⁷² The FAQs imply that the mere recommendation that a retirement saver increase contributions to a retirement account would be considered fiduciary advice. In a recent subsequent FAQ,⁷³ the Department created additional confusion by attempting to clarify that a recommendation to increase contributions to a retirement plan would not constitute investment advice in circumstances when the education exception applies.

The Department's sub-regulatory guidance is in direct conflict with unambiguous language of the fiduciary rule and ERISA itself. The fiduciary rule specifically applies to the "rendering [of] investment advice with respect to moneys or other property of a plan or IRA. . ."⁷⁴ This language parallels the statutory language in ERISA Section 3(21)(ii), which also applies to investment advice "with respect to any moneys or other property of such plan . . ." It is also well understood that contributions are not deemed plan assets until they can be reasonably segregated from an employer's general assets.⁷⁵ The Department is ignoring ERISA and its own regulations in treating discussions about the possibility of making contributions to a plan or IRA as potential recommendations subject to the rule. No special exception or exemption is needed to clarify this issue. Moreover, by relying on the education exception and not the clear text of ERISA for its conclusion, the Department only further complicates the issue. Encouraging individuals to increase contributions not only helps ensure that they fully benefit from employer matching contributions, but makes it more likely that they will have adequate resources for

⁷² See Questions 9 and 10 of Conflict of Interest FAQs (Part II—Rule), issued January 2017, available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-2.pdf>, and Question 12 of Conflict of Interest FAQs (Transition Period), issued May 2017, available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-transition-period.pdf>.

⁷³ See Question 2 of Conflict of Interest FAQs (408b-2 Disclosure Transition Period, Recommendations To Increase Contributions and Plan Participation), issued August 2017, available at <https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-transition-period-2.pdf>.

⁷⁴ See 29 CFR 2510.3-21(a) (emphasis added).

⁷⁵ See 29 CFR 2510.3-102 (emphasis added) (generally amounts paid to or withheld by an employer become plan assets on the earliest date on which they can reasonably be segregated from the employer's general assets).

retirement. The Department simply must withdraw its sub-regulatory guidance in the FAQs. That position is an overreach and is contrary to efforts promoting retirement security.

2. The Department must provide clear and unambiguous thresholds for determining when fiduciary advice is being provided.

The Department must provide clear and unambiguous thresholds for determining when fiduciary advice is being provided and must allow service providers to continue to offer meaningful investment education to retirement savers and plan sponsors without inadvertently triggering fiduciary status. Towards this end, the Institute makes the following suggestions.

First, a more tailored definition of investment advice—one that only includes a discussion or identification of any security or investment property—would provide greater clarity and avoid the ambiguity inherent in the current definition. Consistent with FINRA rules,⁷⁶ the fiduciary rule defines “advice” subject to the fiduciary standard as any recommendations regarding “acquiring, holding, disposing of, or exchanging securities or other investment property,” including recommendations about how rollovers should be invested.⁷⁷ The rule then goes beyond FINRA’s logical construct by including additional categories of activities within the definition. For example, the Department treats as advice recommendations regarding the selection of persons to provide investment advice or management services, and recommendations regarding rollovers, transfers or distributions,⁷⁸ as advice subject to the fiduciary standard regardless of whether the communication includes any discussion of or identifies any security or other specific investment.

Including recommendations designed to encourage positive savings behaviors, when no discussion of specific securities or other specific investment product takes place, only impedes ordinary discussions inherent in the normal course of customer interactions. Of great significance, it severely reduces exchanges of information currently provided at no cost to millions of retirement savers through call centers, walk-in centers, and websites.

The Department’s overly-broad definition of investment advice has had a chilling effect on guidance encouraging contribution increases and preserving assets for retirement because of concerns about possible fiduciary liability and prohibited transactions. Because an exemption, most likely the BIC exemption, would be needed to provide this guidance, the requirements of the exemption—including its cumbersome contract and contractual warranty provisions—would need to be implemented before

⁷⁶ See FINRA 2111. See text accompanying footnote 29, *supra*.

⁷⁷ See subsection 2510.3-21(a)(1)(i) of the final rule.

⁷⁸ See subsection 2510.3-21(a)(1)(ii) of the final rule.

even the most benign conversations regarding a contribution increase or potential rollover could take place.

Call centers and retirement professionals play a critical role in preventing “leakage” of retirement assets. An individual taking a distribution is not always aware that he or she will pay taxes and penalties, and otherwise not have those assets available for retirement. Speaking with a call center representative can result in the participant rolling over the assets into an IRA or moving them to a new employer plan where the assets are more likely to remain in retirement savings rather than being used for current consumption.

The Department should encourage—not effectively prohibit—this type of interaction, regardless of whether it relates to an IRA or an employer based vehicle. Under the rule, discussing the pros and cons of a rollover to an IRA could result in a call center employee offering fiduciary advice, which has the effect of preventing those conversations from happening. The Department needs to take a more realistic and balanced view of retirement asset promotion and retention and support activities that encourage retirement savings and prevent leakage without the need to jump through the contorted (and in very many cases unworkable) hoops of the BIC exemption.

Rather than treating any recommendation to consider a rollover as investment advice, a more tailored approach based on disclosure of information relevant to the decisions—for example, fees, tax considerations and potential conflicts—would be more effective in protecting retirement investors and would facilitate the open exchange of free information on which retirement savers rely.⁷⁹

ICI therefore requests that the Department clarify that recommendations regarding rollovers, transfers or distributions will not be treated as advice subject to the fiduciary standard so long as such communications do not include any discussion or identification of any security or investment property.

Second, the definition unnecessarily limits the ability of parties to freely contract or otherwise mutually agree to the capacity in which services will be provided to a plan, plan fiduciary, participant or beneficiary, or IRA owner, by imposing fiduciary status on a provider who directs communications to a specific recipient or recipients.⁸⁰ The “directs the advice to” paragraph of the definition, not only

⁷⁹ In this regard, FINRA Notice 13-45 provides guidance tailored specifically to rollovers, indicating that broker-dealers should consider fees, available services and investments, distribution options and tax considerations when making a rollover recommendation. FINRA’s notice further requires broker-dealers to review and assess conflicts of interest and to supervise “to reasonably ensure that conflicts of interest do not impair the judgment of a registered representative . . . about what is in the customer’s interest.”

⁸⁰ 29 CFR 2510.3-21(a)(2)(ii) and (iii).

undermines the ability to freely contract or mutually agree, it adds a new level of ambiguity that effectively raises the possibility that any direct, one-on-one communication might give rise to fiduciary status. The challenges attendant to the breadth and ambiguity of the definition are illustrated by the Department's recent recognition that even the most basic of conversations pertaining to the importance of increasing contributions to help ensure adequate retirement savings may give rise to fiduciary status. The confusion resulting from that attempt at clarification led to the need for three sets of sub-regulatory guidance that has only compounded the ambiguity.⁸¹ That experience should cause the Department to recognize that interactions between service providers and their customers are fluid and cannot be readily regulated to predetermined scripts. The Department is now in a position of needing to issue an ongoing stream of guidance relating to the current definition in order to clarify concerns about unintended, inadvertent fiduciary status. Such ambiguity not only affects access to and understanding of products and services critical to a secure retirement, but will potentially deprive plan participants, plan fiduciaries and IRA owners of important guidance about their plans, IRAs, investment options and strategies.

These concerns, in our view, are easily addressed by eliminating the “directs the advice to” paragraph of the fiduciary definition.⁸²

3. **Changes must be made to the rule's exclusion for transactions with independent** fiduciaries with financial expertise to make it workable and eliminate the disparate, paperwork driven approach among industry participants.

The rule excepts from fiduciary status advice or recommendations provided to a fiduciary of the plan or IRA who is independent of the person providing advice or recommendations with respect to an arm's length transaction (the “Independent Fiduciary Exception” or IFE). Prior to the transaction, the person making the recommendation must satisfy certain requirements. These requirements include knowing or having a “reasonable belief” that the independent fiduciary has the independent capability to evaluate investment risks, is a fiduciary under ERISA and/or the Code with respect to the transaction, and has responsibility for exercising independent judgment in evaluating the transaction. The exception encourages firms to “rely on written representations” from the independent fiduciary in satisfying these criteria.

⁸¹ See text accompanying footnotes 72 and 75, *supra*.

⁸² We note that such a change is consistent with the Department's considerably narrower first effort to update this prong of the definition in 2010. See 75 Fed. Reg. 65277, at § 2510.3-21(c)(1)(ii)(D).

The IFE is available for transactions involving (i) plan fiduciaries that have at least \$50 million of total assets under management and (ii) certain “sophisticated parties.” These sophisticated parties include the following entities:

- A bank as defined in section 202 of the Advisers Act or similar institution that is regulated and supervised and subject to periodic examination by a State or Federal agency;
- An insurance carrier that is regulated and supervised and subject to periodic examination by a State or Federal agency;
- An investment adviser registered under the Advisers Act or, if not registered as an investment adviser by reason of paragraph (1) of section 203A of such Act, is registered as an investment adviser under the laws of the State in which it maintains its principal office and place of business; and
- A broker-dealer registered under the Exchange Act.

The industry has spent an enormous amount of time and effort attempting to document its efforts to reasonably rely on the IFE. Asset managers and insurers have sent out numerous writings, from representations to contract amendments, which have been met with a myriad of responses from distributors. The process—taking place between highly sophisticated parties attempting to document compliance with the requirements of the IFE—has been a distracting and wasteful use of limited resources.

We urge the Department to revise the IFE provision to make it workable and eliminate the disparate, paperwork-driven approach among industry participants. We believe that it is possible for the Department to act swiftly and concretely in this area, as it will in no way impact the consumer protections afforded to plan participants or IRA owners, while at the same time greatly reducing the regulatory burden on financial institutions.

As an initial matter, we believe that any recommendations made to the types of licensed and regulated financial professionals listed in the IFE should not be considered fiduciary investment advice under the regulation, unless agreed to in writing by both parties. All of the financial intermediaries listed above must by reason of their profession be sophisticated enough to understand the difference between advice and marketing without any aid from the Department.

In this context, there should be no other requirements for making use of the IFE, beyond having a reasonable belief (with no written representations needed) that the counterparty is one of the enumerated types of financial intermediaries. Furthermore, it should not matter whether the

counterparty in this context is acting as a fiduciary under either ERISA or the Code with respect to the transaction or whether the counterparty is paying a fee for the “advice” that it may use with its IRA or plan customers.

This approach would eliminate the existing ambiguity in the availability of the IFE, which should be the case for interactions between sophisticated parties. This would permit financial institutions to conduct business amongst themselves without undue paperwork and delay. This also will create certainty and avoid the need for obtaining redundant representations regarding the ability to evaluate investment risks and exercise independent judgment.

There are many situations in which a financial institution selling its products could engage in communications with third parties (such as a plan recordkeeper or other service provider) who do not have any authority or control over investing plan assets and these communications—even if meeting the technical definition of a recommendation—should not be treated as fiduciary advice to a retirement investor. In this case, the Department should modify the IFE to clarify that there should be no inference that the fiduciary advice rule is implicated solely because a counterparty is not acting as a fiduciary or refuses to acknowledge fiduciary status.

We also suggest modifications to the IFE that would apply to fiduciaries other than the enumerated financial intermediaries (*i.e.*, internal plan fiduciaries such as an investment committee). For these fiduciaries, the Department should modify the IFE to provide more freedom for the parties to define their own relationship so that the plan fiduciary can continue to obtain valuable information from its service providers. We believe that an understanding between the financial institution (or its representative) and the plan fiduciary that the plan fiduciary is not relying upon the financial institution (or its representative) for impartial advice provides optimal protection. This could take the form of a written disclosure from the firm to the internal plan fiduciary indicating that the firm or its representative is not undertaking to provide impartial advice or any advice, but rather is marketing and selling a product or service in which it has a financial interest, and suggesting that, if such impartial advice is desired, the plan hire an independent fiduciary. At a minimum, ERISA plan fiduciaries (even those fiduciaries with less than \$50 million in assets under management) should be permitted to agree by contract that their service providers are not acting as ERISA fiduciaries so that the service provider can freely discuss its products and services without having to comply with a prohibited transaction exemption. We urge the Department to make this streamlined IFE available regardless of plan size.⁸³

⁸³ There is simply no basis to assume that a plan fiduciary to a plan with less than \$50 million in assets is not financially sophisticated, while a plan fiduciary with \$50 million in assets is sophisticated. The plan fiduciary may include the company treasurer or chief financial executive officer—a professional with a background in investment finance. We question whether the assets managed threshold included in the exception offers any rational test of plan sponsor or plan fiduciary sophistication. It seems unreasonable, for example, for the Department to craft such an important component of a rule on

4. Investment education must permit the identification of investment alternatives within asset classes.

The Institute believes that the Department must preserve the important distinction between non-fiduciary investment “education” and fiduciary investment “advice” that has worked very well for almost 20 years. The rule’s exception for investment education is similar to Interpretive Bulletin (IB) 96-1, but with significant cutbacks—for example, identifying specific securities in connection with an asset allocation model. Identifying an asset class to an individual or even a plan sponsor without identifying which investment options are within that asset class severely limits the utility of investment education.

The rule should be changed to allow consumers to receive examples of investment alternatives within any asset classes discussed in an asset allocation model. More specifically, the following changes to the exception should be made:

- All aspects of the education exception should be available to IRAs in equal measure as to plans.
- The asset allocation samples should be permitted to the same extent as they were under IB 96-1.
- Communications about diversifying or improperly being in two target date funds simultaneously directed to participants and which are provided upon the instruction of a plan fiduciary should be excepted as education.
- Providing a list of three or more investment advisers or managers should not be considered a recommendation and rather should fall within an education safe-harbor in order to encourage retirement savers to connect with professional advisers.

5. The Department should **add a seller’s exception to the rule.** (Question 18)

The fiduciary rule should include a broad seller’s exception modeled after the seller’s exception contained in the 2010 proposed regulation.⁸⁴ The seller’s exception should be available for communications to any plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner when a disclosure stating that the communicator is selling a product or service and not undertaking to provide

the notion that law, engineering, or accounting firms (some of the small employers that sponsor plans) that have less than \$50 million in assets at any time in their formation are not sophisticated enough to understand a disclaimer.

⁸⁴ “Definition of the Term ‘Fiduciary,’” 75 Fed. Reg. 65263 (Oct. 22, 2010) (the “2010 Proposal”).

impartial advice accompanies the communication. This carve-out will maintain the crucial distinction between sales and the special trust that accompanies a fiduciary relationship.⁸⁵

The Department properly recognized and preserved this important distinction between advice and marketing and selling activities in the 2010 version of the proposed regulation. It did so by providing an exclusion from fiduciary status for those selling products where there was no reasonable expectation of a fiduciary relationship—making that option available with respect to all retirement plans, plan participants and IRA owners. The Department appears to base its rationale for changing this position on a belief that large plans are sophisticated procurers of financial services while small plans and IRA owners are not, and that status as a large plan is a valid proxy for sophistication.

As discussed above, there is no sound justification for excluding small participant-directed plans from the **seller's exception**. This is especially inappropriate given that fiduciaries for both small and large plans share the same legal obligations to their plans. The Department also must extend the **seller's** exception to plan participants and IRAs because it does not require a high level of financial sophistication to understand that a discussion is a sales discussion. This is especially true if it follows disclosure that (i) a service provider is selling a proprietary financial product, (ii) is paid to sell the product, and (iii) is not in a relationship of trust and confidence. This type of disclosure, now required under the rule for large plans, is readily understandable to any recipient. The assumption that small plans, participants and IRA owners cannot understand the difference between sales and advice is inconsistent with the real-world experience of our members and their employees.

Retaining the principle behind the **seller's exclusion** from 2010 would preserve choice while providing the information necessary for plans, participants and IRA owners to make informed decisions. This approach is consistent with long-standing common law principles. An investor may consent to a conflict of interest if the financial professional provides full and fair disclosure of the conflict of interest. For example, under the Advisers Act, where an adviser provides full disclosure of a conflict of interest, clients generally may consent to a conflict that would otherwise raise issues under the investment adviser's duty of loyalty. As many have noted, most recently SEC Commissioner Michael S. Piwowar, the Department seems to have unwarranted doubts regarding the efficacy of disclosure to address conflicts.⁸⁶ Along with many others who disagree with the Department's assessment, we believe clear

⁸⁵ It is also a distinction that SEC Commissioner Piwowar seeks to preserve. See Letter from SEC Commissioner Michael S. Piwowar to Timothy D. Hauser, Deputy Assistant Secretary for Program Operations, Employee Benefits Security Administration, US Department of Labor (July 25, 2017), available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00366.pdf> ("SEC Commissioner Michael S. Piwowar Letter").

⁸⁶ *Id.*

disclosures work to address conflicts of interest, and that this approach recognizes investors' ability to make their own choices with respect to the type of investment professional they want to hire and how that professional is to be compensated.

Finally, if the Department's assumptions regarding size and sophistication were true, then the Department should have extended the same logic to participants and IRA owners. A participant or an IRA owner with a large balance should, by the Department's logic, be allowed access to the education, marketing and sales-related information while a small balance account should not. At a minimum, if the Department cannot see the flaw in its supposition that asset size alone is a valid indicator of "sophistication," it should include IRA owners with large balances, such as an "accredited investor" as defined by the federal securities laws,⁸⁷ within the coverage of the exception. There is no rational reason for restricting larger balance and sophisticated IRA investors from access to the education, marketing and sales related information that they need to make informed investment choices. The Department also should clarify that the exclusion would apply to the sales of services, including asset management services, and selling activity in connection with acting as agent for a plan (*e.g.*, futures, brokerage).

* * * * *

We strongly support the Department reexamining and modifying the fiduciary rulemaking. If you have any questions regarding our comments, or would like additional information, please contact Dorothy Donohue at 202-218-3563 or ddonohue@ici.org or David Abbey at 202-326-5920 or david.abbey@ici.org.

Sincerely,

/s/ Dorothy M. Donohue

/s/ David M. Abbey

Dorothy M. Donohue
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Investment Company Institute

David M. Abbey
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Attachment

⁸⁷ See Rule 501 of regulation D of the Securities Act of 1933.



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August 7, 2017

The Honorable Jay Clayton
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549

Re: *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers*

Dear Chairman Clayton:

The Investment Company Institute¹ commends you for inviting public comment in connection with the SEC's assessment of standards of conduct for investment advisers and broker-dealers, and for committing to work constructively on these standards with the Department of Labor (DOL).² The registered investment company ("fund") industry has a significant interest in the conduct standards that apply to financial professionals. Investors in nearly 27.9 million US households own funds purchased through or with the help of financial professionals such as broker-dealers and investment advisers.³ These investors deserve advice from financial professionals that is in their best interests, regardless of whether they are saving for retirement or other financial goals.

The Commission's inquiry is timely, given the harmful effects that DOL's adoption of its "fiduciary rulemaking" has caused. The fiduciary rulemaking re-defined who the Employee Retirement Income

¹ The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's members manage total assets of US\$20.0 trillion in the United States, serving more than 95 million US shareholders, and US\$6.0 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in London, Hong Kong, and Washington, DC.

² Chairman Jay Clayton, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers* (June 1, 2017), available at <https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31> ("Statement").

³ See 2017 Investment Company Institute Fact Book (2017), available at http://www.icifactbook.org/ch6/17_fb_ch6.

Securities Act of 1974 (ERISA) will treat as a fiduciary in connection with providing investment advice, expanded the application of ERISA fiduciary status, and thereby limited the types of activities in which financial professionals may engage.⁴ While DOL intended the rule to improve the quality of the financial advice that retirement investors receive, the rule, in practice, instead has harmed these investors in multiple ways. Many financial professionals serving retirement investors find that the fiduciary rulemaking's BIC exemption is unworkable for certain products, that they cannot justify the resulting risk and liability (including the substantial threat of unwarranted litigation) for certain accounts, or that complying with the BIC exemption is simply too burdensome. This has caused dislocations and disruption within the financial services industry, significantly limiting the ability of retirement savers to obtain the guidance, products, and services they need to meet their retirement goals.

The SEC has considered issues related to standards of care for financial professionals many times over the years.⁵ Yet this is a critical opportunity for the SEC to act to ensure that retail investors' interests are put first, while preserving investors' access to the products and services necessary to meet their savings goals. We believe the Commission should adopt—and DOL should recognize in a streamlined exemption—a best interest standard of conduct for broker-dealers that would apply when they make recommendations to retail investors in non-discretionary accounts, whether those investors are saving for retirement or other important goals. This best interest standard would achieve your stated objectives of clarity, consistency, and coordination with DOL.⁶

⁴ DOL issued a final regulation defining who is a fiduciary of an employee benefit plan under ERISA or an individual retirement account (IRA) under section 4975 of the Internal Revenue Code ("Code"), as a result of giving investment advice to a plan or its participants or beneficiaries, or an IRA or IRA owner. See 81 Fed. Reg. 20946 (Apr. 8, 2016). The Department issued the Best Interest Contract or "BIC" exemption, published at 81 Fed. Reg. 21002 (Apr. 8, 2016), at the same time as the final rule with the stated intent—subject to its many conditions—of permitting intermediaries to receive commissions and other compensation that the rule otherwise would prohibit. Public reports of intermediary actions responding to the rule document that the BIC exemption has failed to meet its intended purpose of continuing to allow commission-based models. See, e.g., "Edward Jones Shakes Up Retirement Offerings Ahead of Fiduciary Rule," *Wall Street Journal*, August 17, 2016, available at <https://www.wsj.com/articles/edward-jones-shakes-up-retirement-offerings-ahead-of-fiduciary-rule-1471469692>; "Fiduciary ready: Edward Jones Unveils Compliance Plans," *On Wall Street*, August 19, 2016, available at <http://www.onwallstreet.com/news/fiduciary-ready-edward-jones-unveils-compliance-plans>; and "JPMorgan Chase to Drop Commissions-Paying Retirement Accounts," *Reuters*, November 10, 2016, available at <http://www.reuters.com/article/us-jpmorgan-wealth-compliance-idUSKBN1343LK>.

⁵ See, e.g., Angela A. Hung, et al., RAND Institute for Civil Justice, *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers* (2008), available at https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf; Staff of the U.S. Securities and Exchange Commission, *Study on Investment Advisers and Broker-Dealers* (Jan. 2011) ("2011 SEC Study"), available at <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>; and *Duties of Brokers, Dealers, and Investment Advisers*, SEC Rel. No. 34-69013, IA-3558 (Mar. 1, 2013) ("2013 SEC Request for Data"), available at <https://www.sec.gov/rules/other/2013/34-69013.pdf>.

⁶ See Statement, *supra* note 2 (describing key elements of clarity, consistency, and coordination).

We briefly describe below our key recommendations to the Commission:

- The SEC should take the lead in establishing and enforcing a best interest standard of conduct for broker-dealers providing recommendations to retail investors in non-discretionary accounts, across both retirement and non-retirement accounts.⁷
- The SEC should coordinate closely with DOL so that DOL explicitly recognizes the best interest standard of conduct in a new, streamlined prohibited transaction exemption for financial services providers that are subject to an SEC-governed standard of conduct.
- The SEC should maintain the existing fiduciary duty standard for investment advisers that has served investors well for over seven decades.

We explain each of these points in more detail below. We first discuss how the DOL's fiduciary rulemaking has harmed investors and disrupted the financial advice market.

I. Current DOL Standard of Conduct for Retirement Accounts Is Harming Investors and Disrupting the Market (Response to Questions 5, 6, 7)⁸

As you are aware, to receive commission-based compensation, the fiduciary rulemaking (through the BIC exemption) requires broker-dealers to comply with a series of complex and burdensome conditions, which expose broker-dealers to significant litigation risk. Many broker-dealers already have limited their product offerings and advice options, and have jettisoned longstanding clients, because of concerns about their ability to satisfy the burdensome conditions of DOL's BIC exemption.⁹

Moreover, the financial professionals that sell mutual funds require product offerings that are consistent with the compensation requirements under the BIC exemption. Bringing these new product offerings to market in an environment of regulatory uncertainty and shifting intermediary demands has created—and continues to create—significant and unrecoverable costs for the fund industry.

⁷ For ease of reference, throughout this letter we refer to our recommended standard of conduct as the “best interest standard of conduct,” and to the SEC-registered brokers and dealers to which it would apply simply as “broker-dealers.”

⁸ As the Statement requests, we identify throughout our letter the particular question to which our response relates.

⁹ The BIC exemption requires a broker-dealer to comply with a series of complex and abstruse conditions, including for IRA clients, a written contractual obligation to adhere to specific warranties about policies and procedures to mitigate conflicts, unclear standards relating to compensation arrangements that seem to require identical compensation with respect to all mutual fund products regardless of differences in selling agreements and service offerings, a variety of disclosure obligations at various points in time, and a ban on class action waivers.

A. Investor Harm (Response to Question 5)

If implemented in its current form, and without accompanying changes to the retail market, the current fiduciary rulemaking will bring an estimated \$109 billion in financial harm to retirement savers, according to ICI analysis.¹⁰ The increasing difficulty of providing commission-based accounts under the fiduciary rulemaking is leading to reduced product choice, a move to asset-based arrangements that may be more costly for buy-and-hold investors, and an increase in account minimums for commission-based accounts. Many of those harmed will be savers with small account balances that cannot obtain affordable financial advice as a result of the fiduciary rulemaking.

Many of these investors may find that broker-dealers are unwilling to continue offering them transaction-based accounts, but that they do not meet the minimum balance that many investment advisers require for a fee-based arrangement.¹¹ As widely reported, intermediaries have announced a variety of changes to service offerings, including no longer offering mutual funds in brokerage IRA accounts and raising account minimums or discontinuing advisory services and commission-based arrangements for lower balance accounts. Other firms have announced that they no longer will offer IRA brokerage accounts at all, or will reduce web-based financial education tools.¹²

Indeed, in many instances, intermediaries have informed our members that they will no longer service certain account holders because of concerns about being deemed an ERISA fiduciary under the fiduciary rulemaking. When an intermediary resigns from an account, this “orphaned” account loses the benefit of the advice and other services that intermediary provided. These “orphaned” accounts already number in the hundreds of thousands, and industry participants indicate that the numbers will climb substantially as implementation efforts proceed.¹³

¹⁰ See Letter from Dorothy M. Donohue, Acting General Counsel, and David M. Abbey, Deputy General Counsel—Retirement Policy, Investment Company Institute, to Office of Exemption Determinations, Employee Benefits Security Administration, Department of Labor, dated July 21, 2017, available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00229.pdf> (“ICI’s July 21, 2017 Letter to DOL”). This would amount to \$780 million per month in investor losses.

¹¹ Whether a fee-based or a transaction-based account is more cost-effective for a particular investor may depend on factors including the investor’s account balance, time horizon, and trading frequency.

¹² See “A Complete List of Brokers and Their Approach to ‘The Fiduciary Rule,’” *Wall Street Journal*, February 6, 2017, available at <https://www.wsj.com/articles/a-complete-list-of-brokers-and-their-approach-to-the-fiduciary-rule-1486413491>.

¹³ Orphaned accounts are those from which an intermediary has resigned as broker-dealer of record because of its concerns about complying with the DOL’s fiduciary rulemaking. ICI informally surveyed its members in March regarding notifications of dealer resignations. Thirty-one out of thirty-two mutual fund companies surveyed reported either having received orphaned accounts or receiving notices regarding some volume of accounts that will become orphaned. Many smaller mutual fund complexes have not yet received resignation notifications from intermediaries. Members have indicated that, depending on the outcome of the rulemaking, they expect the volume of orphaned accounts to increase and that a

Other accounts, while not orphaned, will receive automated, rather than human, advice. Some have asserted that so-called “robo-advisors” will be an adequate substitute for this lost human interaction, but this may not be true in all cases, particularly for investors who seek guidance regarding event-specific questions. Investors may benefit significantly from human advice on issues such as whether to stay the course or shift investments to cash in time of market downturns or stress, whether to take a withdrawal (or a loan, in the case of a plan), or whether to keep assets in a plan versus rolling them over to an IRA.

In short, there is now clear evidence that the fiduciary rulemaking is harming investors in a number of ways. **The rulemaking is limiting retirement savers’ choices, restricting their access to information they need for retirement planning, and increasing costs, particularly for those savers who can least afford it.**¹⁴

B. Market Disruption (Response to Question 5)

DOL estimated that implementing the fiduciary rulemaking would cost \$5 billion in the first year of the final rule’s application.¹⁵ **The Department’s estimate, however, does not include any allowance for the amount that asset managers, including mutual funds, will spend to develop products to assist broker-dealers in complying with the BIC exemption, such as T shares¹⁶ and so-called “clean shares.”**¹⁷ In fact, intermediary requests for new product offerings are causing funds to incur significant and unrecoverable costs as intermediaries continue to change course on the product offerings they need to comply with the fiduciary rulemaking.

significant increase could affect their ability to service shareholders. The expectation is that the number of orphaned accounts likely will run into the hundreds of thousands.

¹⁴ We discuss the “advice gap” that the fiduciary rulemaking is creating in Appendix B to our August 7 letter to DOL. *See* Letter from Dorothy M. Donohue, Acting General Counsel, and David M. Abbey, Deputy General Counsel—Retirement Policy, Investment Company Institute, to Office of Exemption Determinations, Employee Benefits Security Administration, Department of Labor, dated August 7, 2017 (“ICI’s August 7, 2017 Letter to DOL”).

¹⁵ *See* DOL Regulatory Impact Analysis, 82 Fed. Reg. 16902, at 16907-8; and US Department of Labor, Employee Benefits Security Administration, Regulating Advice Markets, Definition of the Term “Fiduciary” Conflicts of Interest—Retirement Investment Advice Regulatory Impact Analysis for Final Rule and Exemptions (April 2016), at p. 10, *available at* <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>.

¹⁶ T shares generally have a uniform front-end load similar to an A share, but with a lower commission, generally around 2.5 percent.

¹⁷ “Clean shares” generally have no front-end load, deferred sales charge, or other asset-based fee for sales or distribution. *See* SEC Interpretive letter (Jan. 11, 2017), *available at* <https://www.sec.gov/divisions/investment/noaction/2017/capital-group-011117-22d.htm>.

For example, we estimated in March 2017 that funds already had spent upwards of \$17 million in sunk costs relating to only one segment of product changes—the creation of T shares.¹⁸ The launch of a new share class is complex and costly. Direct costs that funds incur related to a share class launch generally include legal consultation, audit work, system modifications and establishment of product parameters (*e.g.*, account minimums, shareholder eligibility, rights of accumulation calculations), various filing fees (*e.g.*, NASDAQ, CUSIP), Blue Sky registration fees by state, print and typesetting costs for production of regulatory documents, and seed money. These direct costs do not include compensation of full-time employees, overhead, and other “soft” costs. While the cost to launch a share class can vary widely depending on several factors, the data from our members show that on average the direct cost to launch a fund share class is \$31,000. We estimated that funds may need to launch more than 3,500 T share classes to comply with the rule. The cost of creating approximately 3,500 new share classes would total at least \$111 million.

The move toward T shares is a primary example of the inadvertent market disruption that the fiduciary rulemaking has caused. Many funds have been developing T shares, which in most cases the industry expects to use only as a temporary solution. A sampling of our members¹⁹ reports intermediaries’ declining interest in T shares, and confirms that this development is due in part to a growing perception that “clean shares” offer a better long-term solution. ICI members also report that many of their key intermediary partners are strongly considering using mutual fund clean share classes in both fee-based

¹⁸ See Letter from Brian Reid, Chief Economist, and David W. Blass, General Counsel, Investment Company Institute, to DOL, dated March 17, 2017, available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB79/01073.pdf>.

¹⁹ ICI informally surveyed its members regarding their adoption of T shares. Two-thirds of respondents to ICI’s member survey indicated they had requested SEC approval to introduce T shares to the market, yet only 17% of respondents have actually launched T shares, and another 11% plan to launch later this year. The majority of respondents (approximately 72%) indicated there is not sufficient intermediary demand to warrant the launch of T shares.

and commissionable account arrangements but that certain obstacles²⁰ prevent rapid adoption of clean shares.²¹

II. SEC Should Establish and Enforce a Best Interest Standard for Broker-Dealers; DOL Should Create an Exemption that Defers to an SEC-Governed Standard (Response to Questions 5, 6, 8, 9, 14, 17)

We recommend below that the SEC take the lead in establishing and enforcing a best interest standard for broker-dealers that would apply consistently across retirement and non-retirement accounts.²² This enhanced standard of conduct would better serve investors and would mitigate the harms that the fiduciary rulemaking is causing. We urge the SEC to coordinate closely with DOL so that DOL explicitly recognizes the best interest standard of conduct in a new, streamlined prohibited transaction exemption for financial services providers that are subject to an SEC-governed standard of conduct. We explain below the contours of our recommended standard of conduct for broker-dealers, including using the FINRA definition of “recommendation,” and recommend that investment advisers remain subject to their existing fiduciary duty.

²⁰ These obstacles include: (1) intermediaries must modify significantly both brokerage and sub-account recordkeeping systems to apply the intermediary’s own commission, rather than apply the traditional fund sales charge, on account transactions and report this information on shareholder confirmations; (2) intermediaries must determine how clean shares fit within the intermediary’s ongoing business model for adviser compensation and coverage of account servicing costs; and (3) funds may require intermediaries to execute an addendum to selling agreements to clarify their role as broker when offering clean shares. The contract vetting and sign-off process takes time to execute, especially considering that funds responding to ICI’s survey reported an average of 864 retail intermediary arrangements. While not all intermediaries may choose to offer clean shares, the number of agreement updates to allow intermediaries to sell clean shares to retail investors could be significant. ICI estimates that the total cost to the fund industry to implement clean shares could approach \$100 million.

²¹ A number of our members also report that a large portion of their intermediary partners have not contacted them regarding their compliance plans, which leaves fund firms uncertain about which product offerings they should be developing.

²² This standard would be consistent with Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act”). Section 913 provides that the Commission may promulgate rules to establish a best interest standard of conduct for brokers and dealers that is “no less stringent” than the standard applicable to investment advisers under the Investment Advisers Act of 1940. Section 913 explicitly provides that receiving commission-based compensation, in itself, should not be considered a violation of any such standard, nor should the sale of only proprietary or other “limited range of products.”

A. SEC Should Take the Lead in Establishing and Enforcing a Best Interest Standard for Broker-Dealers (Response to Questions 5, 6, 8, 9)

We agree with you that the principles of clarity, consistency, and coordination should guide reform in this area.²³ We explain below why an SEC-led effort to establish a best interest standard of conduct, in coordination with DOL's efforts to issue a streamlined exemption, will best achieve these objectives.

1. *SEC Standard Would Provide Clarity (Response to Questions 8, 9)*

Only the Commission, as the primary regulator of broker-dealers, is in a position to issue a best interest standard of conduct that will achieve the clarity that both investors and markets sorely need. Only the Commission can issue a standard of conduct that will apply to broker-dealers' conduct across both retirement and non-retirement accounts. Doing so would avoid the confusion of applying two inconsistent standards to broker-dealer conduct—and would make clear to broker-dealers their obligations, and to investors the duties that the broker-dealers that service their accounts owe them. Appropriate disclosure obligations under the standard would help ensure that investors understand the broker-dealer's role and the standard of conduct that applies to the relationship.²⁴

The SEC also could enforce a best interest standard directly, unlike the DOL. As the primary regulator of broker-dealers, the SEC has enforcement authority over them both directly and through FINRA. An SEC-issued best interest standard therefore would avoid the risk, expense, and uncertainty that the DOL's BIC exemption has created because of its reliance on a private right of action for enforcement.²⁵

2. *SEC-Governed Standard of Conduct Would Create Consistency Across Retirement and Non-Retirement Accounts (Response to Questions 8, 9)*

A best interest standard for broker-dealers also would ensure a consistent standard for broker-dealers whether they are providing recommendations to investors with respect to their retirement or non-retirement accounts. Broker-dealers that choose to comply with the BIC exemption currently find themselves subject to an ERISA-based fiduciary standard of conduct that, as the DOL applies it, is

²³ See Statement, *supra* note 2.

²⁴ *Id.* (Question 1).

²⁵ DOL included the private right of action specifically because it does not have enforcement authority over IRAs. The SEC's and FINRA's examination and enforcement programs, however, provide strong protections for investors, including retirement investors, and would serve to enforce compliance with the SEC's conduct standards, making the BIC exemption's contractual warranties and private right of action unnecessary. Our letter to DOL discusses these points in further detail. See ICI's August 7, 2017 Letter to DOL, *supra* note 14.

consistent with neither the fiduciary standard that applies to investment advisers nor the suitability standard that applies to broker-dealers.²⁶ We set out in an appendix to this letter the existing standards of conduct that apply to investment advisers providing advice to their clients, broker-dealers providing recommendations to their customers, and intermediaries providing certain types of advice to plans subject to ERISA.

3. *SEC Should Work with DOL to Ensure a Coordinated Approach Across Investors' Retirement and Non-Retirement Accounts (Response to Question 5, 6)*

Were the SEC to develop a best interest standard, and DOL to establish a corollary exemption recognizing the standard, it would ensure a coordinated approach across investors' retirement and non-retirement accounts. DOL recently released a request for information (RFI) that identifies a number of possible changes to the BIC exemption and questions that imply likely future changes to the fiduciary rule itself.²⁷ Among other things, the RFI requests comment on whether, if the SEC were to “adopt updated standards of conduct applicable to the provision of investment advice to retail investors . . . a streamlined exemption or other change [could] be developed for advisers that comply with or are subject to those standards . . .”²⁸ We believe it could, and recommend that DOL explicitly recognize the best interest standard of conduct in a new streamlined prohibited transaction exemption for financial service providers that are subject to an SEC-governed standard of conduct.²⁹ The application of and compliance with one of these standards of conduct should be sufficient to meet a prohibited transaction exemption for advice under ERISA and the Code.

We cannot overstate the importance of SEC-DOL coordination given the upcoming January 1, 2018 full compliance date for the fiduciary rulemaking. In addition, we urge the SEC and DOL to synchronize efforts with respect to timing to prevent further investor harm and confusion, and avoid unnecessary implementation and compliance costs. For example, to provide time to coordinate with

²⁶ For example, under the fiduciary rulemaking, an investment adviser may be deemed an ERISA fiduciary when engaging in discussions with a prospective client about whether to hire the adviser. Imposing ERISA fiduciary status at this stage of the relationship creates unnecessary operational complexities.

²⁷ *Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions*, 82 Fed. Reg. 31278 (Jul. 6, 2017), available at <https://www.gpo.gov/fdsys/pkg/FR-2017-07-06/pdf/2017-14101.pdf>. ICI submitted a response to the RFI today. See ICI's August 7, 2017 Letter to DOL, *supra* note 14.

²⁸ *Id.* The RFI asks further “[t]o what extent does the existing regulatory regime for IRAs by the Securities and Exchange Commission, self-regulatory bodies (SROs) or other regulators provide consumer protections that could be incorporated into the Department’s exemptions or that could serve as a basis for additional relief from the prohibited transaction rules?”

²⁹ We explain this recommendation in detail in separate correspondence that we provided to DOL today. We recommend to DOL that this streamlined prohibited transactions exemption also cover SEC-registered investment advisers that are subject to an SEC-governed fiduciary duty standard of conduct.

respect to a consistent standard of conduct, we have urged DOL to immediately—by August 15, 2017—issue an interim final rule delaying the January 1, 2018 applicability date for one year.³⁰ In conjunction with the postponement, we recommended that DOL announce that it expects to finalize modifications to the fiduciary rule and related prohibited transaction exemptions prior to January 1, 2019 and that the applicability date of the modified rule and exemptions will become effective no sooner than January 1, 2020.

The SEC should work with the DOL to issue the SEC’s new best interest standard of conduct for broker-dealers within this same timeframe, so that a corollary DOL exemption for SEC-regulated entities can be operational. Coordinated efforts toward a consistent standard would enhance investors’ protections without imposing unnecessary, harmful burdens, and legal risks on the financial professionals serving them. A coordinated effort also aligns with other Administration directives³¹ and reflects the reality that individuals who seek financial guidance often have both retirement accounts and non-retirement accounts. It would permit these individuals to receive guidance that reflects consistent and compatible regulatory requirements.

We also urge the SEC to work with state regulators through the North American Securities Administrators Association (NASAA) as the SEC considers standards of conduct for financial professionals. This coordination should help forestall states from adopting inconsistent standards of conduct. One state recently revised its law to impose a fiduciary duty on certain investment advisers and broker-dealers.³² We understand that other states may have enacted, or be considering, similar laws. If states move in this direction, not only might standards differ among the states, but they may be inconsistent with any federal standards, causing confusion for both financial professionals and their customers. To avoid this result, we urge the Commission to exercise its authority under Section 19(d) of the Securities Act of 1933 (“Securities Act”)³³ to encourage a consistent best interest standard of

³⁰ See ICI’s July 21, 2017 Letter to DOL, *supra* note 10.

³¹ See Presidential Executive Order on Enforcing the Regulatory Reform Agenda, issued on February 24, 2017 (stating that “[i]t is the policy of the United States to alleviate unnecessary regulatory burdens placed on the American people” and encouraging agencies to eliminate regulations that “create a serious inconsistency or otherwise interfere with regulatory reform initiatives and policies”), available at <https://www.whitehouse.gov/the-press-office/2017/02/24/presidential-executive-order-enforcing-regulatory-reform-agenda>; and Presidential Executive Order on Reducing Regulation and Controlling Regulatory Costs, issued on January 30, 2017 (directing agencies to identify at least two existing regulations to be repealed for every new regulation proposed), available at <https://www.whitehouse.gov/the-press-office/2017/01/30/presidential-executive-order-reducing-regulation-and-controlling>.

³² See Nevada Senate Bill No. 383, 79th Sess. (2017).

³³ Section 19(d) of the Securities Act sets out a policy of greater federal and state cooperation in securities matters including, among other things, maximum uniformity in federal and state regulatory standards. See Section 19(d)(2)(B) of the Securities Act.

conduct for broker-dealers. Coordination with the states will promote uniformity and predictability of regulation, to the benefit of investors, regulators, and financial professionals.

B. Best Interest Standard of Conduct for Broker-Dealers (Response to Question 8, 9, 14, 17)

We recommend that the SEC establish a clearly articulated best interest standard of conduct that would apply to broker-dealers providing recommendations to retail investors, regardless of whether those recommendations are made with respect to retirement accounts. The best interest standard of conduct that ICI recommends for broker-dealers would enhance the existing suitability requirements and other obligations that currently apply to broker-dealers under the Exchange Act, the rules thereunder, and FINRA rules.³⁴

Our recommended best interest standard of conduct is consistent with the historical broker-dealer business model. A best interest standard would fit well with the transactional nature of a broker-dealer's business, including the transaction-based compensation broker-dealers typically receive. It also would permit broker-dealers to continue to provide the types of products and services that they offer in the ordinary course and customers have come to expect. The standard would require appropriate disclosure, including of material conflicts.

1. *Description of Best Interest Standard of Conduct for Broker-Dealers (Response to Questions 8, 9, 17)*

Best Interest Standard of Conduct. Our recommended best interest standard would require that a broker-dealer's "recommendation" to a retail customer in a non-discretionary account be in that customer's best interest at the time the recommendation is made, incorporating an explicit duty of loyalty and a duty of care, with the following affirmative obligations:

Duty of Loyalty

- **Client's Interest First.** The standard would require that a broker-dealer's recommendation to a retail customer not put the broker-dealer's interests (or the interests of anyone else) above the client's interests.

³⁴ Generally, broker-dealers that exercise discretion or control over customer assets, or have a relationship of "trust and confidence" with their customers, owe customers a fiduciary duty. See 2011 SEC Study, *supra* note 5, at p. 54 (citing, e.g., *U.S. v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006) (fiduciary duty found "most commonly" where "a broker has discretionary authority over the customer's account"))).

Duty of Care

- **Diligence, Care, Skill, and Prudence.** The standard would require a broker-dealer's recommendation to a retail customer to reflect (1) reasonable diligence;³⁵ and (2) **reasonable care, skill, and prudence based on the customer's investment profile.**³⁶

Fair and Reasonable Compensation. A broker-dealer would be required to charge no more than reasonable compensation for services to its customer.³⁷

Disclosure. The best interest standard would require that the broker-dealer disclose to the customer certain key aspects of its relationship with the customer—such as the type and scope of services provided, the applicable standard of conduct, the types of compensation it or its associated persons receive, and any material conflict of interest.

No Misleading Statements. A broker-dealer would be prohibited from making any misleading statements about the transaction, compensation, or conflicts of interest.

Policies and Procedures. Broker-dealers would be subject to existing regulation requiring them to adopt policies and procedures reasonably designed to prevent violations of the applicable standard of conduct.³⁸ **FINRA already requires a broker's written procedures** and supervisory system to be reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules. The recommended policies and procedures would fall within the scope of this FINRA requirement.

Application of Standard. The standard would be triggered whenever a broker-dealer makes a recommendation to any customer having a **non-discretionary account.** **For this purpose, FINRA's definition of "recommendation" would apply.**³⁹

Scope of Standard. A best interest standard of conduct for broker-dealers would permit the broker-dealer to limit the scope, nature, and anticipated duration of the relationship with the customer.

³⁵ See FINRA Rule 2111.

³⁶ See FINRA Rule 2111.04.

³⁷ See FINRA Rules 2121 and 2122.

³⁸ See FINRA Rule 3110.

³⁹ See FINRA Rule 2111.

A broker-dealer would be able to engage in the following activities or practices, consistent with the best interest standard, if the broker-dealer provides appropriate disclosure and the product or service is in the customer's best interest:

- Selling an investment product and receiving compensation in the form of commissions or other traditional broker-dealer compensation for customer transactions.⁴⁰
- Selling proprietary investment products.
- Engaging in principal trading, subject to appropriate limitations, disclosure, and customer consent.

We recognize that principal trading is one of the more difficult areas that the SEC will need to address through any rulemaking articulating a standard of conduct.⁴¹ A broker-dealer acting as principal in transactions with customers raises the potential for self-dealing. The SEC must address this potential conflict, but also must recognize that dealer activities such as trading as principal have the potential to benefit customers through enhanced liquidity, expanded investment choices, and better trade execution.

Just as we did in 2013, we agree with the SEC's suggestion that certain aspects of Section 206(3) of the Advisers Act could serve as a model to address the potential conflicts that principal trading raises for broker-dealers, without imposing all the requirements of the section, including trade-by-trade disclosure and customer consent.⁴² In considering the appropriate restrictions and disclosures that

⁴⁰ We note that a principal underwriter of a mutual fund (*i.e.*, a limited-purpose broker-dealer) that simply sells fund shares should not be subject to a best interest standard of conduct provided, of course, it does not make a recommendation to a retail investor.

⁴¹ The SEC's 2011 Study on Investment Advisers and Broker-Dealers noted that Dodd-Frank Act Section 913(g) requires that the standard of conduct applicable to broker-dealers should be "no less stringent" than Section 206(1) and (2) of the Investment Advisers Act of 1940 ("Advisers Act"), and does not refer to Advisers Act Section 206(3). The report explains that the omission of a reference to Section 206(3) appears to reflect a Congressional intent not to mandate the application of that provision to broker-dealers when providing personalized investment advice about securities to retail investors (though granting the Commission the authority to impose these types of restrictions). 2011 SEC Study, *supra* note 5, at p. 119.

⁴² See Question 17 of the Statement (asking whether the Commission should consider any material changes to the assumptions in its 2013 request for data as part of its continued review and analysis of this area). This request for data, in connection with the Dodd-Frank Section 913 study, sought information on the benefits and costs that could result from various alternative approaches to standards of conduct for broker-dealers and investment advisers. See Letter from Karrie McMillan, General Counsel, Investment Company Institute, to Elizabeth M. Murphy, Secretary, US Securities and Exchange Commission, dated July 3, 2013, available at <https://www.sec.gov/comments/4-606/4606-3103.pdf> (providing comments on 2013 SEC Request for Data, *supra* note 5).

should apply to broker-dealers' principal trading, however, we recommend that the SEC also revisit its interpretations under Section 206(3) of the Advisers Act for registered investment advisers.⁴³

Certain common activities not constituting the making of a recommendation also should not cause broker-dealers to be subject to a best interest standard. For example:

- Offering the use of financial calculators or similar investment tools for general informational purposes.⁴⁴
- Providing information about investment products derived from third-party sources, such as prospectuses, fund fact sheets, and independent third-party ratings information.
- Executing unsolicited trades.
- Servicing orphaned accounts, including a limited purpose broker-dealer (*i.e.*, fund distributor) providing information about the shareholder's options. This would include holding an account directly with the fund and not re-establishing an intermediary relationship.

2. *Definition of "Recommendation" (Response to Question 14, 17)*

In crafting a best interest conduct standard for broker-dealers, we urge the SEC to define "recommendation" consistently with FINRA's definition of "recommendation." It should not base the definition on the DOL fiduciary rule's expansive approach to "recommendation" or look to the concept of "investment advice" under the Advisers Act. We explain the basis for this suggestion below.⁴⁵

FINRA's definition of "recommendation" and related guidance clearly identify conduct that would subject a broker-dealer to a best interest standard, and appropriately reflect the typically episodic nature of a broker-dealer's relationship with its customer. FINRA generally takes a facts and circumstances

⁴³ For example, the Commission should consider the circumstances under which trade-by-trade disclosure and consent should be required, and how the requirements of Section 206(3) should apply to broker-dealers that are affiliated with registered investment advisers.

⁴⁴ We recognize that the use of these types of tools may, in some circumstances, entail a recommendation, in which case the broker would be subject to the best interest standard.

⁴⁵ We note that because we are suggesting a distinct best interest standard of conduct for broker-dealers, and that the FINRA definition of "recommendation" should apply, the term "personalized investment advice," which the SEC used in its 2013 request for data, would not be applicable, as that term was intended to encompass both "recommendations" under the FINRA rules and "investment advice" under the Advisers Act. See SEC 2013 Request for Data, *supra* note 5; Question 17 of the Statement.

approach to whether a communication constitutes a recommendation⁴⁶ using objective criteria.⁴⁷ In determining whether a communication is a recommendation, key considerations are: (1) whether—given the content, context and manner of presentation—a particular communication from a firm or associated person to a customer reasonably would be viewed as a suggestion that the customer take action or refrain from taking action regarding a security or investment strategy;⁴⁸ and (2) the extent to which the communication is individually tailored to the customer.⁴⁹

FINRA has issued a robust body of guidance around the definition of “recommendation” that provides practical guidance for common situations and activities. Of particular note, existing FINRA guidance provides clarity around the treatment of certain activities that currently is uncertain, ambiguous, or problematic under the fiduciary rulemaking—*e.g.*, certain call center activities⁵⁰ and recommendations to increase contributions to a retirement account.⁵¹ The clarity and objectivity of the FINRA definition also would provide needed certainty to fund transfer agents and limited purpose broker-dealers providing services to so-called “orphaned” fund accounts—which are expected to number in the hundreds of thousands as a result of the fiduciary rulemaking.⁵²

⁴⁶ See, *e.g.*, *Online Suitability*, NASD Notice to Members 01-23, at p. 2 (Apr. 2001) (“NASD Notice to Members 01-23”), available at www.finra.org/web/groups/industry/@ip/@reg/@notice/documents/notices/p003887.pdf.

⁴⁷ *Know Your Customer and Suitability*, FINRA Regulatory Notice 11-02 (Jan. 2011) (“FINRA Regulatory Notice 11-02”), available at <http://www.finra.org/sites/default/files/NoticeDocument/p122778.pdf>.

⁴⁸ *Id.*; see also NASD Notice to Members 01-23, *supra* note 47.

⁴⁹ Specifically, “the more individually tailored the communication is to a particular customer or customers about a specific security or investment strategy, the more likely the communication will be viewed as a recommendation.” FINRA Regulatory Notice 11-02, *supra* note 48; see also NASD Notice to Members 01-23, *supra* note 47.

⁵⁰ FINRA has taken the view that responding to a customer’s request for information does not, in itself, result in a recommendation. In contrast, DOL’s fiduciary rule has created a great deal of uncertainty and ambiguity as to how broker-dealers could conduct certain call center activities. Even the most basic information could trigger ERISA fiduciary status and prohibited transactions. While the definition of advice under ERISA technically excludes some of this information, the rule’s broad interpretation has cast a chill on broker-dealers providing investment education to retirement savers, due to the risk of inadvertently triggering ERISA fiduciary status. See Letter from Brian Reid, Chief Economist, and David W. Blass, General Counsel, Investment Company Institute, to DOL, dated April 17, 2017, at p. 19, available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB79/01409.pdf>.

⁵¹ See *FINRA Reminds Firms of Their Responsibilities Concerning IRA Rollovers*, Regulatory Notice 13-45 (Dec. 2013), available at <http://www.finra.org/sites/default/files/NoticeDocument/p418695.pdf>. The fiduciary rule treats an IRA rollover recommendation as fiduciary advice, even when no discussion of specific securities or investment property takes place. See ICI’s August 7, 2017 Letter to DOL, *supra* note 14.

⁵² See *supra* note 13.

C. Investment Advisers' Fiduciary Duty Should Remain (Response to Question 8)

We recommend that investment advisers remain subject to the strong, longstanding fiduciary duty that governs their conduct and requires them to place their client's interests above their own, as discussed above. The SEC comprehensively regulates registered investment advisers under the Advisers Act, and registered funds under the Investment Company Act of 1940. These laws, the rules thereunder, and the robust body of formal and informal staff guidance that has developed around them, create a comprehensive framework governing all aspects of the registered fund advisory business. A rich body of case law has developed over the years interpreting an investment adviser's fiduciary duty. This case law contemplates the advisory business model rather than the transaction-based broker-dealer business model. This high standard of conduct, with its well-developed body of law, has served investors, including those in registered investment companies, for over seven decades.⁵³

* * *

⁵³ It would be inconsistent with the Statement's goals of clarity and consistency to extend to investment advisers the Exchange Act or FINRA rules that apply to broker-dealers. FINRA rules reflect the transactional nature of the broker-dealer business. These rules are inconsistent with the typically ongoing, relationship-based business of an investment adviser, and applying them in addition to the existing Advisers Act regulatory structure would result in overlapping and conflicting regulatory requirements.

The Honorable Jay Clayton
August 7, 2017
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III. Conclusion

We hope that our views assist you and the full Commission as you consider how to proceed in this area. We suggest that the Commission move forward promptly with a formal proposal on an enhanced standard of conduct for broker-dealers, and look forward to commenting in more detail. We and our members are glad to assist in any way that would be helpful. Please contact me at (202) 218-3563 or ddonohue@ici.org, Sarah Bessin at (202) 326-5835 or sarah.bessin@ici.org, or Linda French at (202) 326-5845 or linda.french@ici.org if you have questions, or we may be of assistance.

Sincerely,

/s/Dorothy M. Donohue

Dorothy M. Donohue
Acting General Counsel

cc: The Honorable Michael S. Piwowar
The Honorable Kara M. Stein
David W. Grim, Director, Division of Investment Management
Heather Seidel, Acting Director, Division of Trading and Markets

Appendix

We explain below the different standards of conduct that apply to investment advisers providing advice to their clients, broker-dealers providing recommendations to their customers, and intermediaries providing certain types of advice to plans subject to ERISA. This discussion provides context for the best interest standard of conduct we recommend for broker-dealers, and the corollary streamlined prohibited transaction exemption that we recommend DOL adopt.

I. Investment Advisers

Under the Investment Advisers Act of 1940 (“Advisers Act”), an investment adviser is subject to a fiduciary duty that requires it to act in the best interests of its clients, including a duty of loyalty and a duty of care.¹ As part of its duty of loyalty, an investment adviser either must eliminate, or fully disclose to its clients and obtain their consent regarding, any material conflicts of interest.² Investment advisers typically charge asset-based fees and have discretionary authority over client accounts. Their fiduciary duty generally applies on an ongoing basis, reflecting the typically ongoing nature of the adviser’s relationship with its client.³

II. Broker-dealers

Under the Securities Exchange Act of 1934 (“Exchange Act”) and FINRA rules, a broker-dealer is subject to a suitability standard that requires the broker-dealer to “have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer.”⁴ This standard may require a broker-dealer making a recommendation, under certain

¹ This fiduciary standard is not set forth explicitly in the Advisers Act. Rather, the Supreme Court has interpreted the antifraud provisions of the Advisers Act as imposing a fiduciary duty on advisers. *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963); see also *Transamerica Mortgage Advisors, Inc.*, 444 U.S. 11, 17 (1979) (“[T]he Act’s legislative history leaves no doubt that Congress intended to impose enforceable fiduciary obligations.”). This fiduciary duty standard has been interpreted further through a series of court cases and SEC guidance over the years.

² See *Capital Gains*, *supra* note 1 (an adviser must fully disclose to its clients all material information that is intended “to eliminate, or at least expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested”).

³ Although an investment adviser’s fiduciary duty is ongoing, it is not unlimited in scope. Instead, the parameters of the duty may depend on the scope of the advisory relationship. See, e.g., *Duties of Brokers, Dealers, and Investment Advisers*, SEC Rel. No. 34-69013, IA-3558, at n.37 (Mar. 1, 2013), available at <https://www.sec.gov/rules/other/2013/34-69013.pdf>.

⁴ FINRA’s Rule 2111, known as the suitability rule, requires a broker to “have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer’s investment profile.”

circumstances, to disclose certain material conflicts of interest to its customers.⁵ Broker-dealers typically do not exercise discretionary authority over customer accounts⁶ and generally provide advice that is incidental to their business as broker-dealers.⁷ A broker-dealer's relationship tends to be transactional in nature—with transactions effected at the behest or with the approval of the customer—and as such may be episodic. The suitability standard of conduct applies to broker-dealers when they provide recommendations to their customers and generally does not apply on an ongoing or continuous basis. Broker-dealers also are subject to a well-established body of prescriptive rules and guidance governing their conduct under the FINRA rules (*e.g.*, just and equitable practices, best execution, fair and reasonable compensation, books and records).

III. Advice Providers under ERISA

When an investment adviser, broker-dealer, or other intermediary provides certain types of advice with respect to a plan or account subject to ERISA, it is subject to a broad fiduciary standard of conduct. The DOL's recent rulemaking significantly expanded who is a fiduciary, and therefore would be subject to the ERISA fiduciary standard of conduct. An ERISA fiduciary is subject to a duty of loyalty, a duty of prudence,⁸ and must comply with plan documents, diversify plan investments, and pay only reasonable plan expenses from plan assets.⁹

In contrast to the SEC's disclosure-based approach to regulation,¹⁰ ERISA takes a *per se* prohibition-based approach, prohibiting ERISA fiduciaries from engaging in a broad range of transactions that may present a conflict of interest, such as providing advice that impacts their compensation (*e.g.*, receiving variable compensation).¹¹ These transactions are prohibited even if the potential conflict has been

⁵ See FINRA Report on Conflicts of Interest (Oct. 2013), available at <http://www.finra.org/sites/default/files/Industry/p359971.pdf>.

⁶ Generally, broker-dealers that exercise discretion or control over customer assets, or have a relationship of "trust and confidence" with their customers, can be said to owe customers a fiduciary duty. See *Study on Investment Advisers and Broker-Dealers*, at p. 54 (Jan. 2011), available at <https://www.sec.gov/news/studies/2011/913studyfinal.pdf> (citing, *e.g.*, *U.S. v. Skelly*, 442 F.3d 94, 98 (2d Cir. 2006) (fiduciary duty found "most commonly" where "a broker has discretionary authority over the customer's account"))).

⁷ See Section 202(a)(11)(C) of the Advisers Act.

⁸ See ERISA Section 404(a)(1)(B) (*i.e.*, the "prudent man" rule), which provides that a fiduciary must act "with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims."

⁹ See ERISA Section 404.

¹⁰ See Speech by Jay Clayton, Chair, Securities and Exchange Commission, at the Economic Club of New York (Jul. 12, 2017), available at <https://www.sec.gov/news/speech/remarks-economic-club-new-york> (discussing the soundness of the SEC's historically disclosure-based approach to regulation).

¹¹ See ERISA Sections 406-407 (29 CFR, *et. seq.*).

disclosed fully and the investor provides his or her written consent. To engage in a prohibited transaction, an ERISA fiduciary must meet one of the prohibited transaction exemptions, such as the recently adopted BIC exemption that permits financial professionals to receive variable compensation if it complies with certain conditions. Unfortunately, the BIC exemption is unworkable for certain products and imposes significant class action risk that many financial intermediaries are unwilling to incur, particularly for smaller balance accounts.

Appendix B¹: Modifications to the Fiduciary Rulemaking Must Be Informed by a Comprehensive Impact Analysis.

The Investment Company Institute (ICI) has shown in a number of letters to the Department of Labor (“Department”) that the weaknesses in the fiduciary rulemaking to date stem from a flawed impact analysis.² Rather than serving as a tool to understand a problem and determine the best solution, the Department started with a predetermined agenda of eliminating perceived “conflicts” in the retirement marketplace and used the 2015 RIA and 2016 RIA³ to justify that effort. The result is an impact analysis that focuses on claims that support the Department’s narrative and that readily dismisses facts that raise contrary conclusions regarding that narrative. In particular, the 2015 RIA and 2016 RIA (1) fail to address adequately the harms of the rule—a topic of primary importance in the President’s Memorandum,⁴ and (2) base their conclusions on a limited review of the marketplace, and then misapplies the academic studies on which it relies causing it to overstate by a factor of 15 to 50 times

¹ This Appendix B, summarizing the flaws in the Department’s impact analysis supporting its fiduciary rulemaking, accompanies our letter to the Department, submitted on August 7, 2017, in response to its request for information (“RFI”). 82 Fed. Reg. 31278 (Jul. 6, 2017), available at <https://www.gpo.gov/fdsys/pkg/FR-2017-07-06/pdf/2017-14101.pdf>. References to “ICI’s August 7 Letter” refer to the main body of this letter.

² See, for example, letter from Brian Reid and David W. Blass, to Office of Regulations and Interpretations, Employee Benefits Security Administration, US Department of Labor (July 21, 2015) (“ICI 2015 Letter”), available at https://www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf; supplemental letter from Brian Reid and David W. Blass, to Office of Regulations and Interpretations, Employee Benefits Security Administration, US Department of Labor (September 24, 2015) (“ICI Supplemental 2015 Letter”), available at https://www.ici.org/pdf/15_ici_dol_ria_comment.pdf; and supplemental letter from Brian Reid and Sean Collins, to Joseph Piacentini, Director, Office of Policy and Research & Chief Economist, Employee Benefits Security Administration, US Department of Labor (December 1, 2015) (“ICI Letter to Joseph Piacentini”), available at https://www.ici.org/pdf/15_ici_dol_ria_comment_supp.pdf. These letters respond to the RIA supporting the Department’s proposed rule. However, because the final rule was largely unchanged, the analysis in our letters applies to the final rule’s RIA. Also see letter from Brian Reid and David W. Blass, to Office of Regulations and Interpretations, Employee Benefits Security Administration, US Department of Labor (March 17, 2017), available at https://www.ici.org/pdf/17_ici_dol_fiduciary_applicability_ltr.pdf and letter from Brian Reid and David Blass, to Office of Regulations and Interpretations, Employee Benefits Security Administration, US Department of Labor (April 17, 2017), available at https://www.ici.org/pdf/17_ici_dol_fiduciary_reexamination_ltr.pdf (“ICI’s April 17 Letter”).

³ US Department of Labor, Employee Benefits Security Administration, *Fiduciary Investment Advice Regulatory Impact Analysis* (April 14, 2015), (“2015 RIA”), available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/proposed-regulations/1210-AB32-2/conflictsofinterestria.pdf>; and US Department of Labor, Employee Benefits Security Administration, *Regulating Advice Markets, Definition of the Term “Fiduciary” Conflicts of Interest—Retirement Investment Advice Regulatory Impact Analysis for Final Rule and Exemptions* (April 2016), (“2016 RIA”), available at <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf>.

⁴ See White House memorandum to the Secretary of Labor, dated February 3, 2017 and published at 82 Fed. Reg. 9675 (February 7, 2017), available at <https://www.gpo.gov/fdsys/pkg/FR-2017-02-07/pdf/2017-02656.pdf> (“President’s Memorandum”). The initial question raised for examination pursuant to the President’s Memorandum is whether the 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.”

any potential benefits of the rule.⁵ An impact analysis that corrects for these omissions and flaws will lead the Department to conclude that a more principles-based rule—consistent with our **recommendations in Part I of ICI’s August 7 Letter**—will better protect investors while ensuring the continuation of affordable access to financial guidance to help individuals prepare for their financial needs.

A. The Department Must Consider the Harms of the Rule in Determining Needed Modifications.

There can be no denying that the final rule is having a consequential impact on the marketplace.⁶ As has been widely reported, several large intermediaries have announced a variety of changes to service offerings, including firms announcing that they will no longer offer mutual funds in IRA brokerage accounts; others no longer offering any IRA brokerage accounts at all; firms reducing web-based financial education tools; and others announcing that account minimums will be raised or that advisory services for lower-balance accounts will be discontinued.⁷ Indeed, in many instances, intermediary partners have informed our members that they will no longer service certain account holders in light of the rule. These so-called “orphaned” account holders already number in the hundreds of thousands and will be left without access to advice (and industry participants indicate that the numbers will climb substantially as implementation efforts proceed). In short, there is now clear evidence that the rule is already harming, and will increasingly harm, investors in a number of ways. Many will be forced to pay more for advice as they lose access to commission-based arrangements.

These market disruptions will ultimately create an “advice gap” for investors—particularly those with small account balances—as investors risk losing access to advice due to **intermediaries’ business model** changes, being abandoned by intermediaries, and having reduced access to information from call centers and websites. Over time, investors who no longer have access to advice are likely to experience lower returns because of poor asset allocation and market timing, or because they incur tax penalties by taking early withdrawals. While the Department has suggested that new innovations in computerized advice models—so-called “robo advice”—will serve such dislocated investors, it is clear that robo-advice will not be an adequate substitute for many of these investors. These concerns, which are discussed in detail in ICI’s April 17 Letter, are summarized below.

⁵ For a detailed discussion of the 2016 RIA’s flaws that underlie the Department’s unsupportable exaggeration of the potential harm to investors if the rule was not made effective, see pages 18 through 28 of ICI’s April 17 Letter.

⁶ ICI’s concerns that the issuance of the rule would harm retirement savers—particularly those with small to moderate account balances—were dismissed by the Department in the 2016 RIA, noting that “estimates of the costs to investors of having to pay more for and/or losing financial advice are based on unsupported assumptions that are contradicted by information provided by other commenters.” See 2016 RIA at p. 166.

⁷ See “A Complete List of Brokers and Their Approach to ‘The Fiduciary Rule,’” *Wall Street Journal*, February 6, 2017, available at <https://www.wsj.com/articles/a-complete-list-of-brokers-and-their-approach-to-the-fiduciary-rule-1486413491>. See also footnote 5 of ICI’s August 7 Letter, *supra*.

Changing business models are leaving many investors without advice. As described above,⁸ intermediaries have been changing their business models in response to the uncertainties caused by the final rulemaking. For example, some investors in commission-based accounts are being moved to fee-based accounts. While both compensation models (fee-based and commission-based) have their advantages, the commission-based model can be a more cost-effective means to receive advice, particularly for buy-and-hold investors, which is the case for many investors with modest-sized accounts.⁹ Moreover, fee-based accounts in many cases will not be available to the significant percentage of IRA investors who cannot meet minimum account balance requirements.

Currently, fee-based advisors often require minimum account balances of \$100,000 because, even with a 1 percent fee, accounts with fewer assets generate too little income to make the provision of ongoing advice profitable. It warrants critical reflection in this regard that 76 percent of investors in traditional IRAs in The IRA Investor Database™ have less than \$100,000 in traditional IRA assets.¹⁰ And 22.2 million US households hold IRA assets of less than \$100,000, with low- and middle-income households more likely to have IRA balances below \$100,000.¹¹ These investors—the very investors the fiduciary rule is intended to protect—are the ones most likely to lose access to advice if the rulemaking is not significantly modified.

Many intermediaries plan to “abandon” small-balance accounts. Many intermediaries plan to “abandon” or “orphan” accounts deemed undesirable or uneconomic in light of the rule. Distribution partners already have notified many of our members that they plan to resign as broker-dealer of record and in some cases as custodians for certain blocks of business. Some intermediaries have begun the resignation process, while others have not yet done so because they are waiting on the resolution of the rule. A sample of our members¹² reports that the average account balance of those accounts where an

⁸ See text accompanying footnote 7, *supra* and footnote 5 of ICI’s August 7 Letter, *supra*.

⁹ See, for example, Figure 1 on page 10 of ICI’s April 17 Letter, which shows varying outcomes for investment in a commission-based account versus a fee-based account.

¹⁰ ICI maintains an account-level database with nearly 17 million IRA investors. The aim of this database is to increase public understanding of this important segment of the US retirement market by expanding on the existing household surveys and Internal Revenue Service (IRS) tax data on IRA investors. By tapping account-level records, research drawn from the database can provide important insights into IRA investor demographics, activities, and asset allocation decisions. The database is designed to shed light on key determinants of IRA contribution, conversion, rollover, and withdrawal activity, and the types of assets that investors hold in these accounts.

¹¹ Federal Reserve Board 2103 Survey of Consumer Finances. Even including taxable investable assets that IRA investors could bring to a financial advisor, half of IRA-owning households still would be unable to meet the typical \$100,000 minimum. *Id.*

¹² ICI informally surveyed its members regarding such notifications regarding dealer resignations. Thirty-one out of 32 mutual fund companies surveyed reported either having received orphaned accounts or receiving notices regarding some volume of accounts that will become orphaned. Many smaller mutual fund complexes have not yet received requests from intermediaries asking to resign from accounts. Members have indicated that, depending on the outcome of the rule, they expect the volume of orphaned accounts to increase and that a significant increase could affect their ability to service shareholders. We expect that the number of orphaned accounts likely will run into the hundreds of thousands.

intermediary has resigned is \$17,138.¹³ If the rule is not revised or rescinded, many owners of these orphaned accounts will be left without access to advice, unless they are able to find other intermediaries who are willing to take their accounts.

The rule is having a chilling effect on exchanges of information through call centers. The fiduciary rulemaking has severely reduced the availability of commonplace exchanges of information previously provided at no cost to millions of retirement savers through call centers, walk-in centers, and websites. Even the most basic information could trigger ERISA fiduciary status and prohibited transactions. While some of this information may be technically excluded from the definition of advice, the rule is casting a chill on the provision of investment education to retirement savers, due to the risk of inadvertently triggering fiduciary status.

Robo-advice will not be an adequate substitute. One mechanism for providing advice that has accelerated as a result of the rule is the so-called robo-advisor (computer-programmed advice delivered online).¹⁴ Robo-advisors are viewed as providing a cost-effective alternative by delivering computer-generated, online advice with little or no human interaction to investors. The Department frequently has touted robo-advice and other online advice as a solution for those investors who may otherwise lose access under the rule.¹⁵

While online guidance has a helpful and growing role to play in assisting investors, it is reckless to presume that such services are a suitable substitute for human interaction in many circumstances. Among the five largest financial institutions that offer robo-advice models, only one provides human-assisted robo-advice for accounts under \$50,000,¹⁶ and just two firms provide human-assisted advice for

¹³ This \$17,138 figure is the median of the average account balances for orphaned accounts, as reported by 27 of 31 fund companies that were able to report average account sizes for orphaned accounts. This sample of 27 fund complexes is representative of a broad spectrum of the industry: the median size of long-term fund mutual assets under management of these complexes is \$116 billion, with the largest complexes having long-term mutual fund assets of more than \$1 trillion and the smallest with long-term mutual fund assets of less than \$5 billion.

¹⁴ The top five digital advisers in the United States managed approximately \$44 billion in assets at the end of 2015, growing to an estimated \$73 billion in assets just one year later. In 2011, there were 11 digital advisory firms launched in the United States; this number grew to 44 in 2015. KPMG estimates that assets managed through all digital advice platforms will grow to \$2.2 trillion by 2020. See “Digital Investment Advice: Robo Advisors Come of Age,” *Blackrock Viewpoints*, September 2016, pp. 4–5. See “America is the Realm of the Robo-Advisor,” *Statista Digital Market Outlook*, February 2017. See “Robo advising: Catching up and getting ahead,” a whitepaper published by KPMG in July 2016.

¹⁵ “Secretary of Labor Perez touts Wealthfront as paragon of low-cost, fiduciary advice,” *Investment News*, June 19, 2015, available at <http://www.investmentnews.com/article/20150619/FREE/150619892/dol-secretary-perez-touts-wealthfront-as-paragon-of-low-cost>.

¹⁶ For example, one well-known robo-advisor, Betterment, offers customers with assets of at least \$100,000 the option of a consultation with a financial adviser once a year, but that service—called “Betterment Plus”—costs 40 basis points, up from 25 basis points for the digital-only service. For an additional 10 basis points, customers with \$250,000 can get “Betterment Premium,” which includes unlimited access to Betterment representatives. See “Betterment now offering human advice with its robo,” *Investment News*, January 31, 2017, available at <http://www.investmentnews.com/article/20170131/FREE/170139989/betterment-now-offering-human-advice-with-its->

accounts under \$100,000. It is unlikely that robo-advice without human assistance will be a good substitute for the guidance offered by human representatives at financial services firms, particularly in times of market downturns or stress.

Finally, the experience of plans offering online advice shows that the Department should be cautious about concluding that robo advice will compensate for the loss of human advice services. As reported by Financial Engines, only 5.4 percent of participants utilized the online advice service available through their plans at least once in the prior 12 months. The report states that “[p]articipants who are younger but have higher balances are more likely to use online advice” and concludes that “[t]hese participants may be more engaged, have a stronger desire to be hands-on and be more comfortable using web-based advice services.”¹⁷

Studies quantify the impact of loss of advice on investor returns. A number of studies show that the loss of advice has a negative impact on investor returns.¹⁸ For example, a 2013 Morningstar study¹⁹ focused on five financial planning decisions and techniques, finding that advice creates value in each of the five categories, for a total increased gain of 1.6 percent, compared to the baseline when no advice is received. An additional Morningstar study showed that financial advice can help investors improve their optimal timing of taking Social Security benefits, adding gains of another 0.74 percent per year.²⁰ Combining both estimates, these studies suggest that better financial decision making achieved through professional financial advice, can add 2.34 percent annually to an investor’s returns.

[robo](https://www.personalcapital.com/). Personal Capital, which also offers human-assisted automated advice for accounts with at least \$25,000, charges a management fee of 89 basis points for accounts under \$1 million (see <https://www.personalcapital.com/>).

¹⁷ Financial Engines and Aon Hewitt, *Help in Defined Contribution Plans: 2006 through 2012* (May 2014), available at <https://corp.financialengines.com/employers/FinancialEngines-2014-Help-Report.pdf>.

¹⁸ The American Action Forum more recently attempted to estimate the consumer impact of the rule. It considered the companies that have either abandoned a segment of their brokerage business or are drawing down their business or moving to fee-based arrangements. It estimates that anywhere from 2.3 million to 14.7 million consumers will face significant changes to their retirement and financial advice. See Sam Barkins, “Fiduciary Rule Has Already Taken Its Toll: \$100 Million In Costs, Fewer Options,” *American Action Forum Insight* (February 22, 2017), available at <https://www.americanactionforum.org/insight/fiduciary-rule-already-taken-toll-100-million-costs-fewer-options/>.

¹⁹ See David Blanchett and Paul Kaplan, “Alpha, Beta, and Now... Gamma,” *The Journal of Retirement* (Fall 2013). An earlier version is available from Morningstar at <https://corporate1.morningstar.com/uploadedFiles/US/AlphaBetaandNowGamma.pdf>.

²⁰ See David Blanchett, “When to Claim Social Security Retirement Benefits,” *Journal of Personal Finance*, 11(2), 2012. Also see Wade Pfau, “The Value of Sound Financial Decisions: From Alpha to Gamma,” *Forbes*, online edition, available at <https://www.forbes.com/sites/wadepfau/2016/05/05/the-value-of-sound-financial-decisions-from-alpha-to-gamma/#7127ba7255df>.

Moreover, a 2015 report²¹ from Hal Singer and Robert Litan found that commission-based arrangements create incentives for brokers to offer beneficial advice to investors, and that the rule “would actually impose net yearly costs of \$2 to \$3 billion (on the average ten-year base of retirement assets),” and that “[t]he loss of brokerage advice alone could adversely affect up to 7 million people.” Further, the report finds that “the decision to stay invested (or not) during times of market stress swamps the impact of all other investment factors affecting long-term retirement savings, including modest differences in advisory fees or investment strategies” and that “the cost of depriving clients of personalized human advice during a future market correction...could be as much as \$80 billion.”

The Department disputed the relevance of these comments in its 2016 RIA by suggesting that the type of small-account investors that were the focus of the studies are not currently getting advice.²² Each of the Department’s examples, however, focuses on ongoing direct service relationships and not the type of transactional or event-based services—for example, the types of services provided by brokerage relationships—most likely to be used by investors with small account balances. These investors are most likely to desire and need guidance when first considering a rollover or other distribution from a plan, when considering whether to continue to buy or hold a particular asset, or when deciding what actions to take during a significant market event (*i.e.*, whether to stay invested in the market or whether to continue to hold a particular investment).

Concerns regarding likely negative impact is reinforced by RDR in the UK. Recent experience from the United Kingdom (UK) reinforces the predicted negative impact of the rule on low-balance investors. The Retail Distribution Review (RDR), which went into effect on December 31, 2012, effectively banned commissions on retail investment accounts in the UK and raised qualification standards for advisers. Leadership of the Financial Conduct Authority (FCA) has said that the RDR, while achieving its objectives, “caused advisers to pull away or make their service too expensive for one-off or limited advice.”²³ There is now a widely-acknowledged “advice gap” in the UK, with two-thirds of financial products sold without professional financial advice and a marked decrease in the number of

²¹ See Hal Singer and Robert Litan, “Good Intentions Gone Wrong: The Yet-To-Be-Recognized Costs of the Department Of Labor’s Proposed Fiduciary Rule,” (July 2015) available at <http://www.ei.com/support-proposed-fiduciary-rule-roposed-fiduciary-rule/>.

²² 2016 RIA at p. 314, arguing that “few households with small IRAs or modest means currently report receiving professional advice.” This statement does not comport with ICI data. ICI’s IRA Owners Survey indicates that 44 percent of rollover households with traditional IRA balances of less than \$50,000 consulted a professional financial advisor when making a rollover from an employer-sponsored plan to an IRA. In addition, among households with traditional IRAs, 76 percent of households with IRA balances of less than \$50,000 reported holding their IRAs through investment professionals. Among those households, 30 percent held their IRAs through full-service brokers, which amounts to nearly 3.2 million households (ICI’s IRA Owners Survey indicates that 13.8 million households have traditional IRA balances of less than \$50,000). For information on the survey, see Sarah Holden and Daniel Schrass, “The Role of IRAs in US Households’ Saving for Retirement, 2016,” *ICI Research Perspective* 23, no. 1 (January), available at www.ici.org/pdf/per23-01.pdf.

²³ See “FCA admits RDR contributed to advice gap,” *FT Adviser*, July 19, 2016, available at <https://www.ftadviser.com/2016/07/19/regulation/rdr/fca-admits-rdr-contributed-to-advice-gap-chujPxa8fmBkivLaaAxxfN/article.html>.

advisers.²⁴ The FCA has pointed to the higher cost for advice after the RDR as contributing to the gap, as well as unwillingness on the part of some advisers to serve the smaller-account investor.²⁵

The Department has been dismissive of comparisons to the RDR, asserting that early results in the UK did not indicate the development of an advice gap and distinguishing the Department's rule as not an outright ban on commissions.²⁶ These assertions are proving to be false, with the FCA itself acknowledging problems in the UK advice market and firms in the US already making changes to their product and service offerings (in many cases dropping smaller accounts altogether) in anticipation of the rule. While the BIC exemption does not expressly ban commissions, its conditions render commission-based compensation effectively unworkable without significant systemic changes in the marketplace.

B. **The Department Should Not Rely on the 2016 RIA's Limited and Illusory Claims of Investor Losses.**

We previously identified several significant flaws in the Department's RIAs supporting its rulemaking.²⁷ As discussed in detail in our prior letters,²⁸ the 2016 RIA bases its claims of investor harm from only one source of potential conflicts (load sharing).²⁹ In its review of this finding, consistent with the President's Memorandum, the Department should provide data and other information on the benefits stemming directly or indirectly from the services provided by these persons and financial services firms. For example, the Department targeted front-end loads or the receipt of 12b-1 fees as creating potential conflicts.³⁰ Given that, it also should have identified and analyzed the benefits of advice or information

²⁴ See "FCA proposes reforms to close 'advice gap'," *Financial Times*, March 14, 2016, available at <https://www.ft.com/content/4324f4dc-e9c8-11e5-888e-2eadd5fbc4a4>; "Review launched after 'advice gap' becomes a gulf," *Financial Times*, October 13, 2015, available at <https://www.ft.com/content/9d15d668-710b-11e5-ad6d-f4ed76f0900a>; and HM Treasury and Financial Conduct Authority, *Financial Advice Market Review – Final Report* (March 2016), available at <https://www.fca.org.uk/publication/corporate/famr-final-report.pdf>.

²⁵ See "FCA proposes reforms to close 'advice gap,'" *Financial Times*, March 14, 2016, available at <https://www.ft.com/content/4324f4dc-e9c8-11e5-888e-2eadd5fbc4a4>. According to the *Financial Advice Market Review – Final Report*, "advice is expensive and is not always cost-effective for consumers, particularly those seeking help in relation to smaller amounts of money or with simpler needs. These changes have highlighted concerns that there is an 'advice gap'." See HM Treasury and Financial Conduct Authority, *Financial Advice Market Review – Final Report* (March 2016) at pp. 5–6.

²⁶ 2016 RIA at pp. 77–78.

²⁷ See ICI's 2015 Letter, ICI's Supplemental 2015 Letter, and ICI's Letter to Joseph Piacentini.

²⁸ See text accompanying footnotes 16 through 68 of ICI's April 17 Letter, in addition to the letters described in footnote 2, *supra*.

²⁹ The Department itself observes that "[t]he illustration is incomplete because it represents only one negative effect (poor mutual fund selection) of one source of conflict (load sharing), in one market segment (IRA investments in front-load mutual funds)." 82 Fed. Reg. 12319, at 12320 (March 2, 2017).

³⁰ See 2016 RIA at pp. 96-97. Significantly, the 2016 RIA makes clear that the studies that it relied on in concluding that broker-sold funds "underperform" found no correlation between revenue sharing and/or 12b-1 fees and poor performance. In fact, as already acknowledged by the Department, the primary study upon which it relies concludes the opposite. See 2016

that brokers who receive those fees have been providing to investors (for example, through the greater availability of guidance, diverse product offerings, educational tools, and information generally). The Department then should have weighed the harm of investors losing the valuable advice that brokers provide under a commission-based model against any potential benefit from reducing potential conflicts. The 2016 RIA's one-sided perspective creates a significant gap in the Department's analysis that the Department must remedy.

Beyond the obvious limitations of such a one-sided analysis, there is a fundamental flaw in the Department's math from which it draws its conclusion of investor harm. As we explained, the Department's 2015 and 2016 RIAs rely heavily on results from an academic study by Christoffersen, Evans, and Musto (2013) (CEM). Using a key coefficient in the CEM study, the 2015 and 2016 RIAs concluded that the benefits of the fiduciary rule could reach approximately \$33 billion to \$36 billion over a 10-year period. As we have previously indicated, however, the Department's estimated benefits calculation (*i.e.*, \$33 billion to \$36 billion over a 10-year period) embodies a mathematical error, which causes the Department to overstate its benefit estimates by about 15 to 50 times.

We also have illustrated the Department's mistake by a simple analogy to a researcher studying the relationship between life expectancy and excess weight. Controlling for height, age, and gender, the researcher plots predicted weights for the adult population. The researcher finds that for every 10 pounds of "excess" weight—weight above the predicted normal weight given height, age, and gender—an individual's life expectancy falls by 0.5 years. Thus, if the predicted normal weight for a 50-year-old man who is 6 feet, 3 inches tall is 195 pounds, a 50-year-old man of that height who weighs 205 pounds could lose an estimated six months (0.5 year) of life due to "excess" weight.

Now, the researcher wants to show how much a government program encouraging people to lose "excess" weight could expect to add to individuals' lives. To form this estimate, the researcher multiplies the man's full weight (205 pounds) times the variable for the impact of "excess" weight on life expectancy (0.5 year per 10 pounds). This is inappropriate because the life-expectancy variable was calculated as the impact of "excess" weight—not total weight. The researcher erroneously concludes that the government program could add 10.25 years (*i.e.*, $(0.5/10) \times 205$) to the individual's life, overstating the true effect (0.5 years) by more than 20 times. This error, which is eminently clear, is entirely analogous to how the 2015 and 2016 RIAs misapplied the CEM results, leading the RIAs to massively overstate any potential benefits from the rule. Had the Department corrected for this mistake, it would have concluded that the net benefits from the rule are approximately zero.

RIA at pp. 176-177 (Christoffersen, Evans, and Musto "find load sharing, but not revenue sharing, to predict poor performance").

What is new is that in the 2016 RIA the Department indicated that it had not corrected this mathematical error,³¹ and in fact, implicitly admitted that it did not understand its mistake.³²

As is required of any agency presented with record evidence demonstrating that its prior analysis and conclusions were wrong in relevant part, the Department is *obligated* to reconsider its earlier work and is *prohibited* from relying on it.³³ ICI has offered irrefutable analysis showing that the Department's previous assessment of the rule's benefits was flawed; it was based on a mathematical error—easily noted and easily fixed. To the extent the Department considers the rule's benefits in deciding whether and what modifications to make, the Department may not rely on demonstrably flawed conclusions, since that would “run counter to the evidence before the agency,”³⁴ and would improperly “fail to respond to substantial problems raised by commenters.”³⁵ Therefore, the Department now must reconsider its flawed earlier conclusions regarding the rule's purported benefits for retirement investors.

³¹ See 2016 RIA at pp. 149-150 stating that “Comments on the 2015 NPRM Regulatory Impact Analysis suggest that DOL inappropriately interpreted results presented in some of the academic papers referenced in this section and other sections of the Regulatory Impact Analysis. Of course, data can be interpreted in a multitude of ways, and reasonable minds can disagree. However, DOL continues to strongly believe that readings contained in the 2015 NPRM Regulatory Impact Analysis and carried over into the current Regulatory Impact Analysis are the most appropriate interpretations of the studies given the available data.”

³² The 2016 RIA responded briefly to ICI's analysis of this math error (see 2016 RIA at p. 348, footnote 641). The Department states “For additional discussion of ICI's critique of the Department's use of CEM results, see Padmanabhan, Panis and Tardiff (2016),” a consultant study commissioned by the Department. See Padmanabhan, Karthik, Constantijn Panis, and Timothy J. Tardiff. “Review of Comments on the Department of Labor's Conflict of Interest Proposed Rule,” Advanced Analytical Consulting Group, 2016. This consultant study on page 35, footnote 39 spells out precisely this mathematical error in mathematical symbols. That footnote argues that the benefits calculation the Department used, based on the CEM study, measures changes in fund returns owing to the rule as $\Delta\text{return} = \beta\Delta\text{Load}$, where β is taken from the CEM study. As ICI's April 17 Letter proved, this formula is incorrect. The correct formula, is $\Delta\text{return} = \beta\Delta\text{Load} \times .071$, or more precisely still $\Delta\text{return} = \beta\Delta\text{Load} \times .071 \times 0.5$. This mistake causes the Department to overstate its benefits calculations by 14 to 28 times. When ICI applied the correct formula to actual data for 2013, we found that the Department had likely overstated its benefits calculations by approximately 15 to 50 times. See Appendix A of ICI's April 17 Letter for a detailed explanation of the arithmetic of how the Department misapplied the CEM model, how to correct that misapplication, and how the Department's misapplication creates a vast overstatement of any potential benefits from the rule.

³³ See pages 12-13 of ICI's July 21 Letter. It is well understood in this regard that the APA “makes no distinction...between initial agency action and subsequent agency action undoing or revising that action.” *FCC v. Fox Television Stations Inc.*, 556 U.S. 502, 514–15 (2009). Thus, when an agency changes course, it need only “adequately explain ... the reasons for a reversal of policy.” *Brand X*, 545 U.S. at 981. While an agency cannot “ignore ... or countermand ... its earlier factual findings without reasoned explanation for doing so,” by the same token, those earlier findings are not forever binding, and may be revisited and revised with an appropriate “reasoned explanation.” *Fox Television*, 556 U.S. at 537. Accordingly, it is sufficient under the APA if the Department identifies weaknesses in the factual analysis underlying the rule and details those weaknesses and its reasons for a new assessment.

³⁴ *Bus. Roundtable v. SEC*, 647 F.3d 1144, 1149 (D.C. Cir. 2011).

³⁵ *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto Ins. Co.*, 643 U.S. 29, 43 (1983).

Appendix C: The SEC and FINRA Provide Robust Oversight that Remediates Potential Investor Harm

Protecting investors -- including protecting holders of retirement accounts -- is a primary mission of both the SEC and FINRA. Both have jurisdiction to examine and investigate broker-dealers involved in the retirement market and to sanction any broker-dealer or their representative that engaged in unlawful conduct, including selling unsuitable products, making false or misleading statements, and failing to disclose material information. Both also are focused on broker-dealers' conflicts of interest. Through their inspection and enforcement teams, the SEC and FINRA are able to effectively police unlawful conduct in order to protect investors. The SEC maintains 11 offices throughout the United States in addition to its Washington, DC headquarters. FINRA maintains 16 offices throughout the United States, in addition to its Washington, DC headquarters.

The SEC's Office of Compliance Inspections and Examinations

The SEC's Office of Compliance Inspections and Examinations (OCIE) inspects registrants for compliance with the Federal securities laws and rules of FINRA. These inspections include both routine inspections, inspections focused on a specific topic, or examinations for cause, where the SEC has received information indicating the registrant may be violating the Federal securities laws. OCIE publishes an annual list of its examination priorities and, for the past few years, OCIE's priorities have included, as a primary focus, senior investors and retirement investors. As mentioned in the Institute's letter, OCIE's 2017 priorities include its "multi-year ReTIRE initiative, focusing on investment advisers and broker-dealers along with the services they offer to investors with retirement accounts." In terms of OCIE's statistics, during fiscal year 2016:¹

- OCIE conducted more than 2400 examinations of regulated entities, an increase of more than 20% over the prior fiscal year and the highest number in the preceding seven years;
- OCIE and FINRA, combined, have historically examined 50% of broker-dealers this year, which has enabled them to identify risks and protect investors.
- Through its examinations, OCIE has seen more than \$60 million returned to investors without the need for enforcement action and has referred approximately 200 cases to the SEC's Enforcement Division.
- OCIE has created an Office of Risk and Strategy to enable it to use big data to surveil registrants' conduct and to enable it to focus its activities on those firms that present the greatest risk to investors, including retirement investors.

¹ The SEC's fiscal year runs from October 1 through September 30. The statistics are available at: Summary of Performance and Financial Information, Fiscal Year 2016, SEC (2016) ("SEC Statistics"), which is available at: <https://www.sec.gov/files/2017-03/sec-summary-of-performance-and-financial-info-fy2016.pdf>.

The SEC's Division of Enforcement

The SEC's Division of Enforcement is charged with filing civil or administrative enforcement proceedings and making referrals for criminal prosecutions to sanction persons who have violated the Federal securities laws. In terms of numbers during fiscal year 2016:²

- The Division brought a record 868 cases, which was a 7% increase over the previous fiscal year and an 18.1% increase over the number of cases brought in the prior five years.
- The Division initiated 173 cases against broker-dealers, which represented approximately 20% of all Division cases for the year.
- In total, the Division obtained orders in judicial and administrative proceedings requiring the payment of over \$1.2 billion in civil penalties and over \$2.8 billion in disgorgement of profits. This is the third year in a row that the Division has been able to obtain more than \$4 billion in fines and disgorgements.

FINRA

FINRA is charged under the Securities Exchange Act of 1934 ("Exchange Act") with overseeing the activities of broker-dealers and their representatives and sanctioning such persons when they violate the Exchange Act or rules adopted under the Exchange Act, including rules adopted by FINRA. Among other things, FINRA's rules impose suitability standards on its members and a duty to deal fairly with investors. As noted above, FINRA's primary mission is to protect investors. In terms of statistics over FINRA's 2016 fiscal year:³

- FINRA conducted more than 4100 examinations of broker-dealers. As with examinations conducted by OCIE, these examinations included routine exams, exams targeted on a specific topic, and examinations based on an allegation that the broker-dealer or its representatives are violating the law.
- FINRA: brought 1434 disciplinary actions against broker-dealers; resolved 1093 formal actions; expelled 24 broker-dealers from the industry; suspended 26 broker-dealers; barred 517 individuals from working in the industry; and suspended 727 individuals from working for broker-dealer firms.
- Through its enforcement proceedings, FINRA levied more than \$204 million in fines and restitution.

² See SEC Statistics at footnote 1, *supra*.

³ See "Statistics," which is available on FINRA's website at: <http://www.finra.org/newsroom/statistics>.

- In addition to the enforcement proceedings it brought, FINRA also referred for criminal prosecution 785 cases involving fraud or insider trading.
- **As an example of FINRA’s commitment to senior investors, in March 2017, FINRA barred a registered representative of a broker-dealer for making unauthorized and unsuitable trades in the account of a 73-year-old retiree. making unauthorized and unsuitable trades totaling approximately \$15 million in the retiree’s account, and for misrepresenting the reasons for the trades. As noted by FINRA in bringing this action, “There is no place in this industry for brokers who take advantage of elderly customers. Protecting senior investors from predatory behavior such as unsuitable and unauthorized trading is part of our core mission and will always be a priority for FINRA.”**⁴

In addition to regulatory oversight at the Federal level under the Exchange Act, each state has a securities act that authorizes the state securities commissioners to inspect and, where appropriate, bring enforcement actions against Federally registered broker-dealers for unlawful and fraudulent conduct.

⁴ The FINRA press release announcing this action is available at [http://www.finra.org/newsroom/2017/finra-bars-rep-
unauthorized-trading-elderly-customers-retirement-account](http://www.finra.org/newsroom/2017/finra-bars-rep-
unauthorized-trading-elderly-customers-retirement-account).