THE COMMITTEE FOR THE FIDUCIARY STANDARD

September 15, 2017

Filed Electronically: EBSA.FiduciaryRuleExamination@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW, Suite 400
Washington, DC 20210
Attention: D-11712, 11713, 11850

Re: Definition of the Term "Fiduciary" –
Extension of Transition Period and Delay of Applicability Dates
RIN 1210-ZA28

Dear Sir or Madam:

This comment letter is respectfully submitted on behalf of the Steering Group of The Committee For The Fiduciary Standard ("the Committee") (www.thefiduciarystandard.org). The Committee, consisting of over 1,000 members via LinkedIn, is led by a volunteer Steering Group of practitioners and financial and investment experts. The Committee seeks to inform and nurture a public discussion on the bona fide fiduciary standard of conduct as applied to the delivery of investment and financial advice. This comment letter addresses both the proposal for a further 18-month addition, until July 1, 2019, of the Transition Period for the Best Interest Contract Exemption ("BIC Exemption") and the Principle Transactions Exemption, and certain amendments to PTE 84-24.

The Committee strongly supports Department of Labor's (DOL's) Conflict of Interest (Fiduciary) Rule (a.k.a. the "Final Rule") and strongly oppose the Proposal to Delay the Final Rule's applicability date. Furthermore, we oppose new exemptions to the Conflict of Interest Rule.

In particular, we believe:

(1) Government has a beneficial role to play in establishing appropriate standards of conduct for American Business.

(2) If adequately enforced, the benefits of the Conflict of Interest Rule to American business and to the U.S. economy, are extremely robust. The U.S. Department of Labor should consider such benefits through a robust economic analysis prior to any further rulemaking, as required by law.

(3) Financial advisers are confused as to the potential availability of private rights of action.

(4) Proper enforcement of the Conflict of Interest Rule is required to change the "buyer beware" sales culture of much of the financial services industry to a

culture that fully embraces fiduciary accountability when personalized advice is provided.

(5) The Conflict of Interest Rule, with its "Impartial Conduct Standards," succinctly sets forth the fiduciary principles as applied under ERISA.

(6) Dangers are inherent in any enactment of specific rules that form the basis for the "disintegrating erosion"[2] of particular exceptions to the application of the fiduciary principles.

(7) The U.S. Department of Labor should proceed with implementation of the Conflict of Interest Rule and related Prohibited Transaction Exemptions, without further delay, and in particular with the requirements of a written acknowledgment of fiduciary status as well as a contractual obligation to adhere to the fiduciary standard and the impartial conduct standards.

(8) The U.S. Department of Labor should express to all financial and investment advisory firms and their advisers that the impartial conduct standards are already in effect and will be enforced, and that neither firms nor their advisers should seek to operate in a "gray area" rather than adhere to the fiduciary principle.

In the paragraphs that follow we elaborate on these observations and recommendations.

1. Government has a beneficial role to play in establishing appropriate standards of conduct for American business.

In the Federalist Papers #51, James Madison famously wrote: "[W]hat is government itself, but the greatest of all reflections on human nature? If men were angels, no government would be necessary."

Government has long imposed thoughtful regulation to protect American business from harm by other American business. This is not favoritism. Rather, it is the imposition of standards of business conduct designed to foster the better accomplishment of commerce in a civil society. Our society, in this age of increasing specialization and complexity, must adopt higher standards for the safety of those engaged in commerce. In particular, government has a role to play in the regulation of the business conduct of those who profess to provide "advice" and "consulting services" to plan sponsors (i.e., business owners, both large and small).

While one might think that providers of advice on investments would be held to an appropriate standard of care, the broker-dealer "self-regulatory organization" – FINRA – has adopted for many decades the "suitability" standard. The suitability standard was originally developed to relieve brokerage firms from liability for executing trades at customer's instructions. Yet, over time, the application of the suitability standard was greatly expanded, including its application to recommendations made of investment managers (i.e., mutual funds, other pooled investment vehicles, etc.). Hence, under this extremely low standard the providers of investment recommendations were free to operate free of the standard of care which nearly all other providers of services are held to.

To better ensure the retirement security of all Americans, and to secure other major benefits (to American businesses, and to the U.S. economy as a whole), the DOL finalized the "Conflict of

Interest Rule." This was a long-overdue correction to the standard of conduct applicable to those who provide investment advice to investors holding accounts that possess tax-favored status.

2. If adequately enforced, the benefits of the Conflict of Interest Rule to American business and to the U.S. economy are extremely robust. The U.S. Department of Labor should consider such benefits through a robust economic analysis prior to any further rulemaking, as required by law.

Inconsistent and ineffective regulation of advice deals long-term damage to not only individuals but to the economy. At an individual level, systemic conflicts of interest result in excessive costs to consumers, prevent investors' best interests from being served, and inflict reputational damage to financial advisors who are deprived of a consistent and undiluted standard for their profession. Collectively, these individual harms translate to not only a breakdown of trust in the marketplace but also a diversion of capital from more productive uses in the economy.

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

Many economic studies have demonstrated that Wall Street's excesses and short-cuts for immediate profitability advantages impair sustainable U.S. economic growth and the formation of new businesses and jobs. As just one example:

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

From a Brookings Institute report by William A. Galston and Elaine C. Kamarck.

The Department speculates that much of the benefit of the Final Rule has been seen. Yet, without more robust mechanisms, compliance with the Final Rule and its fiduciary standard of conduct remains poor.

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

3. Financial advisers are confused as to the potential availability of private rights of action.

Some firms and/or their advisers currently believe that no mechanism exists for enforcement of the Final Rule. Indeed, without an express contractual term, variances in state common law may negate, in some states, the enforcement of the Final Rule through private rights of action.

Under state common law, there is a general principle of contract law that a party is required to comply with the law in the performance of their contractual obligations. In essence, compliance with the law (in this case, the Final Rule) may become an *implied term* of an *express contract.* However, in many states this legal principle has not been fully developed. Questions exist as to whether the Final Rule fits into this category.

In addition, under state common law fiduciary status for the provider of advice may exist when a relationship of trust and confidence exists between the adviser and the client. However, again state common law has not fully developed in this area as to the application of this principle to investment advisers; there are significant differences among the states as to when fiduciary standards will be applied. There do exist a few court decisions that indicate that when fiduciary status is applied by law (such as under the Investment Advisers Act of 1940), fiduciary status under state common law will follow; again, however, the number of reported decisions in this area are small.

In addition, many disputes between brokers and/or SEC-registered investment advisers (and some state-registered investment advisers) are subject to mandatory arbitration, often under FINRA rules. Given FINRA's opposition to the DOL rule, application of fiduciary status is further cast in doubt.

In summation, the lack of a requirement that the financial services firm and its advisers will adhere to the fiduciary standard, in the written contract between the firm and client, has created the situation where firms may seek to ignore the law. Accordingly, there is a danger that the application of fiduciary status will vary depending upon the forum into which the dispute is handled and the state law that applies.

4. Proper enforcement of the Conflict of Interest Rule is required to change the culture of much of the financial services industry.

We have further observed that many financial services firms continue to adopt an attitude of "what can we get away with under the Conflict of Interest Rule and its exemptions." This is not a fiduciary mindset, nor is it proper adherence to the fiduciary principle.

Without proper enforcement of the Conflict of Interest Rule, many firms and advisers will continue to fail to understand what acting in the client's "best interests" truly means. They will fail to ask: "What should we do for the benefit of our client." Instead, they may continue to seek to maximize their own sales results at the expense of their clients' success.

Moreover, given the fact that many clients do not pursue independent claims against financial advisers for harm done to the clients, it appears altogether necessary that individual investors not be foreclosed out of participation in class action claims. Otherwise, the result will be a situation in which "bad actors" in the financial services industry will continue their existing practices, and then settling or otherwise resolving the rare filed claim as a "cost of doing business." Simply put, the private action enforcement tiger needs to have its teeth.

The change from a sales culture to a fiduciary culture will not occur in the financial services industry without a robust enforcement of the Final Rule, with the Department emphasizing the requirements of the fiduciary principle at every opportunity.

5. The Conflict of Interest Rule, with its "Impartial Conduct Standards," succinctly and adequately sets forth the fiduciary principle as applied under ERISA.

The 237 words that form the DOL's "Impartial Conduct Standards" lie at the heart of the DOL's "Conflict of Interest" (Fiduciary) Rule. Like Madison, the DOL recognized in the Final Rule that some government is necessary. And the Final Rule imposed upon financial advisers to retirement accounts a simple, elegant solution - adhere to the fiduciary principle, and act in the best interests of your clients. The Department is well aware of, and has previously identified, the substantial, compelling, and even overwhelming economic evidence and public policy considerations that support the implementation of the Impartial Conduct Standards.

Given the substantial protections the Impartial Conduct Standards afford to individual investors and to plan sponsors, the other requirements set forth in the various Prohibited Transaction Exemptions (PTE's) might well be redundant or unnecessary. Indeed, it is possible that only one, short PTE should exist – in which as a condition of engaging in transactions with clients, the firm and its advisers are required:

(1) to adhere to the Impartial Conduct Standards;

(2) to state in their firm-client contract that the Impartial Conduct Standards are applicable;

(3) to agree that the Impartial Conduct Standards are non-waivable by the client nor disclaimable by either the firm or its advisers.

Additionally, firms should not be permitted to include, as a contractual provision, any statement that would negate the right of individual investors to pursue a claim through class action litigation.

6. Dangers are inherent in any enactment of specific rules that form the basis for particular exceptions to the application of the fiduciary principle.

Each time the U.S. Department of Labor allows for an exemption or exception to the application of the fiduciary principle, firms are tempted to maximize the use of such exemption or exception. In essence, despite the Department's caution that the Impartial Conduct Standards must be complied with, as well, firms seek to use any exemption or exception broadly.

For example, financial services firms have adopted practices to "levelize" compensation under the Best Interests Contract Exemption. Yet, they exclude from their platforms (i.e., the products they approve for recommendation to clients) lower-cost investments, often in favor of higher-cost investments that make payments for shelf space to the brokerage firm. These firms overly rely upon the "particular exceptions" to the fiduciary principle, which the late Justice Benjamin Cardoza so aptly warned against so long ago.[1] The result is not in accord with the fiduciary principle itself, as the best interests of the client may be subordinated to the desire of the firm for greater compensation.

Additionally, the U.S. Department of Labor has provided guidance to firms on what is often called the "education exemption" (i.e., when group education does not arise to the level of an individual advice). As seen in many of the comments letters recently filed with the Department, there exists a robust effort to further expand the boundaries of what constitutes "education."

The Department should resist the call to either expand the current exemptions or to narrow the definition of "recommendation" under the Final Rule. The Department should also not proceed down the path of creating new exemptions. For there is a real danger that the fiduciary principle will be further abrogated by particular exceptions, and that such exceptions will swallow the rule itself.

7. The U.S. Department of Labor should proceed with implementation of the Conflict of Interest Rule and related Prohibited Transaction Exemptions, without further delay, and in particular with the requirements of a written acknowledgment of fiduciary status as well as a contractual obligation to adhere to the fiduciary standard and the impartial conduct standards.

Without full implementation and robust enforcement of the Final Rule, many firms will choose to do the very minimum they believe necessary to comply with the rule. They will continue to operate, effectively, as product distributors, and not as trusted, expert, fiduciary advisers.

As a result, the full benefits of the Final Rule – to retirement investors, to American business owners, and to the U.S. economy – will not only fail to be realized, but will add to the confusion in the marketplace among individual investors who are saving and investing for their future retirement needs.

[1] *See Meinhard v. Salmon*, 164 N.E. 545 (N.Y. 1928), in which Justice Cardoza stated: "Many forms of conduct permissible in a workaday world for those acting at arm's length, are forbidden to those bound by fiduciary ties. A trustee is held to something stricter than the morals of the market place. Not honesty alone, but the punctilio of an honor the most sensitive, is then the standard of behavior. As to this there has developed a tradition that is unbending and inveterate. Uncompromising rigidity has been the attitude of courts of equity when petitioned to undermine the rule of undivided loyalty by the "disintegrating erosion" of particular exceptions. Only thus has the level of conduct for fiduciaries been kept at a level higher than that trodden by the crowd. It will not consciously be lowered by any judgment of this court." *Id.* at 546.

8. The U.S. Department of Labor should express to all financial and investment advisory firms and their advisers that the impartial conduct standards are already in effect and will be enforced, and that neither firms nor their advisers should seek to operate in a "gray area" rather than adhere to the fiduciary principle.

Since June 9, 2017, when the Final Rule became effective, we have continued to observe that some firms have chosen to operate in the "gray area" – rather than seek to adhere to the fiduciary principle.

Rather than assure firms that enforcement will be "light," and rather than leaving firms in the gray area of state common law, the Department should ensure that the fiduciary standards applied through the Impartial Conduct Standards are clearly enforceable.

Without a robust means of enforcement via investor rights to pursue class action claims, and by the resources of the Department of Labor itself, firms may view the potential gains from not complying with the rule (and selling expensive and inappropriate investments to their customers) as far greater than any costs they may incur.

The Department should not further delay the operation of the Final Rule, and especially its requirement for contractual acknowledgement of the fiduciary obligations of the firm and its advisers. Rather, the Department should clearly and repeatedly remind firms and their advisers of their obligations under the Final Rule. Only with a stalwart approach to application and enforcement of the Final Rule will a culture of fiduciary responsibility be adequately promoted within that segment of the financial services industry that professes to dispense competent and trustworthy advice.

In Conclusion.

In conclusion, the Committee for the Fiduciary Standard opposes any further delay in the applicability of portions of the Final Rule. We further caution against the creation of further "particular exceptions" to the fiduciary principle. We also urge the Department to speak out forcefully that the fiduciary standard of conduct, as applied through the impartial conduct standards, is not only in effect but will be robustly enforced.

The members of the Steering Group stand ready to provide further analysis to the Department in the months ahead. We appreciate this opportunity to provide input, and greatly respect the past efforts of the Department to ensure greater retirement security for all Americans, protections for American businesses, and the enactment of policies that will lead to greater U.S. economic growth in the years and decades to come.

Respectfully submitted,

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