



April 17, 2017

Office of Regulations and Interpretations  
Office of Exemption Determinations  
Employee Benefits Security Administration  
U.S. Department of Labor  
200 Constitution Avenue, N.W.  
Washington, D.C. 20210

Re: Definition of the Term "Fiduciary" – Reexamination of Rule and Delay of Applicability Date, RIN 1210-AB79

Ladies and Gentlemen:

On behalf of Americans for Financial Reform, we are writing to express our support for the Department of Labor's (DOL's) conflict of interest rule or "Fiduciary Duty" rule and our strong opposition to eliminating or weakening the rule.<sup>1</sup> This rule strengthens protections for retirement savers by requiring individuals or entities which provide retirement investment advice to act in the best interests of their clients. Eliminating or weakening these new protections would allow those who provide retirement advice to continue to engage in harmful practices that threaten the retirement security of tens of millions of Americans.

The White House has issued a Presidential Memorandum asking you to reconsider the rule in light of the following considerations:

(i) Whether the anticipated applicability of the Fiduciary Duty Rule has harmed or is likely to harm investors due to a reduction of Americans' access to certain retirement savings offerings, retirement product structures, retirement savings information, or related financial advice;

(ii) Whether the anticipated applicability of the Fiduciary Duty Rule has resulted in dislocations or disruptions within the retirement services industry that may adversely affect investors or retirees; and

(iii) Whether the Fiduciary Duty Rule is likely to cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services.

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<sup>1</sup> Americans for Financial Reform is an unprecedented coalition of over 250 national, state and local groups who have come together to reform the financial industry. Members of our coalition include consumer, civil rights, investor, retiree, community, labor, religious and business groups. A list of our members is available at <http://ourfinancialsecurity.org/about/our-coalition/>

The memorandum also states that the rule must be found to be consistent with the Administration’s priority to “empower Americans to make their own financial decisions, to facilitate their ability to save for retirement and build the individual wealth necessary to afford typical lifetime expenses”.

We submit that no objective examination of the rule in light of these considerations and priorities could lead you to rescind the rule or revise it to weaken the protections it provides.

The DOL has already conducted a multi-year examination of the harms and benefits to investors from the rule, the possible costs and impacts of implementation, and the extent to which the rule facilitates retirement savings and empowers investors. These are the very questions posed by the White House Memorandum. This examination led to a thorough and extensive Regulatory Impact Analysis (RIA). This RIA was approved by the Office of Management and Budget (OMB), and the RIA and the accompanying Conflict of Interest Rule have now survived challenges in three different Federal district courts.

After reviewing and analyzing an extensive research base, the RIA finds that conflicts of interest in retirement advice lead to tens of billions of dollars in investor losses each year. The DOL review and analysis estimated that IRA holders receiving conflicted investment advice can expect their investments to underperform by an average of 50 to 100 basis points per year over the next 20 years. Based on this evidence, the DOL concluded that the underperformance associated with conflicts of interest in the mutual funds segment alone is likely to cost IRA investors between \$95 billion and \$189 billion over the next 10 years and between \$202 billion and \$404 billion over the next 20 years. An ERISA plan investor who rolls her retirement savings into an IRA could lose 6 to 12 and possibly as much as 23 percent of the value of her savings over 30 years of retirement by accepting advice from a conflicted financial adviser. In contrast to the harms to investors created by leaving advisors free to act on conflicts of interest, the RIA estimates that the costs of implementing the rule will sum to between \$10 and \$31.5 billion over ten years, with a primary estimate of \$16.1 billion. This cost is dwarfed by the estimated harm to investors created by the conflicts of interest targeted in the rule.

The measured harm to retirement savers from conflicts of interest would be far greater if the complete range of conflicts of interests that influence advisers’ investment recommendations could be fully quantified based on available evidence. For example, the RIA estimate cited above includes only mutual fund products and not fixed indexed or variable annuities, a market segment notorious for its complexity and potential pitfalls for investors.<sup>2</sup> The estimate also excludes losses to plan participants, but there is extensive evidence that losses occur in this areas as well. The RIA pointed to a GAO study, which found that defined benefit pension plans using consultants with undisclosed conflicts of interest earned 1.3 percentage points per year less than other plans. Other recent research supports this finding, including in defined contribution plans.

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<sup>2</sup> Conrad de Aenlle, Annuities Not For Everyone, But They Have A Place, New York Times, Mar. 12, 2014. Available at [http://www.nytimes.com/2014/03/13/business/retirementspecial/annuities-notfor-everyone-but-they-have-a-place.html?\\_r=0](http://www.nytimes.com/2014/03/13/business/retirementspecial/annuities-notfor-everyone-but-they-have-a-place.html?_r=0)

For example, a recent study by the Center for Retirement Research at Boston College found that mutual fund companies involved in plan management often act in ways that appear to advance their interests at the expense of plan participants.<sup>3</sup> Another recent study published in the Yale Law Journal found that a significant portion of 401(k) plans establish investment menus that predictably lead investors to hold high-cost portfolios. Using data from more than 3,500 401(k) plans with more than \$120 billion in assets, the authors found that fees and menu restrictions in an average plan lead to a cost of seventy-eight basis points in excess of index funds. The authors also documented a wide array of “dominated” menu options -- funds that make no substantial contribution to menu diversity but charge fees significantly higher than those of comparable funds in the marketplace.<sup>4</sup>

The Conflict of Interest Rule directly addresses the problem of conflicted retirement investment advice in both the plan and IRA contexts by requiring all financial advisers who provide retirement investment advice to serve their clients’ best interest, not their own self-interest. Importantly, the rule applies this protection not only to individual investors, but also to employers operating small company plans and relying on financial institutions for advice on investment selection. While the rule clearly allows firms to charge commissions for this advice, firms would be required to ensure that charging in this way is consistent with the client’s best interest. The rule would require firms and advisers to charge no more than reasonable compensation based on the value of products and services provided. And, it would require firms to rein in their often toxic web of conflicts of interest that encourage and reward advice that is not in their clients’ best interest. As a result, the rule would better align advisers’ and their clients’ incentives and, ultimately, produce better outcomes for both.

The notion that strengthening advisor requirements to act in investor’s best interest will harm investors by restricting investor choice is deeply misguided. Permitting advisors to engage in misleading sales pitches for investments that are not in the customer’s interest benefits only the seller, not the investor. Many investors lack the financial expertise necessary to determine which investment options are best for them or to detect when their financial adviser is acting against their best interests. On a recent survey that tested investor knowledge, for example, only 10% of respondents were able to answer eight of ten questions correctly, while a majority (56%) answered fewer than half of the questions correctly.<sup>5</sup>

Faced with the complexity of investment choices, working families saving for retirement naturally turn to advice from professionals. But such professionals frequently misrepresent themselves as trustworthy advisors when they are simply engaged in a sales process. As a recent study by Consumer Federation of America and Americans for Financial Reform clearly

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<sup>3</sup> Pool, Veronika K, Clemens Siale, and Irina Stefanescu, “Are 401(k) Plan Investment Menus Set Solely For Plan Participants?”, Center for Retirement Research, Boston College, August, 2015. Available at [http://crr.bc.edu/wp-content/uploads/2015/08/IB\\_15-13.pdf](http://crr.bc.edu/wp-content/uploads/2015/08/IB_15-13.pdf)

<sup>4</sup> Ayres, Ian and Quinn Curtis, “Beyond Diversification: Excessive Fees and Dominated Funds in 401(k) Plans”, Yale Law Journal, Volume 124, Number 5, March 2015. Available at <http://www.yalelawjournal.org/article/excessive-fees-and-dominated-funds-in-401k-plans>

<sup>5</sup> FINRA Investor Education Foundation, Investors in the United States 2016, Dec. 2016 <http://bit.ly/2hMrppX>

documented, many broker-dealers and insurance agents providing non-fiduciary sales recommendations portray themselves to customers as financial advisors, not salespeople and encourage customers to rely on them as trusted fiduciary advisers.<sup>6</sup> Surveys have found that investors believe this representation and already believe those providing them retirement advice have a duty to act as fiduciaries.<sup>7</sup> Not only do investors expect that fiduciary duties are already in place, they also overwhelmingly favor a requirement to place customer interest first.<sup>8</sup>

The rule directly addresses the issue of non-fiduciary advisers taking advantage of investor misperceptions to deliver misleading advice by requiring all financial professionals to operate as the fiduciary advisers they consistently market themselves to be. This common-sense requirement simply aligns the legal duties of those providing retirement investment advisers with the existing perception and representations in the marketplace.

The powerful special interest groups that oppose this rule are trying to re-open the debate by suggesting that the rule will deprive smaller savers of access to advice or driving up the cost of advice. But they ignore substantial evidence that the rule is having the opposite effect.<sup>9</sup> Contrary to industry predictions, a number of firms have chosen to implement the rule through commission accounts, proving that this is a workable option. Others have chosen to move more accounts to fee accounts, but have reduced account minimums to a level that makes this option available to even the smallest accounts and reduced the fees they charge at the same time. For example, Edward Jones and LPL announced shortly after the DOL rule was finalized that they would lower the minimums on their fee accounts, to \$5,000 and \$10,000 respectively.<sup>10</sup> Schwab just announced a new advisory program with a minimum initial investment of \$25,000, all-in-costs between 0.36% and 0.52%, and comprehensive financial and investment planning from a CFP professional.<sup>11</sup> Claims that fear of liability would cause large numbers of firms to exit the market or abandon smaller accounts, have proven to be untrue.

An even more dramatic demonstration of the ways in which even the prospect of this rule has improved outcomes for investors is provided by innovative new product lines that promise to transform commission accounts into an attractive option for investors. For example, the Securities and Exchange Commission recently approved a proposal from Capital Group to create

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<sup>6</sup> Micah Hauptman and Barbara Roper, Financial Advisor or Investment Salesperson? Brokers and Insurers Want to Have it Both Ways, Jan. 18, 2017 <http://bit.ly/2jKUbFD>

<sup>7</sup> Angela A. Hung et al., “Investor and Industry Perspectives on Investment Advisers and Broker-Dealers”, Rand Institute for Civil Justice, 2008.

<sup>8</sup> See for example S. Kathi Brown, AARP Research, “Attitudes Toward the Importance of Unbiased Financial Advice” May 2016, available at <http://www.aarp.org/research/topics/economics/-2016/attitudestoward-unbiased-financial-advice.html>

<sup>9</sup> Consumer Federation of America, “The Department of Labor Conflict Of Interest Rule Is Already Delivering Benefits to Workers and Retirees”, Fact Sheet, January 31, 2017, available at [http://consumerfed.org/wp-content/uploads/2017/01/1-31-17-DOL-Rule-Delivering-Benefits\\_Fact-Sheet.pdf](http://consumerfed.org/wp-content/uploads/2017/01/1-31-17-DOL-Rule-Delivering-Benefits_Fact-Sheet.pdf)

<sup>10</sup> <https://www.wsj.com/articles/brokerages-adapt-to-pending-labor-rule-1458151260>

<sup>11</sup> Charles Schwab Corporation, “Schwab Announces Schwab Intelligent Advisory”, Press Release, December 13, 2016. Available at <http://pressroom.aboutschwab.com/press-release/schwab-investor-services-news/schwab-announces-schwab-intelligent-advisory>

a new class of mutual fund shares for its American Funds that will greatly ease compliance with the DOL rule while preserving investors' ability to get commission-based advice.<sup>12</sup> The approved "clean shares" will allow the broker, rather than the fund, to determine how much to charge for their services. By allowing brokers to separately price commissions, just as they do when recommending ETFs and individual securities, these shares make it easier for firms to adopt compensation policies that pay standardized amounts across different funds and different investments, eliminating the conflicts that are the target of the DOL rule without eliminating commission-based advice. They also allow advisers to succeed and prosper based on the cost and quality of their services and products rather than on how much they are being paid by third parties to recommend particularly investments.

In addition, many other fund firms are responding to the DOL rule by issuing T shares that both dramatically reduce the commissions for broker-sold funds and reduce the compensation-related conflicts associated with those funds. With T shares carrying a maximum sales load of 2.5 percent, compared with an industry standard for A shares of 4.75 percent (and as high as 5.75 percent), and 12b-1 fees of just 25 basis points, all but the very wealthiest investors will also benefit from the dramatic reduction in cost.<sup>13</sup> Indeed, Morningstar's John Rekenhaller notes, these shares have the potential to exert downward pressure on investment advisers' asset-based fees as well, as advisers seek to remain cost competitive.<sup>14</sup> And a number of major firms, including Schwab, Blackrock, Fidelity and Prudential, among others, have announced plans to reduce costs on certain investment products, such as ETFs and mutual funds, at least in part to be more competitive under the DOL rule.<sup>15</sup>

Nor can the DOL justify revisions to the rule based on market disruptions that are an inevitable result of implementing a rule of this significance. Such market disruptions and implementation costs were taken into account in the cost-benefit analysis supporting the original rule, and found to be far less than the benefits gained from the rule. Industry has every incentive to claim that investor-friendly innovations in practices spurred by the best interest mandate, such as those referred to above, are harmful "market disruptions". The DOL must not be deceived by this rhetorical trick. It is because conflicts of interest are so pervasive, and industry practices that encourage conflicted advice are so ingrained, that firms are being forced to change their practices. The mere presence of implementation costs or changes in the market cannot be used as a justification for overturning a rule that was clearly intended to change industry practices, and

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<sup>12</sup> John Waggoner, "American Funds gets SEC approval for clean shares," Investment News, Jan. 13, 2017, available at <http://www.investmentnews.com/article/20170113/FREE/170119955/american-funds-gets-sec-approval-for-clean-shares>.

<sup>13</sup> Wealthy investors are able to qualify for "breakpoints" that bring down the costs on A shares, making them cost-competitive with T shares. Smaller investors do not enjoy that benefit.

<sup>14</sup> Rekenhaller, John, "Lower Cost T Shares Coming to A Fund Near You", Rekenhaller Report, Morningstar Beta, January 6, 2017, available at <http://beta.morningstar.com/articles/787395/lower-cost-t-shares-coming-to-a-fund-near-you.html>

<sup>15</sup> CFA, "The Department of Labor Conflict of Interest Rule is Already Delivering Benefits to Workers and Retirees" Fact Sheet, Jan. 31, 2017, available at [http://consumerfed.org/wp-content/uploads/2017/01/1-31-17-DOL-Rule-Delivering-Benefits\\_Fact-Sheet.pdf](http://consumerfed.org/wp-content/uploads/2017/01/1-31-17-DOL-Rule-Delivering-Benefits_Fact-Sheet.pdf).

where extensive analysis has shown that the costs of such changes are dwarfed by the long-term benefits to investors.

A final area of consideration concerns the question of whether the Fiduciary Duty Rule will create an increase in litigation and a related increase in the price customers pay for investment advice. We would emphasize here that private litigation is the major means for the enforcement of the Best Interests Contract Exemption (BICE) in the rule. In the absence of a litigation option, it can no longer be assumed that the terms of this contract will be followed by investment advisors. Without effective enforcement of the BICE the benefits to investors projected from the rule will be substantially reduced. Stripping the Conflict of Interest Rule of its major enforcement mechanisms would endanger the benefits to investors found in the regulatory analysis, and would not maximize the net benefits of the rule.

In considering any costs of litigation, it is also vital to understand that the bulk of the costs of litigation are not direct economic costs, but a transfer from sellers engaged in wrongdoing to investors who have been harmed by inappropriate investments. Not only are these transfers not economic costs, but the incentive effects of these transfers create positive economic benefits by inducing advisers to act in the best interests of investors, thus reducing economic losses due to principal-agent conflicts. It is true that there are some transaction and resource costs of litigation, but such costs were estimated in the RIA, and when correctly analyzed were found to be dwarfed by the benefits of the rule.

In sum, we urge you not to eliminate or weaken the Conflict of Interest rule based on the issues listed in the Presidential Memorandum. These issues were extensively examined in the recent Regulatory Impact Analysis of the plan, which has now been upheld in multiple court decisions. The full analysis of quantitative evidence in that analysis, including industry-submitted claims, supports the rule as written. The evidence of investor-friendly changes in industry practices since the rule was finalized does so as well. To weaken or eliminate the rule at this point would be a victory of industry lobbying and nakedly political considerations over evidence and analysis.

Thank you for the opportunity to comment on this reconsideration. Should you have any questions, please contact Marcus Stanley, AFR's Policy Director, at 202-466-3672 or [marcus@ourfinancialsecurity.org](mailto:marcus@ourfinancialsecurity.org).

Respectfully submitted,

Americans for Financial Reform