Fund Democracy
Consumer Federation of America
AARP
Americans for Financial Reform
Public Citizen's Congress Watch

October 18, 2013

The Honorable Sylvia Matthews Burwell
Director
Department of Management and Budget
725 17th Street, NW
Washington, D.C. 20503

Dear Director Burwell,

We are writing on behalf of Fund Democracy, Consumer Federation of America, Public Citizen's Congress Watch, AARP and Americans for Financial Reform to respond to and comment on certain statements made in a letter from members of Congress to the Office of Management and Budget dated August 2, 2013 ("Congressional Letter"). The Congressional Letter relates to the Department of Labor's intent to amend its interpretation of "investment advice" under ERISA in order to ensure that Americans are adequately protected when provided advice about their retirement accounts. We strongly support this long overdue initiative and encourage the OMB to expedite its review when it receives the Department's proposal.

In contrast, the Congressional Letter asks that OMB *delay* the Department's initiative pending fiduciary rulemaking by the SEC. It justifies this proposed action based on the unfounded argument that "uncoordinated efforts undertaken by the agencies could work at cross-purposes in a way that could limit investor access to education and increase costs for investors, most notably Main Street investors" who invest through Individual Retirement Accounts (IRAs). The Congressional Letter ignores assurances that the Department has provided that it will address legitimate industry concerns with regard to the rule's potential impact on retail accounts. Moreover, while the Letter bases its argument on the alleged impact of Department rulemaking on IRAs, its proposed "solution" would deprive all retirement accounts as well as traditional pension plans of the important benefits the Department's rulemaking will create. The Letter is suggesting nothing less than that the Department's ability to exercise its authority under ERISA should be bounded by the standards that the SEC may eventually adopt under securities laws. Its proposal must therefore be judged in this light.

The Congressional Letter's request to the contrary, there is no reasonable basis for delaying the Department's rulemaking until the SEC rulemaking is complete.[1] Such a delay would harm investors and further undermine Americans' already shaky retirement security. As discussed below, ERISA establishes different, higher standards for retirement accounts than those that apply under the federal securities laws. It would be inconsistent with the spirit and letter of ERISA to limit its standards based on standards established by the SEC.

We are most concerned regarding the Congressional Letter's implication that the fiduciary duties that apply under ERISA should be lowered to a securities law standard that is appropriate for general retail investment advice but not for advice regarding retirement assets. This proposition directly contradicts ERISA, which expressly, intentionally and appropriately imposes and has always imposed a higher fiduciary standard on providers of services to Americans with respect to the accounts on which they are relying for their retirement security. The SEC's ongoing initiative under the federal securities laws seeks to remedy a deficiency in the regulation of broker-dealers. We are dismayed by the suggestion that this purpose should be turned, instead, to compromising the protections that apply to retirement accounts.

ERISA's Higher Fiduciary Standard

We are particularly dismayed by the Congressional Letter's assertion that:

> Congress clearly intended that a single standard should apply to retail accounts, including retirement accounts, based on specific guidelines enumerated in Section 913 [of the Dodd-Frank Act].

We find no evidence to support this claim. Section 913, by its express terms, addresses only the legal standards that apply to broker-dealers and investment advisers under the securities laws. The purpose of Section 913 was to require the SEC to evaluate the regulation of broker-dealers and investment advisers under the securities laws and to authorize rulemaking on that subject. Section 913 was prompted by the anomaly that broker-dealers provide the same personalized investment advice to clients as investment advisers provide, but broker-dealers are subject to a lower suitability standard. There is nothing in the text of Section 913 or its legislative history that supports the view that it was intended to address fiduciary standards under ERISA.

Congress has, in fact, clearly and appropriately imposed a higher legal standard with respect to the accounts on which Americans rely for their retirement security than the standard that is imposed under the federal securities laws. An

[1] *See generally* Legislative Proposals to Relieve the Red Tape Burden on Investors and Job Creators, before the Subcommittee on Capital Markets and Government Sponsored Enterprises, Committee on Financial Services, United States House of Representatives (May 23, 2013) (testimony of Mercer Bullard).

ERISA fiduciary is required to act solely in the best interests of the ERISA client,[2] whereas a fiduciary under the securities laws is required only to act in the best interests of the client. The Supreme Court has specifically stated that "ERISA imposes higher-than-marketplace quality standards . . . , requiring a plan administrator to 'discharge [its] duties' in respect to discretionary claims processing 'solely in the interests of the [plan's] participants and beneficiaries.'"[3]

Under ERISA, fiduciaries are also explicitly prohibited from engaging in a wide range of transactions that are permitted, with adequate disclosure, for fiduciaries under the securities laws.[4] For example, ERISA fiduciaries are generally prohibited from engaging in principal transactions with their clients, whereas under securities law fiduciaries may do so with appropriate disclosure. These ERISA prohibitions establish a demonstrably higher standard than the standard imposed under the securities laws. Insurance agents, broker-dealers and investment advisers who are currently ERISA fiduciaries have been able to comply with these higher standards for years, including with respect to services provided to IRAs. The Congressional Letter asserts that the Department's original proposal would have "eliminated access to meaningful investment services for millions of IRA holders," but this assertion is contradicted by the fact that all types of financial professionals have ***for decades*** been complying with precisely the same rules that the Department's rulemaking would impose on new ERISA fiduciaries to IRAs.[5]

There is No ERISA "Conflict" with Securities Law

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[2] ERISA Section 404(a) requires, for example, that an ERISA fiduciary discharge its duties "solely in the interests of the participants and beneficiaries . . . with []care, skill, prudence, and diligence." Section 404(a) does not apply to most individual retirements accounts ("IRAs") because they are not employee benefit plans and therefore would not apply to IRAs under the Department's proposal.

[3] *Metropolitan Life Ins. Co. v. Glenn*, 554 U.S. 105, 106 (2008). *See* Lorraine Schmall, *Defined Contribution Plans after Enron*, 41 Brandeis L.J. 891 (2003) ("ERISA fiduciaries are held to a higher standard than are ordinary trustees") (quoting Susan J. Stabile, *Breach of ERISA Fiduciary Responsibilities: Who's Liable Anyway?* 5 Empl. Rts. and Employ. Pol'y J. 135 (2001)).

[4] Pension benefit plans are subject to the prohibited transaction rules in ERISA Section 406, unless exempt under Section 408 or one of the many exemptions granted by the Department. IRAs are subject to the prohibited transaction rules in I.R.C. Section 4975(c), which generally mirror the rules in ERISA Section 406.

[5] Some have criticized the Department's rulemaking on the ground that it "extends" ERISA's prohibited transaction rules to IRAs and thereby encroaches on the SEC's jurisdiction. In fact, there is no question that Section 4975(c) *already* applies to IRAs and those who currently qualify as fiduciaries with respect to IRAs. That includes many insurance agents and broker-dealers that are currently ERISA fiduciaries and are managing to serve their ERISA clients with IRAs in compliance with ERISA. The change that the Department proposes to make would expand the category of IRA fiduciaries that are subject to Section 4975(c).

It is also incorrect to imply that any Department proposal under ERISA would "conflict" with the securities laws. The original proposal included no conflict with the federal securities laws. Nor has any spokesperson for the Department made any statement that even suggests any such conflict. Nor has any commentator, to our knowledge, identified any possible conflict that the fiduciary rulemaking might create. The most recent *potential* conflict between a DOL rule and the rule of another agency (the CFTC) was quickly resolved before the CFTC rule became final.

Critics of the Department have adopted the term "conflict" to describe what is not a conflict at all, but rather a standard under ERISA that Congress decided should be higher than the parallel standard under the federal securities laws. The Department should, ***indeed must***, hold fiduciaries under ERISA to a higher standard than applies under the federal securities laws. This does not create a conflict in any meaningful sense, but simply reflects the higher standard the Congress decided to impose when investment assets are specifically intended for retirement and, not incidentally, subsidized through deferred tax collections.

Securities law and ERISA are different regulatory schemes because they should be different. The public interest in tax-subsidized employee benefit plans and IRAs is far greater than for securities investments in general. Investment regulation takes on greater importance in the context of retirement benefits, where losses resulting from misconduct have greater adverse individual and societal consequences than losses associated with securities investments generally. The Department's application of ERISA's fiduciary duty therefore should not be expected to conform to securities regulation, just as the SEC's application of the fiduciary duty under the securities laws should not be expected to conform ERISA's requirements. Each standard is appropriately designed to fit the context.

Retirement Accounts *Should* be Provided Greater Legal Protection

Indeed, it is difficult to understand how one could reasonably disagree with the proposition that services provided as to Americans' retirement assets should be held to a higher legal standard. Social Security is facing an actuarial shortfall, billions of dollars of municipal retirement obligations are unfunded, and Americans are living longer and not saving enough for retirement. At the same time, Americans are being encouraged to invest their retirement savings in high-risk hedge funds[6] and franchises.[7] The Department is doing what it should have done long ago; it is

[6] *See, e.g.*, Arleen Jacobius, *Carlyle brass: It's 'Unfair' to Deprive DC Investors of Private Equity Investments*, Pension & Investments (Sep. 26, 2013) *available at* http://www.pionline.com/article/20130926/DAILYREG/130929900/carlyle-brass-its-unfair-to-deprive-dc-investors-of-private-equity-investments?newsletter=daily&issue=20130926#utm_source=Newsletters&utm_medium=email&utm_campaign=P%26I%20Daily%20Plan%20Sponsor.

[7] *See, e.g.*, Rodney Brooks, *Using Your 401(k) or IRA to Start That Dream Business*, USA Today (Sep. 23, 2013) *available at*

repealing its own, extralegal narrowing of the meaning of investment advice to ensure that ERISA's fiduciary provision can do its job of protecting Americans' retirement security.

The Congressional Letter's implication that retirement assets should receive no more protection that any investment is striking in light of the most recent research on investment fraud. Earlier this month, FINRA released a study showing that 84 percent of Americans had been solicited with one of 11 types of blatantly fraudulent offers, with 11 percent losing a significant amount of money after engaging with an offer.[8] Forty-two percent of respondents found "claims of achieving 'typical' returns of 110% per year" appealing. Forty-three percent found claims of "fully guaranteed" investments to be appealing. In view of the stunning susceptibility of Americans to the most obvious forms of fraud, one can only imagine how likely they are to follow the advice of non-fiduciary investment professionals when investing for their retirement.

A GAO study released earlier this year documented fraud and abuse in precisely the kinds of transactions to which ERISA's fiduciary duty should apply.[9] The GAO found that call center representatives – employees of the most vocal opponents of the DOL proposal – "encouraged rolling 401(k) plan savings into an IRA even with only minimal knowledge of a caller's financial situation." Excerpts from GAO calls to representatives reveal a pattern of misconduct. Representatives claimed that 401(k) plans had extra fees and that their IRAs "had no fees,"[10] or argued that IRAs were always less expensive, notwithstanding that the opposite is

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http://www.usatoday.com/story/money/columnist/brooks/2013/09/23/retirement-entrepreneur-401k-pension/2833897/.

[8] Financial Fraud and Fraud Susceptibility in the United States, Applied Research and Consulting for FINRA Investor Education Foundation (Sep. 2013) *available at* http://www.finra.org/web/groups/sai/@sai/documents/sai_original_content/p337731.pdf. *See also* Investor Fraud Study Report, NASD Investor Education Foundation (May 12, 2006) *available at* http://www.sec.gov/news/press/extra/seniors/nasdfraudstudy051206.pdf.

[9] Labor and IRS Could Improve the Rollover Process for Participants, Government Accountability Office, GAO-13-30 (March 2013) ("GAO Report") *available at* http://www.gao.gov/assets/660/653506.txt. *See also* Conflicts of Interest Can Affect Defined Benefit and Defined Contribution Plans, Government Accountability Office, GAO–09–503T (Mar. 24, 2009) *available at* http://www.gao.gov/new.items/d09503t.pdf.

[10] "Finally, misleading statements also make it difficult to understand IRA fees. Calls made by our investigator to 401(k) plan service providers, most of which offer IRA products, found that 7 of 30 call center representatives (representing firms administering at least 34 percent of IRA assets at the end of the 1st quarter in 2011) said that their IRAs were 'free' or had no fees with a minimum balance, without clearly explaining that investment, transaction, and other fees could still apply, depending on investment decisions. In our review of 10 IRA websites, we found 5 providers that made similar claims, often with certain conditions such as a $50,000 minimum balance or consent to receive electronic statements explained separately in footnotes." GAO Report, *supra* (footnotes omitted).

generally true: IRAs are *more* expensive for investors, on average, than 401(k) plans. Broker-dealers routinely hold themselves out as fiduciaries – the same standard that their employers do not want to have to meet in practice. The GAO study showed that providers of 401(k) plans undercut *their own plans* in order to push their higher-cost IRA options on unsuspecting investors. These studies suggest that, rather than seeking to undermine legal protections for Americans' retirement accounts, Congress should be seeking to strengthen them.

Investors' vulnerability to fraud is most acute, and the need for fiduciary protection is greatest, in the context of retail accounts, such as IRAs, that are subject to ERISA. One reason is that retail accounts are provided less protection than employee benefit plans under ERISA because they are not subject to section 404's heightened fiduciary standard[11] (and would continue to be exempt under the Department's proposal). Another reason is that retail retirement accounts lack the buffer provided by the employer in an employee benefit plan. Unlike salespersons, employers generally do not have the substantial conflicts of interest and economic stake in fees paid in connection with employees' investments (with the exception of employer stock). A committee of fiduciaries selected by the employer chooses the plan's investment options and generally negotiates lower fees than those charged in IRAs. In contrast, as the GAO has confirmed, some broker-dealers advise retirees to rollover their 401(k) plan assets into higher cost IRAs that directly benefit the broker-dealer. The broker-dealers that would be subject to a fiduciary duty under the Department's proposal have significant conflicts of interest and economic incentives to act in their own best interests rather than their clients'. Retail accounts therefore are in *greater* need of protection under the corrected interpretation of "investment advice" that the Department expects to propose.

We recognize that the prohibited transaction rules of ERISA, especially as applied to small, retail accounts, raise legitimate concerns for financial services professionals. However, this has been true for many years in a wide range of circumstances that the Department has successfully addressed by granting appropriate exemptions. The Department has a long history of appropriately accommodating business practices, consistent with the protection of Americans' retirement accounts, through carefully tailored prohibited transaction exemptions, known as "PTEs." Assistant Secretary Borzi has specifically noted that such exemptions require a finding that they are in the best interests of investors and stated unambiguously that "[w]e think that there are types of compensation that would otherwise be prohibited under a flat prohibition that we will be able to make that finding for."[12] She has repeatedly made it clear that there will be PTEs in the

[11] *See supra* note 2.
[12] Diana Britton, *Borzi Hints at Exemptions to DOL Fiduciary Rule*, WealthManagement.com (Apr. 29, 2013) *available at* http://wealthmanagement.com/imca-2013-annual-conference/borzi-hints-exemptions-dol-fiduciary-rule/.

proposal that will be designed to accommodate existing business practices.[13] We agree that the proposal should include appropriately designed PTEs. However, without knowing the content of these exemptions – that is, without waiting until the proposed rules has actually been proposed – the Congressional Letter's concerns regarding the proposal's effect on current business practices are premature; we urge that OMB not similarly prejudge the Department's proposal.

There is No Limiting Effect on Investor Education

The Congressional Letter contends that the Department's proposal "could limit investor access to education." We agree that the Department should not impede investors' access to education, but the proposal would have no such effect. The concern that investment advice could be deemed to include investor education has long been addressed by an exclusion from the definition of investment advice under a longstanding Department position.[14] Investment advice does not include descriptions of investment options or information regarding asset allocations, asset class returns, diversification, risk and return, or risk tolerance. It does not include asset allocation models based on generally accepted investment theories that provide advice regarding asset classes' historical returns and volatility and their appropriateness for investors with different characteristics. Nor does investment advice include interactive worksheets that allow investors to estimate future income needs and test different asset allocation strategies.

The Department's original proposal expressly adopted the existing exclusion for investor education from the definition of investment advice. This means that this exclusion would apply to new fiduciaries under its proposal. Providers of IRAs, for example, would be able to provide all of the educational information to investors that current fiduciaries have found sufficient for years. We are not aware of any examples of investor education having been "limited" under the existing interpretation and are confident that if there were problems, the Department would ensure that such education did not trigger fiduciary status.

DOL's Overly Narrow Interpretation of "Investment Advice"

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[13] *See Borzi: DOL Fiduciary Rule Won't 'Outlaw' Commissions*, Financial Advisor (Sep. 10, 2013) (proposal will include new PTEs) *available at* http://www.fa-mag.com/news/borzi--dol-fiduciary-rule-won-t--outlaw--commissions-15408.html*;* Darla Mercado, *DOL's Borzi Says Fiduciary Rule Will Be Simple: Clients Come First*, Investment News (June 19, 2013) (Assistant Secretary Borzi stating that the proposal will include new PTEs) *available at* *http://www.investmentnews.com/article/20130619/FREE/130619875#;* Karl Thunemann, *Exemptions from Conflict of Interest Will Be Part of New Fiduciary Proposal*, RIABiz (May 7, 2013) (statement of ERISA attorney Fred Reish: "Phyllis Borzi has been saying — for over a year — that there would be exemptions with the new proposal") *available at* http://www.riabiz.com/a/22106168/borzi-exemptions-from-conflict-of-interest-will-be-part-of-new-fiduciary-proposal*.*

[14] 29 C.F.R. § 2509.96-1 (1996).

If there is a comparison to be made between ERISA and the federal securities laws, it should focus on the significant flaw in the Department's longstanding interpretation of the term "investment advice." The Department has narrowly interpreted the term not to apply to advice provided in connection with a one-time transaction or to advice that is not the "primary basis" for the client's investment decisions. Under the federal securities laws, there is no question that the term "investment advice" includes providing advice as to a single transaction. This is so clear that Congress created an exemption for broker-dealers from the definition of "investment adviser" in the Investment Advisers Act precisely because investment advice so clearly includes one-time advice for which a broker-dealer is paid a commission. Under the Advisers Act, "investment advice" also includes advice that is not the "primary basis" for a client's transaction.

Logic would dictate that the Department interpret "investment advice" under ERISA similarly to cover such obvious cases – if not interpret it *more broadly* for the protection of America's retirees. But the Department has interpreted that term in a way that is inconsistent with the statute.[15] There is no reasonable basis for the Department's narrowing the plain meaning of "investment advice;" this error should have been corrected long ago. Congress's concern should be the Department's delay in correcting its interpretation of the meaning of investment advice, which directly conflicts with the ERISA, rather than the possibility that broker-dealers will actually be subject to the ERISA standards that Congress has always intended to apply to Americans' retirement accounts. We anticipate that these short-comings will be addressed in the revised rule proposal.

The SEC Timetable

The Congressional Letter's suggestion that the Department delay its long overdue rulemaking pending SEC action is also troubling in view of the SEC's record on related rulemaking initiatives. The Commission has been promising rulemaking to establish a fiduciary duty for broker-dealers for years, yet no proposal has ever been issued. More than three years after Dodd-Frank Section 913 became law, the Commission has only just asked for information on the effects of a fiduciary rulemaking. If past practice is any indication, there is no guarantee that any rule proposals will be forthcoming. The SEC's initiatives regarding revenue sharing payment disclosure and 12b-1 fees – two of the primary practices that the Department is expected to address – have been languishing for, respectively, nine and thirteen years.[16] In contrast, the SEC did not hesitate to adopt a "temporary"

[15] Definition of the Term "Fiduciary," Employee Benefits Security Administration, 75 F.R. 65263, 65264 (Oct. 22, 2010) (Department's interpretation of "investment advice" significantly narrows the plain language of section 3(21)(A)(ii)").

[16] *See* Confirmation Requirements and Point of Sale Disclosure Requirements for Transactions in Certain Mutual Funds and Other Securities, and Other Confirmation Requirement Amendments, and Amendments to the Registration Form for Mutual Funds, Securities Act Rel. No. 8358 (Jan. 29, 2004)

rule that lowers standards applicable to broker-dealers' principal trades with their advisory clients. This so-called "temporary" rule has been extended, in clear violation of the Administrative Procedures Act, three times for a total of six years[17] without ever responding to public comments on its deficiencies.[18] On each occasion, the SEC has imposed a "sunset" date, but this is clearly a temporary rule on which the sun may never set. Given the SEC's record of delay and inaction, requiring the Department to wait on the Commission to conduct fiduciary rulemaking is the practical equivalent of prohibiting the Department's rulemaking altogether.

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We urge the OMB to base its ultimate review of the Department's reproposal on the facts, rather than the myriad of myths and falsehoods that have characterized much of the debate regarding the original proposal. We recognize that there were problems with the original proposal,[19] but that proposal has been withdrawn. We see no reason not to accept the Department's acknowledgment of the problems with the original proposal and its intent to address those problems in any reproposal. Secretary Perez has promised the Senate that he will carefully review any reproposal and ensure that it fully reflects industry and investor concerns. We see no reason for OMB to undermine the specialized expertise that the Department brings to bear on regulatory issues affecting Americans' retirement security. Finally, we have no doubt regarding the continued vitality and appropriateness of Congress's undisputed policy of applying higher standards when financial services professionals advise Americans regarding their retirement assets.

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available at http://www.sec.gov/rules/proposed/33-8358.htm. The SEC has been promising 12b-1 fee reform since February 2000, when it conceded that current rules fail to require disclosure of payments received by brokers for recommending fund shares and stated that it had directed its staff to make recommendations on how to fix this problem. *See* Brief of the Securities and Exchange Commission, Amicus Curiae, in Donald Press v. Quick & Reilly, Inc. (2d Cir.)(Feb. 2000). The SEC proposed 12b-1 reforms more than three years ago, but has not taken any further action. *See* Mutual Fund Distribution Fees; Confirmations, Investment Company Act Rel. No. 29367 (July 21, 2010) *available at* http://www.sec.gov/rules/proposed/2010/33-9128.pdf.

[17] The "temporary" rule was originally "adopted" in 2007. *See Advisers Act Rule 206(3)-3T (Temporary Rule Regarding Principal Trades with Certain Advisory Clients)* (Dec. 21, 2012) *available at* http://www.sec.gov/info/smallbus/secg/206-3-3-t-secg.htm. The "temporary" rule was extended to Dec. 31, 2010 in 2009, to Dec. 31, 2012 in 2010, and to Dec. 31, 2014 in 2012. *See id.*

[18] *See, e.g.*, Letter from Mercer Bullard, Fund Democracy, and Barbara Roper, Consumer Federation of America to Nancy Morris, Secretary, SEC (Nov. 30, 2007)(commenting on adoption of temporary rule regarding principal trading restrictions) *available at* http://www.sec.gov/comments/s7-23-07/s72307-18.pdf

[19] Mercer Bullard, *DOL's Fiduciary Proposal Misses the Mark*, Morningstar.com (June 14, 2011) *available at* http://news.morningstar.com/articlenet/article.aspx?id=384065.

Thank you for your consideration of our comments. We would appreciate an opportunity to meet with you, at your convenience, to discuss them further. Please feel free to contact Mercer Bullard (662-915-6835) or Barbara Roper (719-543-9468) if you have any questions regarding this letter or would like to arrange a meeting, or if we can otherwise be of assistance.

Respectfully yours,

Mercer Bullard
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Fund Democracy

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CC:

The Honorable Mark Begich
The Honorable Ben Cardin
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The Honorable Kirsten Gillibrand
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The Honorable Amy Klobuchar
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The Honorable Jon Tester
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The Honorable Thomas E. Perez
The Honorable Phyllis Borzi