

July 21, 2015

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: Conflict of Interest Rule, RIN 1210-AB32
Proposed Best Interest Contract Exemption, ZRIN: 1210-ZA25

Ladies and Gentlemen:

On behalf of the U.S. Public Interest Research Group, the federation of state-based public interest research groups, and our members across the United States, we are writing to express our strong support for the Department of Labor's (DOL's) conflict of interest rule proposal. This rule would strengthen protections for two groups whose interests we fight for, consumers and millennials, who are saving for retirement by requiring financial advisers and their firms to provide retirement investment advice that is in their client's best interests and to minimize conflicts of interest.

Current rules do not adequately protect retirement savers

Under current law, the financial professionals that retirement savers turn to for investment advice are legally allowed to make recommendations that serve their own self interest, at their client's expense. This is because the rules that govern the provision of retirement investment advice are forty years old and do not reflect the modern financial marketplace. When the fiduciary rule under ERISA was first promulgated in 1975, the retirement landscape looked very different. At that time, defined-benefit (traditional pension) plans predominated, IRAs had just been created, and 401(k)s didn't even exist. At that time, most consumers didn't need personalized investment advice, because their retirement savings were being professionally managed for them. And, because their retirement savings were being managed by a pension manager, regulators in 1975 didn't take into account how the rule would affect unsophisticated individual workers and retirees seeking advice about their retirement savings.

The rule doesn't apply to one-time or periodic advice, and it only applies when there's a "mutual agreement" that the advice will be the "primary basis" for the investment decision. These loopholes allow financial professionals to represent that they are providing trusted advice without requiring them to fulfill the legal obligations that come with relationships of trust. As a result, financial advisers are allowed to offer what any reasonable retirement investor would consider as advice that they can rely on without being subject to necessary protections against conflicts. Moreover, these loopholes create distinctions that unsophisticated investors will never understand and be able to defend against by themselves. The current rule also doesn't apply to recommendations to roll over from an employer retirement plan to an Individual Retirement Account (IRA), which can be the most important financial decisions many people will ever make.

Such a restrictive application of the fiduciary standard may have seemed appropriate forty years ago, but it is entirely inappropriate now. We've transitioned from a defined benefit (traditional) pension system to a defined contribution system, where unsophisticated individuals are required to manage their own retirement security. The number of active participants in private-sector defined contribution plans increased from 11.2 million in 1975 to 75.4 million in 2012, while the number of active participants in private-sector defined benefit plans declined from 27.2 million to 15.7 million during the same time period.¹

Consumers Need Advice They Can Trust

Being personally responsible for one's own retirement investments comes with a lot of challenges, one of which is that when consumers try to do the right thing by saving for retirement, they face a multitude of complex, often confusing decisions. For example, they must decide how much to save, what types of retirement accounts they should use, and which products are best for them, depending on their unique features, costs, benefits, and risks.

Consumers shouldn't and can't be expected to know all the relevant information in order to make an informed investment decision about what's best for them. And the SEC's financial literacy study provides evidence of the significant gaps in knowledge that investors have. According to the study, many investors "do not understand the most elementary financial concepts, such as compound interest and inflation."² They also do not understand basic ideas, such as diversification or the differences between stocks and bonds, and are not fully aware of investment costs and their impact on investment returns. Moreover, certain subgroups, including women, African-Americans, Hispanics, the oldest segment of the elderly population, and those who are less educated, have an even greater lack of investment knowledge than the average general population.

Many investors realize they do not have sufficient financial and investment expertise to make informed decisions, so they turn to financial professionals to help them with those. However, the people they turn to may not owe them a legal obligation to serve their best interests. Many financial professionals who are typically not fiduciaries hold themselves out as trusted advisers and use titles such as "financial adviser" or "financial consultant," which is designed to give consumers a reasonable belief that they are giving advice that's designed to serve their best interests. And that portrayal is largely effective at convincing consumers that they are in a relationship of trust. According to a Rand Corporation survey of investors' beliefs about different financial service professionals, 59 percent believed that "financial advisors or financial consultants" are required by

¹U.S. Department of Labor. Employee Benefits Security Administration, Private Pension Plan Bulletin Historical Tables and Graphs (June 2013) <http://1.usa.gov/Rp8Bwu>.

²Study Regarding Financial Literacy Among Investors, As Required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Staff of the Office of Investor Education and Advocacy of the U.S. Securities and Exchange Commission, at vii-viii, August 2012, <http://1.usa.gov/1fMABVZ>.

law to serve their client's best interest.³ The DOL rule proposal can help to turn the reasonable but mistaken belief that consumers have into reality, at least in the retirement context.

Furthermore, consumers are incapable of distinguishing true advisers who are required to serve their interests from salespeople who are subject to a lower suitability standard. According to the Rand study cited above, while 59 percent believed that "financial advisors or financial consultants" are required by law to serve their client's best interest, only 49 percent believed that investment advisers (who in fact do owe their client a legal duty to serve their best interest) have that same obligation.⁴ The Rand study also shows evidence that investors are incapable of telling whether their own adviser is a broker or an investment adviser, let alone whether he or she owes them a fiduciary duty. Even after reviewing a fact sheet explaining the differences between different financial professionals and the duties they owe, investors are still incapable of distinguishing between financial professionals. This is compelling evidence that disclosure and education about various financial professionals and the duties that they owe will not solve this problem.

Conflicted Advice Hurts Consumers

Because many financial professionals are not required to put their clients' interests first, they can freely steer them into excessively high cost, low performing investments that drain their clients' hard-earned savings and maximize their own profits. While many advisers may try to serve their clients' interest, this issue comes down to incentives. If an adviser is paid based on the products that he sells, and selling one product makes the adviser an 8 percent commission instead of another product that makes the adviser a 3 percent commission, it's natural that many advisers will rationalize recommending the product with the 8 percent commission. And, if the adviser's firm is pressuring the adviser to hit specific sales quotas for selling the product with the 8 percent commission, and bases the adviser's compensation and bonus on hitting certain sales goals for that product, it creates headwinds that even the most ethical adviser would have difficulty dealing with. Without adequate safeguards, retirement savers will remain at risk of being harmed by conflicted recommendations that are the direct result and predictable outcome of these incentives.

When financial professionals put their own interests ahead of their clients' it can cost retirement savers tens if not hundreds of thousands of dollars over time. Because small differences in cost add up over time, retirement savers may not know that their nest egg is being drained slowly but steadily. However, just because they may not know, doesn't mean that the harm is not real, significant, and pervasive. As the DOL documented in its Regulatory Impact Analysis, there are a range of independent studies providing evidence that mutual funds marketed and sold by brokers perform significantly worse than mutual funds marketed and sold directly to the public. Working from the various studies, the DOL estimates that retirement savers will lose between \$210 billion and \$430 billion over 10 years, and between \$500 billion and \$1 trillion over 20 years, as a result of conflicted advice just with regard to mutual fund investments in Individual Retirement Accounts

³Angela A. Hung, et al., *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*, Rand Corporation, Sponsored by the United States Securities and Exchange Commission, January 2008, <http://1.usa.gov/1nePF0L>.

⁴*Id.*

(IRAs). The DOL also estimated that a retirement saver who rolls money out of a 401(k) plan and into an IRA based on conflicted advice can expect to lose 12 to 24 percent of the value of his or her savings over 30 years, according to the DOL analysis.

The most logical reason for the difference in performance between funds that are marketed and sold directly to the public compared with funds that are marketed and sold by brokers is that funds that are marketed and sold directly to the public are forced to compete based on cost or quality; otherwise investors won't buy them. However, the economic dynamics are different for broker-sold funds. Broker-sold funds are not forced to compete on cost and quality; rather, they are able to compete based on the remuneration they are willing to provide for recommending them to clients.

The harm that consumers suffer as a result of conflicts of interest can have profound effects on how they'll spend their retirement, including where they'll be able to live, what they will be able to afford to eat, their quality of life, their ability to be self-sufficient and independent, and their dignity. And that is money that retirement savers cannot afford to lose. If consumers have less than they otherwise would, they may become more dependent on state and federal programs to cover their shortfall. This would be dangerous for two reasons: first, because of conflicts, many consumers wouldn't be able to inject money into the economy, which would create economic drag, and second, because of conflicts, already limited federal and state resources would be depleted.

Moreover, money that should be in consumers' pockets (and would be if they received advice in their best interests) is instead in financial professionals' pockets and serving their companies' bottom lines. For example, just looking at the IRA market, the federal government subsidized consumers' IRAs by \$16 billion in 2014. At the same time, retirement savers lost \$17 billion from load mutual funds and variable annuities alone, because of conflicted retirement advice. The tax subsidies that the federal government provides should flow to the consumers who are actually saving for retirement and should not be siphoned off by financial firms who profit at their expense.

The DOL's Conflict of Interest Rule is Good for Millennials and Young Savers

Unlike other generations that trust that financial advisers are serving their best interests when they receive investment advice, many millennials seem to be more skeptical of financial advisers' motives. According to a recent Merrill Lynch survey of high net worth millennials, only 19 percent agreed that advisers act in their best interests, while 40 percent disagreed.⁵ The survey concluded, based on conversations with millennials, that they seem to equate financial advisers with salesmen.⁶ Similarly, in a survey about whom millennials trust most on money matters, Fidelity found that only 13 percent said they trust a financial professional.⁷ A staggering 23 percent said they

⁵Michael Liersch, *Millennials and Money*, Private Banking and Investment Group, Merrill Lynch, 2015, <http://bit.ly/1zYRdAb>.

⁶*Id.*

⁷Catey Hill, *1 in 4 millennials 'trust no one' for money advice*, MARKETWATCH, October 11, 2014, <http://on.mktw.net/1skxacY>.

trust no one.⁸ In another survey that Fidelity conducted on meeting recruiting challenges for the advisory business, Fidelity found that most millennials surveyed believe financial advisers spend a significant amount of time in a sales capacity, which is unappealing to a largely sales-averse generation.⁹

However, other surveys indicate that many millennials are still inclined to use the services of a financial adviser. For example:

- The Transamerica survey, discussed above, found that 32 percent of millennials who are saving for retirement use a professional financial adviser to help them, compared with 35 percent of Generation Xers and 40 percent for Baby Boomers.
- T Rowe Price found in a recent survey that 38 percent of millennials have paid for financial advice, compared with 36 percent for Baby Boomers.¹⁰
- The Merrill Lynch survey of high net worth millennials found that they are willing to use their parents' advisers. Of those who aren't already using their parents' advisors, 49% say they'd be open to it.¹¹

Whether millennials are distrustful of advisers or ready to embrace them, the DOL fiduciary rule is the solution. That's because the best way to increase millennials' trust of financial advisers is to require those advisers to comply with the legal standards that traditionally accompany positions of trust. By the same token, for those who are already receiving retirement investment advice, they need the protections that the DOL's rule will provide to ensure that any advice they receive is in their best interests and not ridden with harmful conflicts of interest.

Of all the generations, millennials have the most to gain long-term from the protections of DOL's conflict of interest rule. That's because small differences in cost add up over time. For example, if a 25 year old invests \$5,000 a year for 45 years, a 1 percent increase in fees and expenses could result in a decrease of the investor's portfolio balance at retirement by approximately \$500,000.

Furthermore, millennials are likely to switch jobs more often than other generations. Ninety-one percent of millennials expect to stay in a job for less than three years, according to a recent Future Workplace Multiple Generations at Work survey.¹² This means that millennials could have

⁸*Id.*

⁹Fidelity Investments, Perspectives on Meeting the Millennial Recruitment Challenge, Recruiting Redefined, May 2015, <http://bit.ly/1lhTZpF>.

¹⁰Veronica Dagher interview with Judy Ward, *What Millennials Think about Saving and Investing*, WALL STREET JOURNAL, May 28, 2015, <http://on.wsj.com/1GO5WB8>.

¹¹Liersch, Millennials and Money, *supra* note 9.

¹²Jeanne Meister, *Job Hopping Is the 'New Normal' for Millennials: Three Ways to Prevent a Human Resource Nightmare*, FORBES, August 14, 2012, <http://onforb.es/J1APIL>.

anywhere between 15 and 20 different jobs over the course of their careers. In comparison, the average worker today stays at his or her jobs for 4.4 years, according to the most recent available data from the Bureau of Labor Statistics.¹³ The likelihood of switching jobs more often than other generations means that millennials will have to make many more decisions about what to do with money in their workplace savings plans, including whether to roll over their workplace savings into Individual Retirement Accounts (IRAs). In many if not most cases, workers would be better off leaving their retirement in a workplace plan because the expenses are on average lower than IRAs, and they are protected under ERISA by a fiduciary duty that requires their employer to manage the plan in their best interest. Under current law, IRAs are not subject to the same fiduciary protections. At the same time, financial services firms have an incentive to capture assets leaving workplace plans because it results in higher revenues. As a result, financial firms and their advisers often encourage workers to roll over their accounts into IRAs, regardless of whether those recommendations are in the retirement saver's best interests. In fact, inappropriate rollover recommendations are a common market abuse. For example, a 2013 report by the Government Accountability Office chronicled the types of deceptive and predatory tactics that financial services firms and their call centers engage in to secure retirement savers' assets.¹⁴ Retirement savers need protections against these types of harmful industry practices.

This rule proposal provides those necessary protections. It updates current law to ensure that any retirement investment advice is in the retirement saver's best interest rather than financial services firms' and their advisers'. Specifically, the proposal eliminates loopholes in the current law that have no justification in our current financial landscape, and allow financial professionals to provide what appears to be trustworthy advice, but is in reality a sales pitch designed to benefit the financial professional. For example, one-time advice would now be covered under the rule, and there would no longer have to be a "mutual agreement" that the advice forms the "primary basis" for the investment decision. Perhaps most significantly, rollover recommendations would be covered under the rule so as to protect against conflicted recommendations that are designed to maximize financial services firms' and their advisers' best interest rather than the financial interests of the retirement saver. These are exactly the right updates to the rule that millennials need in order to safeguard their retirement savings.

The DOL's Conflict of Interest Rule Helps All Consumers

Moderate income Americans—those who save for retirement in the smallest amounts, if they save at all—need to make every dollar count more than anyone, and can least afford to have their retirement savings drained due to conflicted advice. But, according to the industry's own data, moderate income savers are disproportionately served by advisers who are not required to serve their best interests.¹⁵ This means that they are the ones who are most likely to receive harmful advice.

¹³*Id.*

¹⁴401(K) PLANS: Labor and IRS Could Improve the Rollover Process for Participants, GOVERNMENT ACCOUNTABILITY, OFFICE, March 7, 2013, <http://1.usa.gov/1iQFeOR>

The proposed rule will fundamentally change these dynamics. The proposed rule will update the 1975 five-part test that allows financial professionals to skirt their fiduciary obligations. Specifically, it will close the “regular basis” loophole that allows one-time or episodic recommendations to evade the duty. It will also close the “mutual agreement” and “primary basis” loopholes that allow advisers and their firms to disclaim mutuality through fine print. It will also update the rule to make clear that rollover recommendations would be covered investment advice, and therefore subject to fiduciary duties of prudence and loyalty. These updates will ensure that consumers who are saving for retirement are protected when they need to be and financial professionals won’t be able to escape those rules based on mere technicalities.

Perhaps the most important feature of the rule is the Best Interest Contract Exemption (BICE), which will provide important protections for consumers from conflicted advice, even in the IRA market. And, it would do so while still permitting advisers and their firms to collect commission and other sales-related compensation, which was exactly what the industry asked for so as not to fundamentally disrupt the broker-dealer business model. To qualify for the BICE, advisers and firms would be required to contractually agree that any recommendations that they provide are in their client’s best interest, without regard to their financial or other interests. This would mean providing advice that a prudent and impartial expert would provide under the same circumstances. In addition, the fees that advisers charge would have to be reasonable in light of the services that they provide. Firms would also have to make certain warranties that they have instituted policies and procedures that are reasonably designed to mitigate the harmful effect of conflicts of interest. Specifically, they would have to warrant that they are not structuring their advisers’ compensation or engaging in other practice that reward their providing advice that is not in the customer’s best interest, for example, by requiring advisers to meet sales quotas for certain products or providing bonuses to advisers for hitting sales goals. Advisers would also be required to provide important point-of-sale and on-going disclosures showing the costs that retirement savers are paying. Consumers will then be able to know how much they are paying for the products that their adviser recommends and for the recommendations themselves. Consumers will also be able to see and understand the impact that costs can have on their retirement portfolios over the long-term. If firms or advisers breach any of the contractual provisions, retirement savers can hold them liable for any losses that resulted from the breach. Having a mechanism to hold firms and advisers accountable will be beneficial for two reasons: first, it will have a prophylactic effect, forcing advisers and firms to compete better on cost and quality rather than on how much they stand to profit from a recommendation; and second, it will allow consumers to receive compensatory damages when they suffer harm as a result of advice that is not in their best interests.

However, the proposal is not perfect. We object to the proposed allowance in the rule for firms to insert pre-dispute mandatory arbitration clauses in these consumer contracts. The proposal follows FINRA’s policy with regard to arbitration of claims and ensures that the vast majority of claims will be heard in the industry-run FINRA arbitration forum, thus depriving retirement investors of their right to have their cases heard in court. Pre-dispute mandatory arbitration strips investors of their right to a judge and jury. In many cases, retail investors do not receive fair hearings or awards. There is substantial evidence that investors may “win” FINRA arbitrations but

¹⁵Letter from Kent Mason, Partner at Davis and Harman, citing Oliver Wyman’s “Assessment of the impact of the Department of Labor’s proposed ‘fiduciary’ definition rule on IRA consumers,” April 12, 2011, <http://1.usa.gov/1CyB9V2>.

receive significantly less than they deserve. For example, a study analyzing 14,000 FINRA arbitration awards over a ten-year period found that investors with significant claims suing major brokerage firms could expect to recover only 12 percent of the amount claimed.¹⁶ There is also evidence that brokers are easily able to expunge their records of investor complaints, as if they never occurred.¹⁷ Furthermore, arbitrators are not required to explain their decisions and their decisions are virtually impossible to appeal. The result is an opaque, unfair process that benefits the brokerage industry, not retail investors.

The opportunity for firms to require retirement investors to sign away their right to litigate in court should put to rest the financial industry's illegitimate claim that this rule will result in a flood of litigation. In the vast majority of cases, even when consumers have suffered concrete harm as a result of receiving conflicted advice, it would not make sense to bring suit. Only when their losses are significantly greater than the costs of bringing suit, and only where they stand a very high chance of winning, would it make sense to pursue their claims. It is for those types of claims and those types of claims alone that this new rule will provide greater help.

The financial industry and its allies in Congress continue to make another false claim—that the rule will result in a loss of access for small balance investors to vital products and services. That claim is entirely without merit. As stated above, small savers are disproportionately served by non-fiduciaries today and therefore most susceptible to being given conflicted, harmful advice. The fact is that small savers have the most to gain from this rule because it will ensure that every dollar that they save for retirement counts—that investment returns are maximized and unnecessary and hidden costs are minimized. Whether certain financial firms decide that it is no longer financially sensible for them to serve this multi-trillion-dollar market if they can't profit at their clients' expense is a business decision, not a consequence of the rule. We believe that if they make this decision, they will regret it because they will lose market share as other market participants who are ready, willing, and able to provide high quality, low cost advice step in.

Dr. Ron. A Rhoades, *JD, CFP®*, who serves as director of Western Kentucky University's renowned B.S. Finance/Financial Planning Program, has chronicled just some of the many ways consumers currently can receive fiduciary advice.¹⁸ For example, in addition to seeing a Certified Financial Planner,¹⁹ small account savers can receive fiduciary hourly advice from an adviser with the Garrett Planning Network, they can receive advice from a National Association of Personal Financial Advisors (NAPFA) certified adviser, they can pay a monthly retainer for an adviser

¹⁶Edward S. O'Neal, Ph.D. and Daniel R. Solin, *Mandatory Arbitration of Securities Disputes* — by Edward S. O'Neal, Ph.D. and Daniel R. Solin 1 A Statistical Analysis of How Claimants Fare, Securities and Litigation and Consulting Group, June 2007, <http://bit.ly/1LtUCgU>.

¹⁷Susan Antilla, *A Murky Process Yields Cleaner Professional Records for Stockbrokers*, NEW YORK TIMES DEALBOOK, September 25, 2014, <http://nyti.ms/1uqiwyn>.

¹⁸Ron Rhoades, *Why Wall Street's DOL killer threat – that 'millions' of IRA investors will go unadvised under new rules – is hogwash*, RIABIZ, June 8, 2015, <http://bit.ly/1JnVh40>.

¹⁹Certified Financial Planner Board of Standards, Inc. <http://www.cfp.net/>

through the XY network, and they can use robo-advisers to receive automated advice. Several of these platforms provide advice for free on the first \$10,000 and put their clients in low-cost index funds, which is significantly cheaper at the outset and over time than what a typical broker is likely to charge: 5 percent front-load fund (\$500 at the outset) with a 1 percent higher expense ratio (an additional \$100 per year). While robo-advisers get a bad name in some quarters, they comprise what is likely to be the wave of the future, as more traditional advisory firms include technological components to improve their user experience and lower costs. For example, Vanguard just rolled out its Personal Adviser Services, and Schwab recently introduced its Intelligent Portfolios. With these and other investment advisory options, there will be no advice gap from this regulation.

Conclusion

Most moderate income Americans save for retirement in tax-advantaged retirement accounts, regardless of whether they hold securities or non-securities in those accounts. They need the protections that this rule will provide and cannot afford to wait any longer for those protections to be in place. Accordingly, we urge the DOL to finalize and implement this rule as soon as possible.

Respectfully submitted,

U.S. Public Interest Research Group