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Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave., N.W.
Suite 400
Washington, D.C. 20210

Re: Application No. D-12011- Improving Investment Advice for Workers & Retirees

To Whom it may Concern:

The National Employment Law Project ("NELP") appreciates the opportunity to provide comments on the Department of Labor's (DOL's) proposed new retirement advice rulemaking package pursuant to the Employee Retirement Income Security Act ("ERISA"). The package includes both a final rule reinstating the 1975 regulatory definition of "fiduciary investment advice," and a proposed exemption allowing investment advice fiduciaries to earn conflicted compensation when providing advice to workers and retirees regarding retirement plans and individual retirement account (IRA) investments.

NELP is a non-profit research and policy organization that for over 50 years has advocated for the employment and labor rights of workers. NELP's goals are to promote economic security, dismantle structural racism, and promote worker power in our society. NELP's constituents include the millions of workers and their families in the U.S. who invest their savings for retirement either through employer sponsored ERISA plans or through IRAs that have been rolled over from employer sponsored plans. These workers count on every dollar of their retirement and non-retirement savings to make ends meet. These investors (also called "retail investors" in the trade) are hardworking individuals who rely on professional advice for their economic security.[1]

[1] Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act defines "retail customer" as "a natural person . . . who (1) receives personalized investment advice about securities from a broker or dealer or investment adviser; and (2) uses such advice primarily for personal, family, or household purposes." Dodd-Frank Wall Street Reform & Consumer Protection Act, at § 913(a), Pub. L. No. 111-203, 124 Stat. 1376, 1824 (July 21, 2010) (the "Dodd Frank Act"). Our references in this comment letter to "retail customer" or "retail investor" are intended to use the same definition as Section 913 of the Dodd-Frank Act.

Retail investors, especially small investors, are generally not aware of the different regulatory frameworks that apply among financial services professionals. They are being harmed every day by endemic confusion regarding their relationship to, and duties they are owed, by different financial services professionals. This confusion is compounded by the weak standards of conduct that govern personalized investment advisors. If finalized, the DOL's proposed rules would undermine the retirement security of millions of American workers by exposing them to conflicted retirement investment advice without meaningful protections to limit the harmful impact of those conflicts. Moreover, people of color with retirement savings have, on average, less than half the savings of white non-Hispanics. They are among those who can least afford to have their retirement savings drained because of financial advisors' conflicts.[2] NELP therefore urges you to withdraw the regulatory package and engage in a rulemaking that prioritizes the Employee Benefits Security Administration's core mission--protecting retirement savers. At a minimum DOL should hold public hearings on the rulemaking package. In 2015, the DOL held four days of public hearings featuring testimony from over 80 different stakeholders. Given the significance of this package, the DOL should, as it has in the past, formally engage the public through a hearing.

1. **Workers Need Retirement Investment Advice They Can Trust.**

As defined contribution retirement accounts have replaced defined benefit pensions as the primary form of workplace retirement plan, workers have become increasingly responsible for making the investment decisions necessary to ensure their financial security in retirement. According to DOL data, 93.4 percent of pension plans in 2017 were defined contribution plans, and roughly 68 million Americans were responsible for directing some or all their investments in a 401(k) defined contribution plans[3]. Millions more, roughly 36 percent of U.S. households, owned an IRA as of mid-2019 either in addition to a workplace retirement plan or as their only retirement account.[4]

The shift from defined benefit to defined contribution plans has made the financial landscape much more reliant on individual knowledge and understanding of finance and investing. However, the 2018 National Financial Capability Study found that "only 30% of the general population demonstrates understanding of basic financial concepts such as the workings of interest rates, inflation, and risk diversification."[5] This lack of financial sophistication makes these investors more dependent on professional financial advisers when saving for retirement, and less able to detect when the advice they receive does not serve their financial interests.

In addition, the investment choices available to these retirement savers have grown far more complex in the years since ERISA was enacted. Retail investors are generally not aware about the roles and duties of different financial services professionals.[6] There are several reasons for this. Many financial services

[2] See: EPI "The State of American Retirement Savings" slide 11 (December 19, 2019), https://www.epi.org/publication/the-state-of-american-retirement-savings/.
[3] Employee Benefits Security Administration, U.S. Department of Labor, Private Pension Plan Bulletin Historical Tables and Graphs 1975-2017, September 2019, https://www.dol.gov/sites/dolgov/files/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.pdf at p. 1 and p. 32.
[4] Investment Company Institute, The Role of IRAs in US Households' Saving for Retirement, 2019, ICI Research Perspective, December 2019, Vol, 25, No. 10 https://ici.org/pdf/per25-10.pdf.
[5] New Evidence on the Financial Knowledge and Characteristics of Investors - FINRA (2019) at p2. Available at https://www.usfinancialcapability.org/downloads/FINRA_GFLEC_Investor_Knowledge_Report.pdf.
[6] See, e.g., U.S. Securities & Exchange Commission, Study on Investment Advisers and Broker-Dealers as Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, at i, 101, 165-66 (Jan. 2011),

companies advertise themselves to the public in such a way that conveys they are advisors who occupy a position of trust and confidence, i.e. fiduciaries, when in fact they do not conduct themselves as such. Non-fiduciary broker dealers often hold themselves out as a “financial advisor” or “wealth manager”. They often describe their services as “investment advice” or “investment planning”. Misleading advertising only heightens the public’s confusion. Numerous examples exist of broker-dealers’ advertisements that claim that the client’s interests come first or that the relationship is one of trust when in fact their legal position, is that they are mere salespersons selling products.[7] This confusion costs retail investors billions of dollars a year. Retail investors who mistakenly believe their advisor is putting their best interests first can pay higher costs, face unnecessary risks, or receive substandard returns. Conflicted advisors are pervasive in an industry where compensation incentives can lead to biased sales recommendations. The White’ House’s Council of Economic Advisors found in 2015 that as a result of conflicted advice, retail investors “will lose an estimated 12 percent of the value of [their] savings if drawn down over 30 years.”[8]

Instead of protecting workers and retirees, the DOL’s regulatory proposal would increase the likelihood that retirement savers will rely on conflicted advice, and advice which is little more than a sales recommendation, while doing little to prevent conflicts of interest from tainting that advice. As a result, millions of financially vulnerable workers and retirees – individuals who need to make every dollar count – will continue to see billions of dollars a year siphoned out of their retirement accounts.

2. The Rule allows Firms to Entirely Evade Any Fiduciary Duty

NELP strongly opposes the DOL’s decision to adopt a Final Rule reinstating the 1975 five-part regulatory definition of fiduciary investment advice. When DOL promulgated the five-part test in 1975, employees were not permitted to contribute a portion of their salary to 401(k) plans, and most retirement assets were in defined-benefit pension plans. Even though the world of retirement investing has changed considerably since then, the DOL did not even consider whether its definition should be revised from the 1975 version to better protect retirement savers. *This failure means that most of the advice retirement savers rely on, including most rollover recommendations, will not be held to a fiduciary standard at all*.

Under the DOL’s 1975 definition, advice must be provided “on a regular basis” for fiduciary duties to attach.[9] Thus, one-time recommendations, no matter how consequential, do not carry fiduciary responsibilities.[10] The impact on rollover recommendations will be particularly harmful. Deciding whether to roll your retirement savings out of a workplace plan into an IRA can be some of the most consequential decisions retirement savers make. Yet they are most often one-time decisions. As a practical matter, this means that few rollover recommendations are likely to be covered by a fiduciary standard, and retirement savers will suffer.

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available at https://www.sec.gov/news/studies/2011/913studyfinal.pdf (the “2011 IA/BD Report”); Angela A. Hung et al., Investor and Industry Perspectives on Investment Advisers and Broker-Dealers, at xviii-xix, 87-113, RAND Institute for Civil Justice, commissioned by the U.S. Securities & Exchange Commission, at http://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf (the “2008 RAND Report”).

[7] See Brief for Chamber of Commerce, SIFMA, FSI, et al., Chamber v. DOL, Case Number 17- 10238, at 1, http://bit.ly/2f4wVBW (“A broker, insurance agent, or other financial-sales professional may make ‘individualized solicitations much the same way a car dealer solicits particularized interest in its inventory.’”) (internal cites omitted).

[8] White House Council of Economic Advisers, The Effects of Conflicted Investment Advice on Retirement Savings 3 (Feb. 2015).

[9] Improving Investment Advice for Workers & Retirees, 85 Fed. Reg. 40834 at 40834 (July 7, 2020).

[10] Id. at 40839.

When it comes to recommendations to rollover to non-securities, the DOL fiduciary standard will seldom if ever apply. For example, the DOL is explicit in stating that a one-time recommendation to roll assets out of a workplace plan to purchase an annuity would not be considered fiduciary investment advice.[11] But this is precisely where the protections of a fiduciary standard are needed most. Non-securities, including certain annuities, commodities, and real estate, are among the most complex and costly investments sold to retail investors. They are typically sold subject to compensation conflicts held by the brokers. A recent academic study indicated that variable annuity sales are roughly six times more sensitive to brokers' financial interests than to investors financial interests.[12] Misled into relying on these recommendations as trusted advice, workers and retirees are likely to lose billions of dollars a year as a result of this bad advice.

The DOL's 1975 and now currently reinstated five-part test also requires that by "mutual agreement" advice will serve as a "primary basis" for investment decisions with respect to plan or IRA assets before fiduciary duties attach.[13] So even if advice is given on a regular basis, firms can still evade their fiduciary duties by claiming they never intended the advice to serve as "a primary basis" for the retirement saver's investment decisions. Identifying whether advice, independent research, or some other reason served as the "primary basis" for an investment decision may be impossible. Fine print in contracts claiming that the purchaser warrants that they have made their own decision can be used to rebut the existence of any mutual agreement. In any event, persons giving financial advice for a fee should not be able to dispense poor quality advice on the theory that an investor should not rely on that advice as the primary basis for their investment.

As a result of the five-part test's reinstatement, financial firms and investment professionals will only be retirement investment advice fiduciaries *when they choose to be*, even as they market themselves as "trusted advisers" and offer services retirement savers reasonably believe to be fiduciary advice. Because the test strips retirement savers of the protections of a fiduciary standard in so many situations, NELP urges the DOL to withdraw this final rule and consider a definition of fiduciary investment advice that ensures that the full range of advisory services reasonably relied on by retirement savers as fiduciary investment advice is captured by the definition.

3. The Proposed Exemption Does Not Protect Retirement Savers from Conflicted Advice.

The DOL is also proposing a broad new exemption to the prohibited transaction provisions under ERISA. It would allow investment advice fiduciaries who give advice regarding workplace retirement plans and IRA investments to receive conflicted compensation that would otherwise be prohibited. The DOL admits its proposed exemption is largely based on the Securities and Exchange Commission's (SEC's) recently implemented Regulation Best Interest (Reg. BI).[14] Reg BI preserves the ability of broker dealers to engage in industry practices which are harmful to retail investors, but profitable to them. Importing such an approach into the retirement context will only increase the harm that retirement savers suffer when they receive conflicted advice.[15]

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[11]Id. at 40840.

[12] Mark L. Egan, Shan Ge, Johnny Tang "Conflicting Interests and the Effect of Fiduciary Duty -- Evidence from Variable Annuities" NBER Working Paper No. 27577 (July 2020). Available at https://www.nber.org/papers/w27577.

[13] 85 Fed. Reg. at 40834.

[14] See https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/fact-sheets/improving-investment-advice-for-workers-and-retirees.

[15] DOL defines the standard as ""reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs

Among the primary deficiencies in Reg. BI that the DOL incorporates into the proposed exemption is its amorphous "best interest" standard. The SEC explicitly acknowledged in adopting Reg. BI that it is not a fiduciary standard.[16] Moreover, the SEC has made clear that it will not interpret Reg. BI's non-fiduciary "best interest" standard to require that brokers must recommend the investments they reasonably believe are the best available option for the investor from among those they have available to recommend.[17] Reg BI only requires that broker interests not be placed "ahead of" investors' interests. Thus, it expressly countenances a broker considering their own interests in making a recommendation. Finally, instead of explaining what "best interest" means, the SEC has provided virtually unfettered discretion to firms to decide for themselves how to comply with the best interest standard. As a result, it's not clear to what extent, if any, Reg. BI actually raises the standard above the FINRA suitability framework.[18] Under FINRA suitability, however, firms have been permitted to recommend the high-cost, low-quality investments that pay the firms more, but saddle the retail investor with excessive risks and substandard returns, instead of those that are best for the investor. For all these reasons, Reg. BI cannot serve as an appropriate basis for compliance with ERISA's high fiduciary standard.

There are similar problems with the proposed exemption's requirement that firms mitigate conflicts of interest, which is also modeled on Reg. BI. Here again, the SEC refused to say what types of conflicts of interest, if any, that are currently permitted under the FINRA suitability framework would be prohibited under Reg. BI. And nor has it provided any guidance on how permitted conflicts would have to be "mitigated" to satisfy the standard and protect the retail investor. Rather, the loud and clear signal that the SEC has sent is that firms can continue to structure their compensation and incentives in ways that are reasonably likely to encourage and reward harmful advice to retail investors. For example, Reg. BI explicitly allows firms to continue to pay differential compensation to their registered representatives, which creates the incentive to recommend products that pay the highest compensation, even when alternatives are reasonably available that would be a better fit for the investor. In addition, Reg. BI explicitly allows firms to use a wide variety of sales contests, quotas, trips, and other special awards to encourage and reward production. These perverse incentives work to undermine rather than promote clients' best interest. Production incentives, for example, encourage rollovers regardless of whether that is in the customer's best interests.

By echoing Reg. BI's lax guidance on mitigating conflicts of interest, the DOL is sending the same message as the SEC – that the vast majority of advisors' conflicted practices can continue unabated under the proposed exemption.

Making matters worse, the exemption's weak standard will be unenforceable for the millions of investors who save for retirement through IRAs. That's because there is no meaningful enforcement mechanism for IRA investors under the proposed exemption. The Department explicitly states in the rule proposal preamble that the standard does not create a private right of action, and DOL itself has no authority to enforce the standard as it applies to IRAs.[19] As a result, IRA investors who are financially harmed by the conflicted advice unleashed by this proposal would have no recourse and no ability to recover their losses. In consequence,

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of the Retirement Investor, and does not place the financial or other interest of the Investment Professional, Financial Institution or any affiliate, related entity or other party ahead of the interests of the Retirement Investor, or subordinate the Retirement Investor's interests to their own." 85 Fed. Reg. at 40842.

[16] Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 at 33,322 (July 12, 2019).

[17] Id. at 33,491.

[18] Compare FINRA Rule 2111.05, Components of Suitability with 84 Fed. Reg. at 33,491.

[19] 85 Fed. Reg at 40837.

there will be little incentive for firms to comply with the amendment's requirements when advising IRA investors.

Taken together, these flaws in the proposal dramatically increase the risk that retirement savers will rely on investment advice that is tainted by conflicts of interest and suffer fraud and serious financial harm as a result. For this reason, the Department cannot reasonably conclude that the exemption is sufficiently protective for retirement plans, plan participants, or IRA investors.

Conclusion

The DOL's rulemaking package undermines the retirement security of millions of workers by exposing them to conflicted retirement investment advice without meaningful protections to limit the harmful impact of those conflicts. NELP urges the DOL to withdraw the regulatory package and engage in a rulemaking process, including a public hearing, that prioritizes the Employee Benefits Security Administration's core mission--protecting retirement savers. These protections are especially important during the high unemployment and economic recession the country is encountering.

Sincerely,

Judith M. Conti
Government Affairs Director