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Office of Exemption Determinations
EBSA (Attention D-11933)
U.S. Department of Labor
Suite 400
200 Constitution Ave, NW
Washington, D.C. 20210

Re: RIN 1210-AB82

Ladies and Gentlemen,

The National Employment Law Project ("NELP") submits these comments in response to the Department of Labor's (the "Department") July 6, 2017 request for information (the "RFI") on the possible bases for promulgating new, or amending existing, administrative class exemptions from the prohibited-transaction provisions of ERISA and the Internal Revenue Code (the "Code"). As relevant here, these prohibited-transaction exemptions (or "PTEs") provide relief from several statutory bans on conflicted transactions by investment-adviser fiduciaries.[1] The RFI is particularly focused on exemptions from prohibitions on transactions that were created or amended in association with the Conflict of Interest Rule that the Department adopted after a robust notice-and-comment process and that became applicable in June of this year.

NELP is a non-profit research and policy organization that for more than 45 years has advocated for the employment and labor rights of low-wage workers who count on every dollar of their retirement savings. We strongly oppose any efforts to weaken the important new protections involving conflicted transactions by investment-adviser fiduciaries, including those provided by the PTEs. Because PTEs provide relief from several statutory bans on conflicted transactions by investment-adviser fiduciaries, their scope and conditions serve as particularly important safeguards for retirement savers.

Given the acute conflicts of interest involved, perhaps no PTEs are more important than those that exempt transactions in which investment-adviser fiduciaries receive conflict-inducing compensation from either a "Retirement Investor"[2] or third-parties – often in the form of commissions, sales loads, 12b-1 fees, or third-party revenue-sharing arrangements. When fully in place, PTE's in these situations permit advisers to get paid while offering conflicted advice to Retirement Investors. The primary exemption for these transactions is the Best

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[1] *See*, EBSA; Adoption of Class Exemption, 81 Fed. Reg. 21002, 21006 (Apr. 8, 2016) (discussing Section 406(b) of ERISA and Section 4975(c) of the Code, along with the framework for statutory and administrative exemptions to these provisions).

[2] As used here, the term "Retirement Investor" has the same meaning as that ascribed to it in Section VIII(o) of Best Interest Contract Exemption, *id.* at 21084.

Interest Contract Exemption (the "BICE"), which contains robust protections for Retirement Investors by conditioning relief on adherence to impartial conduct standards ("ICSs"), implementation of policies and procedures to mitigate conflicts of interest, and the disclosure of conflicts and fees.[3] Although not yet fully implemented,[4] the BICE facilitates private enforcement of these conditions by further conditioning relief on acknowledgment of the investment adviser's fiduciary status,[5] and for most[6] transactions concerning plans not covered by Title I of ERISA – notably IRAs – representation and warranty as to the satisfaction of key conditions, including the ICSs.[7] For these transactions, the BICE conditions relief on the use of a contract (the "Best Interest Contract" or "BIC") to make these acknowledgements, representations, and warranties.[8]

Notwithstanding the exhaustive study and analysis that preceded the BICE's release,[9] the Department now seeks to revisit both the BICE's substantive conditions and its enforcement mechanisms.[10] Directly in the line of fire appear to be the BIC, and even the ICSs. Low-wage workers in particular need the protections afforded by BICE's conditions, especially the ICSs and the enforcement conditions that support them. NELP therefore strongly opposes any attempt to amend the private-enforcement structure currently in place. NELP opposes the removal or weakening of the BIC condition, which is the only meaningful compliance mechanism for transactions involving IRAs. We also oppose the elimination or alteration of the BICE's warranty conditions, which

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[3] *See id.* at 21003.

[4] *See generally* Comment Letter from NELP to the U.S. Dep't of Labor (July 21, 2017), https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB82/00273.pdf, (discussing the applicability dates for various provisions of the BICE).

[5] *See* Adoption of Class Exemption, 81 Fed. Reg. at 21077.

[6] Under Section II(h) of the BICE, so-called "Level Fee Fiduciaries" also do not need to warrant the implementation of anti-conflict policies and procedures. *See id.* at 21079.

[7] *See id.* at 21020.

[8] *See id.* at 21076-77.

[9] In connection with the BICE's rulemaking, the Department produced a nearly 400 page regulatory impact analysis, much of which was devoted to PTEs, *see* U.S. Dep't of Labor, *Regulating Advice Markets, Definition of the Term 'Fiduciary,' Conflicts of Interest, Retirement Investment Advice, Regulatory Impact Analysis for Final Rule and Exemptions* (hereinafter "RIA") (Apr. 2016), and the Preamble to the BICE itself occupies 73 pages of the Federal Register. This work product reflects the receipt of over 3,000 comment letters, 30 petitions containing over 300,000 submissions, and the testimony of 75 speakers over four days of hearings. *See* Adoption of Class Exemption, 81 Fed. Reg. at 21007.

[10] The Department also seeks information about parallel conditions in the related Principal Transactions Exemption. Here, both exemptions are addressed through discussion of the BICE.

again provide the sole material incentive for investment-adviser fiduciaries to comply with important substantive conditions of the exemption for IRA's. And we oppose any effort to allow investment-adviser fiduciaries to enjoy this PTE while effectively insulating themselves from liability for systemic violations through judicial class-action waivers.

NELP also opposes any proposal that the Securities and Exchange Commission, or any other regulatory body, supplant the Department's judgment as to the conduct standards on which PTEs are conditioned. Not only do these bodies lack the jurisdiction to set conduct standards for the full scope of investment advice subject to the prohibited transaction provisions, but history suggests that any conditions adopted on the basis of such conduct standards will be weaker and less uniform than those currently in place.

Further, NELP opposes any effort to ease PTE conditions for transactions involving variable or indexed annuities. Following extensive investigation, the Department found that these products are highly complex and their distribution channels especially conflicted. If they are sold at all, such recommendations should be made only subject to the full protections of the BICE, not the more lenient conditions of PTE 84-24.

Finally, the Department asks whether product innovation in the mutual fund market should prompt changes to the PTEs. In NELPs view, the arrival of so-called "T-shares" and "clean shares" – while a positive development – is a consequence of the BICE's stringent conditions, not a sign of their obsolescence. Weakening these conditions now would be like throwing away one's umbrella in a rainstorm because conditions have been thus far dry beneath it.

<u>The Best Interest Contract Condition Is the Only Effective Enforcement Mechanism for IRAs and Non-ERISA Plans and Must Be Retained</u>

The Department requests information about the costs and benefits of 'the contract requirement for IRAs," and notes its interest in "regulatory changes that could alter or eliminate contractual . . . requirements." Specifically, the Department asks: "What is the likely impact on Advisers' and firms compliance incentives if the Department eliminated or substantially altered the contract requirement for IRAs."

The BIC is an indispensable part of the BICE because without the threat of private enforcement it creates, there is no meaningful incentive for investment-adviser fiduciaries to comply with the exemption's other conditions. Retirement Investors do not have a statutory private cause of action, and the Department *itself* lacks authority to investigate and enforce violations of the exemption.[11] In terms of enforcement, it is the BIC or nothing.

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[11] *Id.* at 21021.

In fact, the Department's existing and well-developed administrative record on this point is definitive, and it is difficult to imagine additional information that could credibly lead to a different outcome. Based on that record, the Department long ago "determined that the enforceable right to adherence the Impartial Conduct Standards is a *critical* safeguard with respect to investments in IRAs and non-ERISA plans" and acknowledged that the BIC "forms the basis of" these enforcement rights.[12] These rights are so critical because, in absence of the BIC, the only mechanism to enforce compliance with the PTE's conditions is a *self-enforced* 15% excise tax. In preparing the BICE, the Department concluded the obvious: That the excise tax provides an "inadequate [] incentive to ensure compliance with the exemption's standards-based approach," and that this "is particularly true because the excise tax critically depends on fiduciaries self-reporting violations, rather than independent investigations and litigation by the IRS.[13] The BIC condition, on the other hand, in the Department's words, "creates a mechanism for investors to enforce their rights and ensures that they will have a remedy for misconduct." It also, according to the Department, "creates a powerful incentive for Financial Institutions and Advisers alike to oversee and adhere to basic fiduciary standards."[14] Overall, it is Department's conclusion that the "contractual commitment provides an administrable means of ensuring fiduciary conduct, eliminating ambiguity about the fiduciary nature of the relationship, and enforcing the exemption's conditions."[15]

It is worth highlighting briefly why the enforcement of the BICE's conditions – especially the ICSs – is so important. The prohibited transactions are prohibited under ERISA and the Code for a reason. As the Department's regulations make clear, these transactions involve "conflicts of interest that may affect the fiduciary's best judgment on behalf of the plan or IRA."[16] That is to say, these are transactions where the interests of an investment-adviser fiduciary are likely adverse to those of the Retirement Investor. A PTE that allowed investment adviser fiduciaries to engage in such transactions without substantial, *enforceable* protections for Retirement Investors could therefore never meet the requirements under ERISA and the Code that the exemption be "in the interests of plans and their participants and beneficiaries and IRA owners" and "protective of the rights of the participants and beneficiaries of such pans and IRA owners."[17]

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[12] *Id.* at 21020 (emphasis added).

[13] *Id.* at 21022.

[14] *Id.* at 21021.

[15] *Id.* at 21022.

[16] *Id.* at 21006.

[17] *See id.*

Having determined and memorialized the virtues of the BIC condition – the "powerful incentive" it creates for investment-adviser fiduciaries to adhere to the ICSs and the "remedy for misconduct" it provides to Retirement Investors – it would be arbitrary and capricious for the Department to abandon or cripple it without a reasoned explanation for doing so. None appears to exist. Certainly, the Department cannot fall back on the statutory excise tax as a sufficient incentive for compliance with the ICSs and other substantive conditions. It has already determined, for good reason, that this mechanism is "inadequate." Indeed, given the restrictions on public enforcement of PTEs involving IRAs and non-ERISA plans, the BIC is the only meaningful compliance mechanism for such transactions. The Department has said as much, treating the ICSs as dependent on the BIC in this context. "The enforceability of the exemption's provisions *enables* the Department to grant exemptive relief based on broad protective standards, applicable to a wide range of investments and compensation structures, rather than rely exclusively upon highly prescriptive conditions applicable only to tightly specified investments and compensation structures."[18]

Without the BIC there is no private enforcement of the ICSs for IRA transactions; without private enforcement there is no significant enforcement at all, and of course, without enforcement, the ICSs are worthless.

<u>The Warranties Contained in the Best Interest Contract Are the Only Effective Enforcement of the Policies-and-Procedures Conditions for IRAs and Non-ERISA Plans and Must Be Retained</u>

The Department also requests new information about the BICE's warranty conditions, asking: "What is the likely impact on Advisers' and firms' compliance incentives if the Department eliminated or substantially altered the warranty requirements." No new information is likely to detract from the Department's previous exhaustive analysis.

The warranties of compliance with the BICE's anti-conflict policies-and-procedures conditions are the only way to directly enforce these conditions with respect to IRAs. As with all of the conditions enforced through representations or warranties in the BIC, there is no realistic alternative incentive for compliance. Retirement Investors lack a statutory private right of action, and the minimal government enforcement that exists – the excise tax – turns on self-reporting. And compliance with these policies-and-procedures conditions is important. According to the Department, they are "a critical part of the exemptions protections."[19]

Moreover, the warranty conditions are not just the only compliance mechanism, they are likely also an effective one. After reviewing the substantial

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[18] *Id.* at 21022 (emphasis added).

[19] *Id.* at 21041.

record on this point, the Department already concluded that: "The warranty, and potential liability associated with the warranty, gives Financial Institutions both the obligation and the incentive to tamp down harmful conflicts of interest . . .."[20] It continued:

> [T]he enforceable obligation to maintain and comply with the policies and procedures as set forth herein, and to make relevant disclosures of the policies and procedures and of Material Conflicts of Interest, should create a powerful incentive for Financial Institutions to carefully police conflicts of interest, reducing the need for litigation in first place.[21]

As with the BIC condition, if Department believes that this expectation is unjustified, Section 706 of the Administrative Procedure Act requires it to explain why, and support that explanation with new evidence. NELP is aware of none.

<u>The BICE's Ban on Class-Action Waivers in Court Is Crucial to Effective Enforcement</u>

Since it concluded that "the risk of litigation . . . gives fiduciaries a powerful incentive to adhere to broad, flexible, and protective standards applicable to an enormous range of transactions and provides a remedy when fiduciaries fail to comply with those standards,"[22] the Department reasonably barred investment-adviser fiduciaries from mandating waiver of class claims in court ("Class Actions") for violations of the ICSs or other conditions.[23] Just as the use of liability disclaimers would vitiate the incentive to comply with the BICE's conditions, so too would this type of waiver overly narrow an investment-adviser fiduciary's scope of liability. The reason is simple. As the Department recognized, the monetary effect of systemic violations on individual investors is often "too small to justify pursuit of an individual claim."[24] Thus, unless aggregated claims of some form are permitted, Retirement Investors have severely limited redress for economically minor, but nonetheless painful, violations of the BICE's conditions. This problem is especially severe for lower-income investors for whom damages may be personally substantial but still not sufficient to attract private counsel. And, with respect to IRAs, where private enforcement of the BICE is the only serious enforcement mechanism, investment-adviser fiduciaries have *carte blanche* to engage in small-bore systemic violations.

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[20] *Id.*

[21] *Id.*

[22] *Id.* at 21022.

[23] *See id.* at 21043.

[24] *Id.*

These two conclusions by the Department were recently confirmed analysis conducted by the Consumer Finance Protection Bureau (the "CFPB"), which also banned pre-dispute arbitration agreements that prohibit class actions.[25] The Rule was promulgated after the CFBP, at the direction of Congress, made a comprehensive study of the use of arbitration agreements.[26] In the preamble to the Rule, the CFPB concluded that "allowing consumers to seek relief in class actions, in turn, would strengthen the incentives for companies to avoid legally risky or potentially illegal activities and reduce the likelihood that consumers would be subject to such practices in the first place".[27] The CFPB also agreed with the Department's conclusion about the relative inadequacy of individual relief. "The Bureau believes that the class action mechanism is a more effective means of providing relief for violations of law or contract affecting groups of consumers than other mechanisms available to consumers, such as individual formal adjudication (either in court or in arbitration) or informal efforts to resolve disputes."[28]

Once it is accepted that class-wide relief must remain available if the BICE's private enforcement regime is to function, it is clear that it must remain available *in court*. As the Department concluded, arbitral tribunals are poorly equipped to handle class claims.[29] The Supreme Court concurs. Writing for the majority in *AT&T Mobility LLC v. Conception*, Justice Scalia noted:

> Classwide arbitration includes absent parties, necessitating additional and different procedures and involving higher stakes. Confidentiality becomes more difficult. And while it is theoretically possible to select an arbitrator with some expertise relevant to the class-certification question, arbitrators are not generally knowledgeable in the often-dominant procedural aspects of certification, such as the protection of absent parties.[30]

To NELP's knowledge, there are no countervailing arguments in favor of class arbitration under the BIC. The CFPB's analysis is telling on this point too. It concluded that class arbitration is not widely used in consumer transactions.[31]

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[25] *See* CFPB, Final Rule; Official Interpretations, 82 Fed. Reg. 33210 (July 19, 2017).

[26] *See* CFPB, *Arbitration Study: Report to Congress, Pursuant to Dodd-Frank Wall Street Reform and Consumer Protection Act § 1028(a)* (Mar. 2015), *available at* http://files.consumerfinance.gov/f/201503_cfpb_arbitration-study-report-to-congress-2015.pdf.

[27] Final Rule; Official Interpretations, 82 Fed. Reg. at 33280.

[28] *Id.* at 33273.

[29] Adoption of Class Exemption, 81 Fed. Reg. at 21043 (discussing FINRA's ban on class actions in arbitration).

[30] 563 U.S. 333, 348 (2011).

[31] *See* Final Rule; Official Interpretations, 82 Fed. Reg. at 33274.

Industry does not like class arbitrations and therefore between 85 and 100 per cent of contracts with arbitration agreements ban class arbitration, in addition to class actions.[32] So even if class arbitration was as effective as class actions, it is not widely available.

Critics of the BICE have raised general complaints that class actions will impose steep costs on investment-adviser fiduciaries and their employers. But these concerns are greatly exaggerated. To begin with, class actions are generally only appropriate where traditional joinder of all parties is impracticable.[33] For advisers with relatively small client-bases, it is reasonable to question whether the putative class-sizes could ever meet applicable numerosity requirements. Beyond this, typicality and commonality requirements[34] ensure that only systemic violations of the BICE's conditions are subject to class claims.

Nor should the Department pay heed to the Justice Department's (the "DOJ") erroneous and misguided new litigation position that the BICE's ban on class-action waivers conflicts with the Federal Arbitration Act (the "FAA"). Nothing in the FAA prevents the Department from barring class action waivers in contracts in order for investment-adviser fiduciaries to be exempt from otherwise prohibited transactions pursuant to the BICE.

Although the DOJ claims its switch in position is compelled by the Acting Solicitor General's new position in *NLRB v. Murphy Oil*,[35] the issues in these cases are entirely distinct. The core question presented in *Murphy Oil* is whether private arbitration agreements that ban collective actions can be enforced given the right to concerted activity established in the National Labor Relations Act.[36] Regardless of the merits of this argument, it is entirely irrelevant to the BICE, which implicates the scope of the Department's exemptive authority under ERISA and the Code to allow something which would otherwise be prohibited by law. The BICE does not prohibit the enforcement of existing arbitration agreements, the core focus of the FAA, but rather bans class action waivers for investment-adviser fiduciaries who want to choose the option of the BICE. The FAA is not concerned with promoting or hindering class action waivers in this context.

Moreover, the DOJ provides no other rationale than *Murphy Oil* to support its reversal of position. It barely addresses the dispositive issue in this case. In conclusory fashion, and without a single citation, the DOJ declares that "losing the exemption and the associated relief from the prohibited transaction provision

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[32] *Id.*

[33] *See, e.g.*, Fed. R. Civ. P. 23(a)(1); N.Y. C.P.L.R. 901(a)(1).

[34] *See, e.g.* Fed. R. Civ. P. 23(a)(2)-(3); N.Y. C.P.L.R. 901(a)(2)-(3).

[35] Nos. 16-285, 16-300, and 16-307 (U.S. June 16, 2017).

[36] See Br. for United States as Amicus Curiae, *Murphy Oil*, Nos. 16-285, 16-300, and 16-307 (U.S. June 16, 2017).

[] for having entered into an arbitration agreement" would be "a significant obstacle" to the FAA.[37] To the extent the DOJ equates "obstacles" to the formation of agreements with prohibitions on enforcement of existing agreements in violation of the FAA, its formulation is incorrect.

Finally, if the Department abandons the provision in the BICE banning class action waivers it cannot reasonably rely on the financial services industry's grossly exaggerated estimates of liability costs, or the threat of market disruptions related to those costs, to justify revisions to the BICE or adoption of new PTEs. Having relieved the industry of its primary concern about the BICE no further changes could be justified.

<u>The Department Should Not Incorporate Conduct Standards from the SEC or Any Other Regulatory Body</u>

The Department paid substantial attention to the ICSs, devoting seven Federal Register pages of the BICE's preamble to their careful explanation.[38] This underscores that a hypothetical future SEC adviser conduct standard – let alone mere compliance with existing securities and insurance regulations – cannot be justified.

The Department now asks: "To what extent does the existing regulatory regime for IRAs by the Securities and Exchange Commission, self-regulatory bodies or other regulators provide consumer protections that could be incorporated into the Department's exemptions or that could serve as a basis for additional relief from prohibited transaction rules." Creating an exemption from newly applicable prohibited transaction provisions based on no more than compliance with the preexisting regulatory regime defeats the purpose of extending those provisions in the first place. During the six-year rulemaking that produced the Conflict of Interest Rule and the BICE, the Department thoroughly studied the market for IRA investment advice and concluded that it was rife with conflicts of interest, harming Retirement Investors.[39] This situation existed notwithstanding presumed compliance with the "existing regulatory regime." At its broadest, what the Department appears to propose here is nothing less than a back-door withdrawal of the Conflict of Interest Rule as it applies to investment advisers serving IRAs, which will result in a substantial loss of protections (and assets) for Retirement Investors.

The Department's apparent suggestion that compliance with a future SEC conduct standard could form the basis of a PTE fares little better. For one thing, the SEC must regulate investment advisers and broker-dealers whose advisory services are "solely incidental" to their broker or dealer services under separate

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[37] *Id.*

[38] *See* Adoption of Class Exemption, 81 Fed. Reg. at 21026-33.

[39] *See* RIA at 127-166.

statutes.[40] While investment advisers are subject to the Investment Advisers Act of 1940, exempted broker-dealers are only subject to the Exchange Act and certain self-regulatory organizations. The dichotomy has resulted in radically different standards of conduct, notwithstanding the public's difficulty in differentiating between the two types of advisers.[41] Unless the SEC proposes to, for the first time, harmonize the applicable standards of conduct between registered investment advisers and exempted broker-dealers, incorporation of the SECs standards as conditions for a PTE will continue to reflect this distinction and confuse Retirement Investors. Further complicating matters is the fact that the SEC's regulatory authority is limited to investment advice related to securities. In contrast, the prohibited transaction provisions in ERISA and the Code cover all plan assets, introducing a potentially third separate standard of conduct on which a PTE would need to be conditioned. In this scenario, a Retirement Investor might benefit from one standard of conduct when receiving advice from an SEC-registered investment adviser, receive a different – probably lower – standard of conduct from a broker-dealer, and a still a third one from an insurance salesman. The uniformity provided by the ICSs under the BICE is far superior to such a regime in terms of its protections and practicability. Finally, while it is impossible to know what a still-hypothetical new SEC conduct standard might look like, in the past, the SEC has shown a penchant for disclosure-based regulation of conflicts of interest. And research has consistently shown that disclosure is a generally ineffective protection against conflicts of interest in the market for financial advice.[42]

<u>Conflicted Advice about Variable and Indexed Annuities Must Remain Subject to the BICE</u>

One of the most important aspects of the regulatory package that produced the BICE and the Fiduciary Rule was the revocation of PTE 84-24 as to variable and indexed annuities. After extensive study and outreach,[43] the Department concluded because these products are highly risky, "often quite complex[,] and subject to significant conflicts of interest at the point of sale," they should be sold under the BICE.[44]

It is therefore surprising that, without providing any evidence of a change in the complexity of these products or the serious conflicts affecting their

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40 *See* 15 U.S.C. § 80b-2(a)(11)(C) (exempting certain broker dealers from the definition of "investment advisers" for the purposes of the Investment Advisers Act of 1940).

41 *See* RIA at 108, 135-36.

42 *See Id.* at 108, 135-36, 268-71

43 *See* EBSA, Adoption of Amendment to and Partial Revocation of PTE 84–24, 81 Fed. Reg. 21147, 21152 (Apr. 8, 2016) (noting the receipt of thousands of comment letters).

44 *Id.* at 21153.

distribution, the Department would now request information on moving variable and indexed annuities back to PTE 84-24. The conditions of PTE 84-24 are far less protective than those of the BICE. For example, PTE 84-24 does not require the implementation of anti-conflict policies and procedures, nor does it require disclosures of material conflicts, as under the BICE. And, although PTE 84-24 does require adherence to the ICSs, compliance with this condition cannot be meaningfully enforced for transactions involving IRAs because PTE 84-24 does not require use of the BIC. In NELP's view, movement of variable and indexed-annuities out of the BICE would open a huge loophole in the Department's effort to reduce harmful conflicts of interest.

The Department also asks whether insurance intermediaries ought to be allowed to qualify as "Financial Institutions" for purposes of the BICE. This is a bizarre request since, as the Department knows, such entities may already qualify as a Financial Institution if they are described as such in an "individual exemption granted by the Department."[45] Although these entities lack the independent regulatory oversight to qualify as Financial Institutions on categorical basis, they are free to apply to the Department for an individual exemption, explaining their controls and "their ability to effectively supervise individual Advisers' compliance" with the BICE.[46] The availability of individualized relief from the prohibited transaction provisions strikes an appropriate balance between the maintenance of flexibility in insurance distribution models and the Department's heretofore expressed concern that investment-adviser fiduciaries be properly supervised.

<u>The Development of New Mutual Fund Shares Does Not Justify Changes to the PTEs</u>

The Department asks whether the development T-shares and clean shares of mutual funds "creates an opportunity for a more streamlined exemption." It does not, for a variety of reasons. First, T-shares, while less conflicting than traditional "A-shares," may still provide investment-adviser fiduciaries with third-party payments that can skew their recommendations about which investments to make and how often to trade or "rebalance." A clean-shares PTE is unnecessary, because clean shares properly used allow investment-adviser fiduciaries to take advantage of an already existing streamlined exemption available under the BICE to Level-Fee Fiduciaries.

T-shares reduce the severity of conflicts of interest inherent in adviser-recommendations of mutual fund shares because the payments the funds make to distributors in the form of front-end loads and 12b-1 distribution fees are smaller

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[45] Adoption of Class Exemption, 81 Fed. Reg. at 21067.

[46] *Id.*

than those under traditional A-shares.[47] To the extent they entirely supplant A-shares, they will also eliminate conflicts with respect to recommendations between mutual fund investments since they will provide distributors uniform payments across funds.[48] But make no mistake: The availability of T-shares still entails a conflict of interest. Because these shares continue to provide third-party compensation to distributors, investment-adviser fiduciaries have an incentive to recommend them over other investment products, such as many Exchange Traded Funds, that make no such payments. Additionally, because one type of payment provided by T-shares continues to be a one-time front-end load made upon purchase of the share, "churning" is still a risk.

Experience may eventually prove that the lower third-party payments associated with T-shares reduce these conflicts sufficiently to allow for easing some of the BICE's conditions. But for now, the T-shares are new and their precise effect on investment-adviser-fiduciary conflicts of interest is unknown. Since T-shares appear to have emerged as a product of the BICE's conditions,[49] not in parallel to them, it would be a mistake to weaken any of the BICE's protections now.

As for clean-shares, when used by investment-adviser fiduciaries as part of a level-fee compensation arrangement, they already receive special treatment under the BICE. Under these circumstances, Level-Fee Fiduciaries do not face any conflicts of interest with respect to recommending particular investments or trading frequency and so qualify for the streamlined conditions of Section II(h) of the BICE.[50] Nevertheless, as the Department recognizes, Level-Fee Fiduciaries are conflicted in a broad sense when they recommend that a Retirement Investor rollover funds into an IRA or switch from a low-activity commission-based account to a fixed-fee account.[51] This dynamic does not change just because clean shares may be one of the investment products recommended following a rollover, and so the minimal conditions currently in place under Section II(h) of the BICE remain appropriate.

In any case, NELP believes that the Department should be extremely cautious about creating product-specific exemptions. To do so can have the effect

[47] Morningstar, *Early Evidence on the Department of Labor Conflict of Interest Rule: New Share Classes Should Reduce Conflicted Advice, Likely Improving Outcomes for Investors*, Morningstar (Apr. 2017), *available at* https://corporate1.morningstar.com/ResearchLibrary/article/802119/early-evidence-on-the-department-of-labor-conflict-of-interest-rule/.

[48] *Id.*

[49] *Id.*

[50] *See* Adoption of Class Exemption, 81 Fed. Reg. at 21079.

[51] *See id.* at 21011.

of picking winners and freezing future innovations promoted by the BICE and other flexible, standards-based, PTEs.

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Finally, the release of the RFI and the Department's resulting receipt of the information such as this letter from stakeholders, in no way excuses the Department from engaging in full notice and comment procedures should it decide to commence a rulemaking with respect to the PTEs or any other issue related to the Fiduciary Rule.[52]

Sincerely,

Christine L. Owens
Executive Director

[52] *Cf.* 5 U.S.C. §553 (limiting the circumstances under which an agency may avoid notice and comment procedures in a rulemaking).