



PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

2415 A Wilcox Drive | Norman, OK 73069
Toll Free (888) 621-7484 | Fax (405) 360-2063
www.piaba.org

September 24, 2015

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflicts of Interest Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: RIN 1210-AB32: Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice

To Whom It May Concern:

I write on behalf of the Public Investors Arbitration Bar Association (“PIABA”), an international bar association comprised of attorneys who represent investors in securities arbitrations. Since its formation in 1990, PIABA has promoted the interests of the public investor in all securities and commodities arbitration forums, while also advocating for public education regarding investment fraud and industry misconduct. Our members and their clients have a strong interest in rules which govern the conduct of those who provide advice to investors.

The Department of Labor (the “Department”) has solicited comment on whether it should replace its 1975 regulations with a new definition of fiduciary investment advice. PIABA submits this second comment to supplement our initial comment and to address certain objections raised with respect to the Department’s proposed rulemaking.

As with our original comment letter, this letter will primarily focus on the delivery of investment advice to retail investors and those contemplating whether they should roll over their employer sponsored retirement plans into IRAs. Members of PIABA represent investors who have received flawed investment advice from brokers and investment advisers, frequently in connection with their retirement savings. Our members have represented tens of thousands of investors who have been harmed by conflicted investment advice, which is often subject to FINRA’s suitability standard. These investors will continue to be harmed by this conflicted advice, and forced to determine the impact of the conflicts themselves, if changes are not made to the standards governing those who provide advice to retirees.

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Throughout this process, it has been argued that the Department should wait for the SEC to adopt its fiduciary standard first. But that argument is flawed for a variety of reasons. First, the SEC has not yet given any indication it is even going to adopt a fiduciary standard. It has been studying the issue since Dodd-Frank was adopted in 2010, yet has not taken any steps to issue its own proposed rule. To suggest that the SEC is on the verge of proposing a rule which would impose a fiduciary standard on brokers does not recognize the reality that currently exists. Second, the Department is a separate entity with its own regulatory agenda. It is an agency separate and distinct from the SEC. Nothing in the statutory language of ERISA suggests that the Department should operate in a subordinate capacity to the SEC, or that the SEC has superior regulatory authority over the brokerage industry. The Department has been tasked with enforcing ERISA in the same manner the SEC has been tasked with enforcing aspects of the Securities Act of 1933 and the Securities Exchange Act of 1934. One does not preempt the other from acting.

Representatives of the securities industry have also set forth the “too many cooks in the kitchen” argument, claiming that adding another regulator with oversight over the industry will only serve to confuse those who try to sell investment products to retirees. This argument ignores the fact that the Department already oversees ERISA enforcement. Further, the brokerage industry is a complex industry, and depending on the type of business it is engaged in, the industry may be subject to the oversight of the CFTC, the NFA, the MSRB, the Treasury, as well as every state securities and insurance regulator. Obviously, given the critical nature of the securities markets, close oversight is warranted. The industry has figured out how to work within these constraints. To argue that it will be overly burdensome to add the Department to the list of regulators is just not credible.

It has also been argued that adding a new standard of conduct that would only be applicable to retirement accounts may confuse investors. The proponents of the argument continue, claiming it would be better to leave brokers subject to the lesser suitability standard until the SEC adopts a standard which would be applicable to all investment accounts. As discussed above, the SEC has not indicated that it intends to adopt a uniform fiduciary standard at this time.

Moreover, under the current regulatory structure, investors are already confused about what standard governs their financial advisor. An investor may have a discretionary account with the financial advisor, which will require that the financial advisor act as a fiduciary. That same investor may also have an advisory account with the same financial advisor, which will require that the financial advisor act as a fiduciary. The investor may have a third account, a commission-based brokerage account, which will allow that same financial advisor to act under the suitability standard. Under the current regulatory structure, investors are faced with varying standards covering the same financial advisor depending on the hat that person may be wearing at any given point in time. One must also consider the fact that some states impose a strong fiduciary duty upon financial advisors, regardless of which hat the advisors may be wearing. Neither FINRA nor the industry have been concerned that the investor may be “confused” under the current regulatory regime or eager to address the confusion.

In fact, the industry’s conduct feeds into the confusion. Individuals with whom customers are interacting are calling themselves, “Financial Advisor,” “Wealth Management Specialist,” and “Vice-

President of Investments,” furthering investor confusion. Brokers do not call themselves “brokers” or “salespersons.” More than three out of four investors don’t understand that the current laws and rules may impose different duties on brokers and investment advisers, according to a 2010 survey conducted for the Consumer Federation of America (CFA), AARP, the Investment Adviser Association, the Financial Planning Association, the CFP Board, the North American Securities Administrators Association (NASAA), and the National Association of Personal Financial Advisors.¹ A 2015 study confirmed that most retail investors think their financial advisor – regardless of which type of advisor it is – is a fiduciary.² The industry is well-aware of the confusion. In a survey open to all brokers, investment advisers, and insurance consultants and producers, 97 percent of them said “investors don’t understand the differences between brokers and investment advisers.”³ This confusion will be addressed to some degree by requiring financial advisors to conform to the standard to which investors believe they are already held. The Department’s rule proposal is the first step in that direction.

PIABA agrees it would be ideal to have brokers held to a fiduciary standard when handling every account; however, the fact that the Department’s rule proposal only reaches retirement savings is not a reason to reject the rule. Retirement savings are an important place to begin because this is the money that is meant to provide for individuals as they age and can no longer work. If this money is lost, is it more difficult to replace. FINRA itself has pointed out that retirement is a key liquidity event and transactions involving retirement money are deserving of special scrutiny:

These events may heighten conflicts of interest because of the large sums of money that may be involved. When an individual changes jobs or retires, she must decide what to do with her 401(k) account—leave it in place, roll it over to a new employer’s plan or roll it into an individual retirement account (IRA). Firms have a strong incentive to gather assets, and as a recent Government Accountability Office report noted, “(r)ollovers have become the largest source of contributions to IRAs.” It is not always clear, however, that rolling over a 401(k) to an IRA—as opposed to keeping money within the plan or rolling it over to a new employer’s

¹ See Infogroup/ORC, “U.S. Investors & The Fiduciary Standard: A National Opinion Survey,” September 15, 2010, available at http://www.cfp.net/docs/public-policy/us_investors_opinion_survey_2010-09-16.pdf?sfvrsn=2.

² See Spectrem Group, “Fiduciary – Do Investors Know What It Means,” 2015, available at <http://349ab54c3b58919c6638-ff70f51d4942f2bbd11ba0e41cfec577.r51.cf2.rackcdn.com/Fiduciary%20Whitepaper.pdf>

³ See “Trustworthy Advice and Individual Investors: Will Regulators Act in Investors’ Best Interest?” issued in August 2013 to report the findings of the 2013 fi360-ThinkAdvisor Fiduciary Survey, available at http://www.fi360.com/uploads/media/fiduciarysurvey_resultsreport_2013.pdf; see also “Seeking Trustworthy Advice for Individual Investors – Financial Intermediaries Indicate Strong Support for Fiduciary Standard” issued in February 2015 to report the findings of the 2015 fi360 Fiduciary Standard Survey, available at <http://www.fi360.com/uploads/media/2015fiduciarysurvey.pdf>; and “Fiduciary Duty and Investment Advice: Attitudes of 401(k) and 403(b) Participants,” a report published by the AARP in September 2013 (majority of participants concerned investment advice by plan providers not held to fiduciary standard). All related documents available at <http://www.aarp.org/research/topics/economics/info-2014/fiduciary-duty-and-investment-advice---attitudes-of-401-k--and-4.html>.

plan—is the best option for an investor. The recommendations a representative makes at these points in time may have profound implications for the investor and deserve thorough scrutiny and review.⁴

As FINRA has recognized, retirement may free up large sums of money for a retiree and may heighten conflicts of interest between the customer and the financial advisor. Because of these heightened conflicts, a broker should have a higher duty when handling this money and providing advice with respect to these accounts. Unfortunately, the current system does not effectively manage the conflicts present when a broker gives advice to a retirement investor. FINRA's suitability rule falls short when it comes to protecting individuals as the following stories illustrate:

- *George and Phyllis both worked for a large manufacturing company. After working most of their adult lives for the same company, they decided to retire early after meeting broker Bob. Bob told them they could take the early retirement option in a lump sum payout and if they invested it with him, they would receive far more money every month than if they opted for the guaranteed pension benefit (which also provided them with medical insurance). George and Phyllis rolled over almost a half million dollars to Bob, agreeing to let him manage their retirement. He ended up investing them in risky mutual funds, and in two and a half years, Bob lost half their money.*

- *Perry was a machinist for two major manufacturing companies. He retired after meeting his broker, Charlie. Charlie convinced Perry that he would earn enough from his investments that he would not have to work. Charlie invested Perry's retirement savings in a number of different securities, including stocks, variable annuities and a ponzi scheme. Perry has since returned to work, teaching part-time. Charlie also handled Walter and Kaye's retirement accounts. Walter was a mechanic and Kaye was an office assistant. They counted on Charlie to help them manage their retirement savings as well. Like Perry, Charlie invested their retirement funds in speculative stocks and the same ponzi scheme.*

- *Mary was a bus driver. She received disability payments following a bout of lung cancer, but at the time, was still working as a bus driver. Broker Sam told her that if she died while on the job, her daughter would not receive any death benefits. He told Mary that if she retired and turned her pension over to him, he could earn her much more than her pension would pay her, and her daughter would receive the principal of the estate on her death. Sam showed her income plans demonstrating how much she would receive each month, but the hypothetical projections utilized unrealistic returns. Mary retired and turned her pension over to Sam, believing he was going to provide for her. She withdrew her living expenses*

⁴ FINRA Report on Conflicts of Interest, October 2013, available at <https://www.finra.org/sites/default/files/Industry/p359971.pdf>.

from her account, believing she could based on the projections Sam had provided to her. Unfortunately, the account performance did not meet the projections, and the withdrawals severely depleted the accounts. Mary can barely pay her mortgage.

- *Harry and Joyce met Steve at a retirement planning seminar. Harry was a cable splicer and Joyce was a secretary. As Harry approached retirement, Steve convinced Harry to sign away his pension and roll over his 401(k) into an IRA so that Steve could manage it. A year later, Joyce followed suit and rolled over her retirement savings to Steve. Steve told them he would invest the money safely and ensure that they could withdraw approximately 10% each year. In reality, he invested the accounts aggressively, and in a short period of time, they lost almost half the value of the two accounts. Larry worked for the same company as Harry and Joyce and met Steve at about the same time Harry began investing. Steve provided Larry with a retirement projection, showing that he could receive returns of 10 to 12% per year. Steve's presentation and the retirement projection induced Larry to retire early, sign away his pension as Harry had done, and turn over his million dollars in retirement savings to Steve to manage. Here too, Steve invested Larry's retirement funds aggressively, and in a short period of time, he had lost more than half his retirement funds. George worked for the same company. He and his wife, Barbara, also met Steve at a retirement planning seminar that he had hosted. After being offered an early retirement package, George sought Steve's advice. He convinced George that he had more than enough savings to retire if Steve could manage it as a rollover IRA. George retired, signed away his pension, and rolled over his retirement savings to Steve to manage. Shortly thereafter, Barbara transferred her IRA to Steve to manage as well. Steve invested George and Barbara's retirement savings in aggressive mutual funds, in an attempt to generate the income he promised they could receive each month. In two short years, they had lost half of their original investment.*

In each of these cases, the financial advisor encouraged his client to retire and cash out a pension so that it could be rolled over into an IRA. Absent those retirements, the financial advisor would not have any money to invest, and would not earn any money from his client. The suitability rule did not prevent the financial advisors from convincing their clients from cashing out their pensions and rolling their retirement funds over into IRAs so that the financial advisors would have access to the money. In each case, the clients would have been better served had they left their money with their company sponsored pension plans. However, their trust was betrayed by advisors they believed were acting in their best interests. None of these investors understood that the financial advisors were acting under a suitability standard, that conflicts of interest affected the advice to buy certain products, or even that the advice to roll over the retirement money in the first place was impacted by a conflict of interest. They thought they were getting assistance from financial professionals regarding their retirement options.

As FINRA itself points out, IRAs are primarily funded by rollovers:

Rollovers from employer-sponsored retirement plans are the largest source of contributions to IRAs. A June 2013 Employee Benefits Research Institute report states that in 2011, assets rolled over into IRAs were almost 13 times the amount of direct contributions. This is not a new trend; ICI data indicates that from 1996 to 2008 more than 90 percent of funds flowing into traditional IRAs came from rollovers, primarily from plans. In 2013, 49 percent of the traditional IRAs held by U.S. households included rollover funds.⁵

The suitability rule may or may not govern the financial advisor's recommendation that an individual cash out a pension and roll that money into an IRA. According to FINRA:

A recommendation concerning the type of retirement account in which a customer should hold his retirement investments typically involves a recommended securities transaction, and thus is subject to Rule 2111. For example, a firm may recommend that an investor sell his plan assets and roll over the cash proceeds into an IRA. Recommendations to sell securities in the plan or to purchase securities for a newly opened IRA are subject to Rule 2111.⁶

There is ambiguity here. While the rule clearly applies to purchases and sales of securities, it does not address the advice preceding the opening of the IRA account in which the trading takes place. It does not clearly address the underlying recommendation to close a 401K or other retirement account and roll the funds into an IRA. This critical gap in regulation must be addressed. The gap leads, time and time again, to disastrous results for retiring investors, who must be protected and it is clear that the current regulations are not doing so.

Based on the number of assets being rolled into IRAs each year, it is obvious that financial advisors are not fully weighing the factors set forth by FINRA⁷ when analyzing whether it is appropriate for an individual to roll over assets from an employer's plan. FINRA expects firms to maintain a commitment to high ethical standards and to putting customers' interests first as a means of managing conflicts of interest.⁸ However, as demonstrated by the conduct outlined above, expectation of a commitment to ethical standards is not enough to protect investors. More must be done. These conflicts must be eliminated to protect investors, rather than continuing to rely on the firms to manage them.

⁵ FINRA Regulatory Notice 13-45, "Rollovers to Individual Retirement Accounts, FINRA Reminds Firms of Their Responsibilities Concerning IRA Rollovers," December 2013, available at <http://www.finra.org/sites/default/files/NoticeDocument/p418695.pdf>. (Internal citations omitted.)

⁶ *Id.*

⁷ See FINRA Regulatory Notice 13-45, pp. 2-3.

⁸ See FINRA Report on Conflicts of Interest, p. 2.

Moreover the FINRA rules do not cover insurance brokers. Not every transaction involves securities.

- *Mike had been a fire marshal and had participated in the State Public Employees Retirement System (PERS). He asked his insurance company for a broker to review his life insurance policy. He ended up being assigned to Larry, who, on his own initiative, created a financial plan for Mike and his wife, Jen. Larry recommended that Mike take a lump sum distribution of his PERS money and roll it into an IRA annuity. About four months later, Larry recommended that Mike withdraw almost half the funds from the IRA annuity and purchase two non-IRA annuities, one each for Mike and Jen. Four months later, Larry recommended Mike withdraw half the remaining value of the IRA annuity and deposit the funds in the non-IRA annuities. As a result of the withdrawals from the IRA annuity, Mike incurred significant tax penalties because he had not yet reached age 59 ½. He also incurred significant withdrawal charges by taking money from the IRA annuity so soon after the purchase. Mike lost over 40% of his retirement money due to the tax implications of the transactions and the surrender charges. Mike also lost his pension.*

Fixed annuities are not considered securities – they are considered life insurance products. Thus, while they are undoubtedly investment products, they escape regulation from the SEC and other securities regulators. While neither the SEC nor FINRA can or will step up and forbid the sort of conduct that destroyed Mike and Jen’s retirement savings, the Department’s rulemaking will address the gap in regulation and ensure that all advice to retirement investors is treated equally and that investors receive the same level of protection.

The Department’s rule proposal must be enacted to protect retirement investors. PIABA supports the scope of the proposal to cover all retirement accounts, especially advice directed towards IRAs and rollovers considering the heightened conflicts such advice triggers.

The Best Interest Contract Exemption and its timing

The Best Interest Contract Exemption allows brokers to engage in what would otherwise be prohibited transactions so long as they enter into a contract with retirement investors and agree to certain parameters on the relationship which are intended to protect these investors. For the reasons set forth in our original comment letter, PIABA is very supportive of the best interest contract exemption. It is essential that financial advisors acknowledge their fiduciary status under either ERISA or the Code with respect to any recommendation to a retirement investor to purchase, sell or hold an asset.

Arguments have been raised during the comment period that there should be a distinction between selling and advising; however, PIABA disagrees. The definition of recommendation, as set forth by FINRA, has been made clear over time. To the extent the interaction between a retirement investor and a financial advisor is an advisory relationship, and involves an otherwise prohibited transaction, the financial advisor should be required to use the Best Interest Contract Exemption.

There is no need to expand any other exemption to cover the relationship. In that context, the financial advisor will not be acting as a seller.

This distinction is important for another reason. It is important that the relationship be memorialized in a contract which is fully enforceable by the investor. As described in our prior comment letter, financial advisors are currently subject to fiduciary standards under state law in a number of states. Courts in at least ten percent of the states across the country have recognized that the broker – customer relationship is a fiduciary relationship in all instances,⁹ and courts in other states have recognized a fiduciary relationship when special circumstances exist, such as when the client is naïve with regard to financial matters.¹⁰ Notwithstanding this case law, brokerage firms routinely disclaim any fiduciary relationship, taking the position that the financial advisor was acting solely at the direction of the customer, executing the transactions the customer demanded. The financial advisor and the firm take no responsibility for their role in advising the customer, beyond complying with the bare minimum requirements of the suitability rule. The brokerage industry has relied on the distinction between “selling” and “advising” for decades, arguing that they have been paid to execute transactions - for their services related to selling securities rather than for providing advice. The industry ignores that the sales would not take place but for its representatives advising clients to buy or sell certain products. It is time for the illusory distinction between selling and advising to end.

Certain objections have been made with respect to the timing of the signing of the contract as currently contemplated by the proposed rule. PIABA does not object to adjusting the timing of the delivery of the Best Interest Contract, and requiring that it be signed once it agreed that the customer will do business with the financial advisor. However, the terms of the rule should make it clear that the financial advisor will be bound by the terms of the Best Interest Contract prior to its signing and may not engage in any prohibited conduct even prior to a customer signing the agreement.

As outlined in its initial comment letter, PIABA continues to support the prohibition of sales of certain types of securities to retirement accounts. There are a number of types of securities that are not appropriate investment options for retirement accounts, especially when sold by financial advisors given the conflicts of interest present. PIABA hopes the Department will continue to prohibit certain transactions in retirement accounts as outlined in the original rule proposal. In particular, PIABA urges the Department to ensure that annuities be prohibited in retirement accounts. The vast majority of annuities (be they fixed or variable) offer a single benefit: tax deferral. Those annuities are typically ridden with exceptionally high fees and surrender charges. Given that retirement accounts are, by their nature, tax deferred, the principal annuity benefit of tax deferral is redundant and there is no justification to saddle retirees with the costs and fees associated with these products.

Several commenters have suggested that adoption of the Best Interest Contract will eliminate options for smaller retirement savers. The industry has indicated its members may opt to migrate its

⁹ See, e.g. California, Georgia, Florida, Missouri, Puerto Rico, South Carolina, and South Dakota.

¹⁰ See, e.g. Massachusetts, Michigan, New York, Utah, and West Virginia.

IRA business from transaction based accounts to fee based accounts.¹¹ However, to do so would be wholly inappropriate. Such advice would itself violate the best interest rule and is simply a threat to replace one conflict with another:

Conflicts also may arise in recommending the type of account that a customer should open with a firm. A firm that is dually registered as a broker-dealer and an investment adviser should consider whether a commission-based or fee-based account is more appropriate for a customer. Many variables, including a customer's desire for ongoing advice and portfolio management, may affect the decision. Depending on the circumstances, fee-based accounts may be preferable for customers with a fair amount of trading activity or the desire for active account monitoring and ongoing advice. Commission-based accounts may be more cost-effective or appropriate for customers with low trading activity.¹²

This threat also fails to take into account the variety of fee based alternatives that exist. In addition to an asset-based fee, a firm may charge a one-time or periodic fixed fee for advice. As set forth during her testimony, Sheryl Garrett, Founder and President of Garrett Planning Network, Inc., outlined a number of different fee arrangements available to customers of financial advisors within her network.¹³

Several commenters suggested that investors should just receive greater disclosure. For example, Fidelity suggested replacing the Best Interest Contract with a three point disclosure that provides information about the scope of an advisor's services, the compensation payable to the advisor for the types of investment options the advisor might recommend, as well as any other material conflicts of interest, and a link to a website where an investor may obtain more detailed information about the cost of and compensation to related to any recommended investments.¹⁴ Fidelity's suggestion ignores the fundamental nature of a client's relationship with his or her broker: one of trust. Clients do not believe they have to negotiate with their brokers to receive solid advice, nor do they think their brokers are trying to squeeze every last bit of compensation from their accounts. Simply put, clients do not think their brokers are lying to them and that it is the client's job to find the lies. PIABA does not believe that Fidelity's suggested disclosures are the right solution to the problems investors face today.

Providing greater disclosure does not appropriately mitigate the conflicts of interest inherent in the relationship between financial advisors and customers. It places the burden on the customers to fully understand the impact of those conflicts on the future of their retirement savings. However, the

¹¹ See, Testimony of Kenneth E. Bentsen, Jr., President and CEO, Securities and Financial Markets Assoc., August 10, 2015, available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-HearingTranscript1.pdf>.

¹² FINRA Report on Conflicts of Interest, p. 29.

¹³ See, Testimony of Sheryl Garrett, Founder and President of Garrett Planning Network, Inc., August 11, 2015, available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-HearingTranscript2.pdf>.

¹⁴ See, Testimony of Ralph Derbyshire, Senior Vice President and Deputy General Counsel of Fidelity Investments, August 11, 2015, available at <http://www.dol.gov/ebsa/pdf/1210-AB32-2-HearingTranscript2.pdf>.

financial advisors have held themselves out to be professionals, to offer guidance to investors on important, life decisions. They should accept the responsibility that comes with the profession and with the trust they have sought to earn by managing the life savings of an individual.

Conclusion

PIABA thanks the Department of Labor for the opportunity to comment on this important rulemaking. We are hopeful that this opportunity to protect investors will not pass without action. If we can offer any further information, please feel free to contact us.

Very truly yours,



Joseph C. Peiffer
PIABA, President