IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

The National Association for Fixed Annuities, Plaintiff, v. Thomas E. Perez, in his official capacity as Secretary of the United States Department of Labor and United States Department of Labor, Defendants.	Civil Action No. 1:16-cv-1035 Hon. Randolph D. Moss

BRIEF OF PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION
AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS

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INTRODUCTION AND INTEREST OF *AMICUS CURIAE*

The Public Investors Arbitration Bar Association ("PIABA") is an international bar association whose members represent investors in disputes with the securities industry. Currently, there are over 400 members from 44 states, Puerto Rico, and Japan. PIABA was established in 1990 as an educational and networking organization for securities arbitration attorneys who represent the public investor in securities disputes. Many PIABA members are involved in promoting the interests of the public investor in securities and commodities arbitration through service on committees of PIABA, as well as national, state and local bar associations.

The mission of PIABA is to promote the interests of the public investor in securities and commodities arbitration by protecting public investors from abuses in the arbitration process; making securities and commodities arbitration as just and fair as systematically possible; and creating a level playing field for the public investor in securities and commodities arbitration.

PIABA accomplishes its mission partly through active involvement in the administrative rule-making process. PIABA members have a strong interest in the standards of conduct that govern those who advise investors. PIABA members represent investors who have received conflicted advice from investment advisers, securities brokers, and insurance brokers, often for their retirement accounts. PIABA members have seen firsthand the harm that has resulted from the regulatory system that falls short of protecting the public. PIABA gave voice in the rule-making process to those investors and advocates for their protection.

This case involves a rule which has been adopted by the Department of Labor (the "Department") governing retirement investment advice. Definition of the Term "Fiduciary"; Conflict of Interest Rule – Ret. Inv. Advice, 81 Fed. Reg. 20946, 20997 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2510.3-21) (the "Department's Conflict of Interest Rule"). Plaintiff, the National Association for Fixed Annuities ("NAFA"), contests the rule, arguing that the rule will

cause irreparable harm to its members. Because PIABA is a bar association consisting of attorneys who primarily represent investors, PIABA can speak to the impact on investors of the current system, if the Department's Conflict of Interest Rule fully enacted and the status quo is maintained. PIABA can also provide some background as to why the Department is best suited to enact this rule, given the differing entities working within the retirement advice space. For these reasons, NAFA's claims and request for a preliminary injunction should be denied and implementation of the rule should proceed.

BACKGROUND

I. Laws Governing the Securities Industry and Investment Advice

The foundation for the legislative and regulatory framework governing the securities industry was constructed following the stock market crash in 1929. Congress adopted the first of the federal statutes governing the securities industry, the Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified at 15 U.S.C. § 77a, *et seq.* (2012)), in the midst of the Great Depression. This statute "require[s] that investors receive financial and other significant information concerning securities being offered for public sale." *The Laws That Govern the Sec. Indus.*, Sec. & Exch. Comm'n., https://www.sec.gov/about/laws.shtml.

A year later, Congress adopted the Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified at 15 U.S.C. § 78a, *et seq.* (2012)) (the "1934 Act"). Congress created the Securities and Exchange Commission (the "SEC") with the 1934 Act, and empowered it "to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self-regulatory organizations (SROs)." *The Laws That Govern the Sec. Indus.*, Sec. & Exch. Comm'n.

Congress continued to consider additional regulation of the securities industry. In 1939, the SEC submitted a report to Congress on Investment Trusts and Investment Companies.[1] The report examined investment counselor firms and investment counselors, who were not regulated broadly at that time. Representatives of investment counselors recognized that their function was the "furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments" and they could not do this "unless all conflicts of interest between the investment counsel and the client were removed." *Id.* at 28. Following the issuance of this report, Congress adopted the Investment Advisers Act of 1940, ch. 686, 54 Stat. 847 (1940) (codified at 15 U.S.C. § 80b-1, *et seq.* (2012)) (the "Advisers Act").

In 1974, Congress adopted the Employee Retirement Income Security Act, Pub L. 93-406, 88 Stat 832 (1974) (codified at 29 U.S.C. § 1001, *et seq.* (2012)) ("ERISA"). Although not exclusively regulating the securities industry, it does regulate investment advice when rendered in connection with retirement accounts. Congress determined that it would protect participants in employee benefit plans and their beneficiaries "by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts." *Id.* at § 1001(b). Congress adopted a definition of "fiduciary" which covered those who rendered investment advice. *See Id.* at § 1002(21)(A). A parallel definition was adopted under the Internal Revenue Code (the "Code"), as applicable to IRAs. *See* Tax on Prohibited Transactions, Pub. L. 93-406, 88 Stat. 829, 971 (1974) (codified at 26 U.S.C. § 4975(e)(3) (2012)).

By 1978, the Department was given certain responsibilities under both ERISA and the Code for employee benefit plans and IRAs, as explained by President Carter: "Labor will have statutory

[1] *See Inv. Trusts and Inv. Cos.: Report of the Sec. and Exch. Comm'n Pursuant to Section 30 of the Public Utility Holding Co. Act of 1935*, Sec. & Exch. Comm'n (1939).

authority for fiduciary obligations. ERISA prohibits transactions in which self-interest or conflict of interest could occur, but allows certain exemptions from these prohibitions. Labor will be responsible for overseeing fiduciary conduct under these provisions." Reorganization Plan No. 4 of 1978, § 102, 43 FR 47713 (1978).

II. Standards of Conduct Applicable to the Provision of Investment Advice

There are a number of statutes and regulations that govern the provision of investment advice; accordingly, there are a number of different standards of conduct applicable to the giving of advice depending on who is giving the advice and what type of advice is being given.

Both the 1934 Act and the Advisers Act contain antifraud provisions, which are the primary source for the standards of conduct applicable to securities brokers and investment advisers. The Supreme Court has interpreted the antifraud section of the Advisers Act to establish a federal fiduciary duty on the part of investment advisers, but has interpreted the antifraud section of the 1934 Act as not establishing such duty on the part of securities brokers. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963) (holding that under the Advisers Act, a relationship between an investment advisor and a client is fiduciary in nature); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (holding that scienter is a necessary element of the antifraud section of the 1934 Act).

The Advisers Act fiduciary standard includes "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' . . . clients." *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). This fiduciary duty imposes continuing duties of loyalty and care. *See* SEC Staff, *Study on Inv. Advisers and Broker-Dealers*, p. 22 (2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf. The duty of loyalty requires investment advisers to act in their clients' best interests and disclose all

conflicts of interest. *Id.* The duty of care requires investment advisers to provide suitable investment advice after investigating a customer's financial situation and investment objectives. *Id.* at 27-28.

A securities broker has other obligations to investors which are defined by FINRA rules.[2] FINRA Rule 2111 (the "Suitability Rule") governs the recommendations a securities broker or brokerage firm makes to an investor. The Suitability Rule provides in relevant part:

> A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile.

FINRA Manual, Fin. Indus. Regulatory Auth., Rule 2111(b).[3]

Layered upon the federal regulatory scheme is state regulation and state common law, which also governs the conduct of securities brokers. A number of states impose a fiduciary duty upon brokers as a matter of common law, depending upon the relationship between the broker and the customer.[4] Thus, securities brokers are subject to the FINRA Suitability Rule and may also be subject to a fiduciary standard depending on the state in which they are doing business and the nature of their relationship with their customer. However, the duties vary widely across the country.

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[2] FINRA is a self-regulatory organization, and is responsible for regulating brokerage firms and securities brokers. *See What We Do*, Fin. Indus. Regulatory Auth., http://www.finra.org/about/what-we-do.

[3] A "member" is a brokerage firm and an "associated person" is a securities broker.

[4] *See, e.g., Glisson v. Freeman*, 532 S.E.2d 442, 449 (Ga. Ct. App. 2000) (A "stockbroker's duty to account to its customer is fiduciary in nature, so that the broker is obligated to exercise the utmost good faith."); *Thropp v. Bache Halsey Stuart Shields, Inc.*, 650 F.2d 817, 819 (6th Cir. 1981) ("As a fiduciary, a broker stands in a special relationship to a client and owes him a duty to use reasonable care and to act in good faith."); *Dinsmore v. Piper Jaffray, Inc.*, 593 N.W.2d 41, 46 (S.D. 1999) ("Investors, as a rule, employ securities brokers to perform specialized financial services and entrust the brokers with the authority to act for them. This repose of trust in the broker, that the broker will act in the client's best interest, is a mark of a fiduciary relationship."); *Leib v. Merrill, Lynch, Pierce, Fenner & Smith*, 461 F.Supp. 951, 952 (E.D. Mich. 1978) ("Unlike the broker who handles a nondiscretionary account, the broker handling a discretionary account becomes the fiduciary of his customer in a broad sense.").

Individuals providing investment advice with respect to retirement accounts may have been fiduciaries, so long as they met the five-part test for rendering investment advice which had been promulgated by the Department following the enactment of ERISA. *See* Definition of Fiduciary, 29 C.F.R. § 2510.3-21(j)(1) (2016).[5] A person would only be a fiduciary if such person (i) rendered advice to a plan as to the value of securities or other property, or made recommendations as to the advisability of investing in, purchasing, or selling securities or other property; (ii) on a regular basis; (iii) pursuant to a mutual agreement, arrangement or understanding, written or otherwise; (iv) that such advice would serve as a primary basis for investment decisions with respect to plan assets; and (v) the advice would be individualized based on the particular needs of the plan. *See Id.*, *see also* Definition of Fiduciary, 26 C.F.R. § 54.4975-9(c) (2016). Many securities brokers would avoid meeting this definition by entering into agreements whereby they would disclaim the investor's reliance on their advice. This definition was the subject of the Department's Conflict of Interest Rule Proposal, and was amended with the final rule.

III. Investors Do Not Understand the Difference Between Brokers and Investment Advisers

The duty a financial professional owes to an investor is not always readily apparent to the investor. Although the individuals who provide advice to investors have specific titles under the respective regulatory regimes – broker or investment adviser – they rarely use those titles when dealing with the investing public. Financial professionals often use the title "financial advisor," "financial consultant," "wealth manager," or any of a number of other titles. According to FINRA, these "are generic terms or job titles, and may be used by investment professionals who may not hold any specific credential." *Prof'l Designations Database – Rules and Resources*, Fin. Indus. Regulatory Auth., http://www.finra.org/investors/rules-and-resources. FINRA has created a database for

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[5] The Department of Treasury enacted a parallel definition of "investment advice" in the Code. *See* Definition of Fiduciary, 26 C.F.R. § 54.4975-9(c) (2016).

investors "to decode the letters that sometimes follow a financial professional's name" and to understand the various professional designations used by financial professionals. *Prof'l Designations Database*, Fin. Indus. Regulatory Auth., http://www.finra.org/investors/professional-designations. The North American Securities Administrators Association ("NASAA") has recognized the confusion and trouble that may be caused by the use of professional designations and has adopted a model rule prohibiting the misleading use of senior and retiree designations to address concerns over particularly troubling designations. *See* Press Release, NASAA, State Sec. Regulators Announce New Model Rule on the Use of Senior Certifications and Prof'l Designations, NASAA (Apr. 1, 2008), http://www.nasaa.org/5685/.

Equally troubling as the confusing titles is the industry's advertising, which creates the perception that the industry is acting in the best interests of its customers. PIABA examined several firms' websites and marketing materials and found that the firms used phrases such as "You're in good hands;" "get a more personalized plan for achieving success;" "Our advisors are ethically obligated to act with your best interests at heart;" and "your Financial Advisor should make you feel that your best interests are the top priority, no matter what is happening in the market and no matter the size of your portfolio." Peiffer & Lazaro, *Major Investor Losses Due to Conflicted Advice: Brokerage Indus. Adver. Creates the Illusion of A Fiduciary Duty Misleading Ads Fuel Confusion, Underscore Need for Fiduciary Standard*, 22 PIABA B.J. 1, 10-19 (2015). Notwithstanding the firms' presentment that they were looking out for their customers and acting in their best interests, when faced with claims for wrongdoing in arbitration, the firms denounced any fiduciary duties to their customers, often claiming they were nothing more than mere order takers. *See Id.*

It is not surprising that investors are confused by ambiguous titles and advertising that implies that investment firms are looking out for their customers. Most investors think stockbrokers, insurance brokers, financial advisors and investment advisers are all held to a fiduciary standard,

even though investment advisers are the only ones consistently held to such a duty. *See* Infogroup/ORC, *U.S. Investors & The Fiduciary Standard: A Nat'l Opinion Survey* (Sept. 15, 2010), https://www.cfp.net/docs/public-policy/us_investors_opinion_survey_2010-09-16.pdf. More recently, a 2015 study confirmed that most retail customers think their financial advisor – regardless of which type of advisor it is – is a fiduciary. *See* Spectrem Group, *Fiduciary – Do Investors Know What It Means* (2015), http://349ab54c3b58919c6638-ff70f51d4942f2bbd11ba0e41cfec577.r51.cf2.rackcdn.com/Fiduciary%20Whitepaper.pdf. 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." *See* fi360, *Seeking Trustworthy Advice for Individual Investors – Fin. Intermediaries Indicate Strong Support for Fiduciary Standard*, 3 (Feb. 2015), http://www.fi360.com/uploads/media/2015fiduciarysurvey.pdf.

IV. Investor Confusion as to the Differing Roles Between Brokers and Investment Advisers Has Lead to Significant Harm

Conflicted advice harms investors every day. PIABA members have witnessed firsthand the devastating effects of the advice, seeing retirees forced to return to work making little more than minimum wage, and even dealing with clients attempting suicide after having lost their life savings to conflicted investment advice. *See* Joseph Pieffer, *Statement for the Record Submitted to the U.S. Dept. of Labor Employee Benefits Sec. Admin. On the Conflict of Interest Proposed Rule* (Aug. 11, 2015).

PIABA commented on the Department's Conflict of Interest Rule Proposal, and provided a number of examples of investors who had been represented by PIABA members and who had been harmed by conflicted investment advice with respect to their retirement funds. *See generally*, Letter from PIABA *to the U.S. Dept. of Labor Employee Benefits Sec. Admin.* (July 21, 2015), https://www.dol.gov/ebsa/pdf/1210-AB32-2-00654.pdf, and Letter from PIABA *to the U.S. Dept. of*

Labor Employee Benefits Sec. Admin. (Sept. 24, 2015), https://www.dol.gov/ebsa/pdf/1210-AB32-2-03038.pdf (collectively "PIABA Comment Letters"). The cases discussed in the PIABA Comment Letters involved mutual funds, annuities – both variable and fixed, private placements, promissory notes, real estate investment trusts, as well as other investment products. *See Id.* Investors trusted their retirement funds to financial advisors – securities brokers, investment advisers and insurance brokers – and lost substantial portions of their retirement savings as a result of the conflicted investment advice they received. In many cases, the financial advisors were subject to the FINRA Suitability Rule; however, that rule was not sufficient to protect the investors. *See Id.*

The products identified in the PIABA Comment Letters are similar to products which have raised concerns in the past for regulators. For example, the SEC, NASAA and FINRA jointly determined that "[e]xaminers found that the most commonly discussed products at the sales seminars were variable annuities, real estate investment trusts, equity indexed annuities, mutual funds, private placements of speculative securities (such as oil and gas interests) and reverse mortgages." SEC, NASAA and FINRA, *Protecting Senior Investors: Report of Examinations of Sec. Firms Providing "Free Lunch" Sales Seminars*, p. 4 (Sept. 2007). The report went on to state that:

> Individuals who attend the seminars or who are considering attending are not always provided with the name of the firm sponsoring the seminar, and may not be aware that product sponsors (e.g., mutual fund companies and insurance companies) may provide funding for the seminars with the expectation that investment professionals will sell their products. In these situations, seminar attendees may not have known that the financial adviser speaking at the seminar was not unbiased in making product recommendations.

Id. at 5.

Conflicts of interest were a concern in 2007 when these entities examined "free lunch" seminars and looked at ways senior investors may be protected. Several of the investors discussed in the PIABA Comment Letters attended "free lunch" or sales seminars prior to being sold the

products at issue. They did not understand the conflicts of interest which were present and which may have impacted the recommendations made by the various financial advisors.

The Department's Conflict of Interest Rule will require a heightened standard of care, one which will benefit investors such as those highlighted in PIABA's Comment Letters. It is important that the Rule be permitted to be fully enacted. It closes loopholes which had been left open when the Department adopted the five-part test in 1975, and protects investors who receive retirement investment advice.

ARGUMENT

The Department has the authority to issue the Conflict of Interest Rule and the related exemptions. It is necessary that the Department amend its definition of "investment advice" as originally set forth in its 1975 regulation to adequately protect retirement investors and to fully effectuate the definition of fiduciary set forth in ERISA and the Code. Pursuant to the authority set forth in ERISA and the Reorganization Plan established by President Carter, the Department is responsible for the fiduciary standard and for determining appropriate exemptions. The Department exercised that authority when it adopted the Conflict of Interest Rule and the accompanying exemptions. The Conflict of Interest Rule and accompanying exemptions, in particular, the Best Interest Contract Exemption, 81 Fed. Reg. 21002 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2550) (the "BICE"), is essential to protect retirement investors from conflicts of interest present throughout the financial services industry. Those conflicts are harming retirement investors, undermining the purpose of ERISA and the rationale for Congress having established fiduciary standards in the first place. Accordingly, the Department's Conflict of Interest Rule should be permitted to go forward, and NAFA's requests should be denied in their entirety as they are without merit.

I. The Department of Labor Has the Authority to Regulate All Retirement Plans

NAFA has filed this lawsuit to stop the implementation of the Department's Conflict of Interest Rule. NAFA seeks to undermine the Department's efforts to protect all retirement investors with professional accountability standards. NAFA states the Department has pursued an improper regulatory end-run by promulgating this new regulatory regime through its exemptive authority under ERISA. Pl. Br. at 27. NAFA claims the Department has disregarded the regulatory framework established by Congress, and has exceeded its authority. Additionally, NAFA alleges the Department lacks affirmative authority to do this outside the context of employee benefit plans. *Id.* at 41. However, NAFA fails to acknowledge the authority that has been allocated to the Department by Congress.

As long as it has suited its financial interests, NAFA has embraced the Department's authority to define "investment advice." The Department's 1975 regulation, and the parallel Code regulation, defined investment advice in such a way that it narrowed Congress's statutory definition of 'fiduciary," and created a loophole which would lead to significant investor harm. The industry relied on the five-part test to ensure they did not fit into the definition of "fiduciary," avoiding the obligations that accompany the title of fiduciary.

Knowing they would not be held to the fiduciary standards, the industry created ambiguous titles and misleading advertising, leading investors to believe they could be trusted. The industry then abused the trust it developed with investors by dispatching financial advisors with little or no professional accountability to push expensive, inferior investment products. Over time, as the method for retirement saving became more self-directed, investor abuses became more commonplace and, for many, what was supposed to be their golden years became a retirement nightmare. Now, that the Department has taken a momentous step toward correcting the rampant conflicts of interest which have driven investment advice and has closed the loopholes created by

the five-part test, the same group cries foul and claims the Department does not have the authority to act at all. However, as will be shown below, the Department does have the authority to issue the Conflict of Interest Rule as well as the accompanying exemptions.

A. The Department of Labor Has Express Authority Under Presidential Reorganization Plan No. 4 to Promulgate the Conflict of Interest Rule

The public perception is that an investment professional's loyalty is to its clients; its duty is to recommend what is in their best interest and to maximize the value of their holdings. But oftentimes that perception is misplaced, and investment professionals have other loyalties. Judging from NAFA's complaint, it believes those divided loyalties should be disregarded, and retirement savers should be left to fend for themselves. It seems that NAFA's argument rests on the premise that only when it does not cost the industry anything to act in the best interests of their customers, may such a rule governing investment advice be enacted.

But NAFA must know that the authority to oversee fiduciary conduct and prohibited transactions applicable to IRAs has been under the jurisdiction and authority of the Department since 1978. Reorganization Plan No. 4 of 1978, § 102, 43 FR 47713 (1978) transferred from the Secretary of the Treasury to the Secretary of the Labor the ultimate authority over certain rule making authority, interpretations, and exemptions relating to IRAs under § 4975 of the Code.

> <u>§ 102 Reorganization Plan No. 4</u>
>
> Except as otherwise provided in Section 105 of this Plan, all authority of the Secretary of the Treasury to issue the following described documents pursuant to the statutes hereinafter specified is hereby transferred to the Secretary of Labor: (a) regulations, rulings, opinions, and exemptions under section 4975 of the Code [26 U.S.C. 4975] . . .

Id. President Carter, in explaining the Reorganization Plan to Congress, was explicit: "Labor will have statutory authority for fiduciary obligations." *Id.* President Carter's Order enabled the Department to direct its rule making attention to the activities of conflicted investment professionals who let self-dealing influence their investment recommendations.

Courts have recognized that § 102 of Reorganization Plan No. 4 grants much authority to the Department. *Baizer v. Comm'r of Internal Revenue,* 204 F.3d 1231 (9th Cir. 2000); *See also Comm'r of the Internal Revenue Serv. v. Keystone Consol. Indus., Inc.* 508 U.S. 152 (1993) ("[B]oth the Internal Revenue Service and the DOL administer §4975 prohibited transaction provisions."). The United States Supreme Court has consistently accorded considerable weight to an executive department's construction of a statutory scheme it is entrusted to administer. *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 866 (1984) (**"**When a challenge to an agency construction of a statutory provision, fairly conceptualized, really centers on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail.").

Reorganization Plan No. 4 manifestly gives the Department front-line responsibility for regulating IRAs. Specifically, the Reorganization Plan empowers the Department to define a fiduciary, prohibit certain transactions, and grant exemptions therefrom. In the Conflict of Interest Rule, the Department identified prohibited transactions, which it is authorized to do, and adopted detailed exemptions for various categories of prohibited transactions, which it is also authorized to do.

To say that the Department has exceeded its authority, NAFA's position is completely severed from the reasoning based on the evidence and the plain language of § 102 of Presidential Reorganization Plan No. 4.

B. The Department Has Authority To Regulate IRAs Pursuant To The Code

The Department does not rely on ERISA to regulate IRAs. As the Department explained:

> IRA fiduciaries do not have the same general fiduciary obligations of prudence and loyalty under the statute, but they too must adhere to the prohibited transaction rules or they must pay an excise tax. The prohibited transaction rules help ensure that investment advice provided to plan participants and IRA owners is not driven by the adviser's financial self-interest.

Definition of the Term "Fiduciary"; Conflict of Interest Rule – Ret. Inv. Advice, 81 Fed. Reg. at 20991.

NAFA argues that the Code does not provide the Department authority to impose fiduciary duties on IRAs because it only allows it "to issue regulations clarifying the circumstances under which an excise tax may be imposed" on "disqualified persons." Pl. Br. at 59. But this is exactly what the Rule does. If a person engages in a "prohibited transaction" but does not fit the definition of "fiduciary" as set forth in the amended Tax on Prohibited Transactions, 26 I.R.C. § 4975(e)(2)(3) (2012), then an excise tax is imposed. "In this context, however, the sole statutory sanction for engaging in the illegal transactions is the assessment of an excise tax enforced by the Internal Revenue Service (IRS)." Definition of the Term "Fiduciary"; Conflict of Interest Rule – Ret. Inv. Advice, 81 Fed. Reg. at 20953. In other words, the Rule *does clarify* when the excise tax applies.

NAFA attempts to taint the Court's view by making oblique references to "imposing" and "extending" ERISA fiduciary obligations to parties involved in IRA transactions. This ignores the Department's acknowledgment that Section 4975 (including the new amended portion) imposes "a more limited regulation of fiduciary conduct." Definition of the Term "Fiduciary"; Conflict of Interest Rule – Ret. Inv. Advice, 81 Fed. Reg. at 20953. The Department is not directly translating any part of ERISA to IRAs; it is placing a new definition into the Code.

NAFA also tries to confuse the Court by claiming that the Rule contains a "paradox" in that an advisor whose compensation is "not conflicted" has "no prudence standards at all." Pl. Br. at 59 n.22. But that is simply false. To qualify for the BICE, a person who would otherwise be "disqualified" "must adhere to basic standards of impartial conduct," such as "give prudent advice that is in the customer's best interest, avoid misleading statements, and receive no more than reasonable compensation" and "must set forth the standards of fiduciary conduct and fair dealing in an enforceable contract with the investor." Definition of the Term "Fiduciary"; Conflict of Interest Rule – Ret. Inv. Advice, 81 Fed. Reg. at 20947. In other words, the BICE only allows an exemption

from the defined fiduciary duties under the Rule "under conditions designed to ensure the adviser is acting in accordance with fiduciary norms and basic standards of fair dealing." *Id.*

C. The Department of Labor Is Needed To Effectively Regulate Fiduciary Duty Standards

The Department is the only entity that may effectively regulate fiduciary standards with respect to retirement accounts. There is an entire universe of investment professional that falls below the regulatory radar. A person may sell to an IRA commercial paper, bankers' acceptances, commercial bills, certain government and municipal securities, and units of a collective trust fund but, such person is not required to register with the SEC as a broker dealer under Section 15(a) of the 1934 Act, Registration and Regulation of Brokers and Dealers, 15 U.S.C. § 78(o) (2012), and therefore may be unregulated. Furthermore, a person who provides investment advice to an IRA on government securities, municipal securities, or common trust funds does not meet the definition of investment adviser under Section 3(11) of the Advisers Act, Definitions, 15 U.S.C. § 80b-2(a)(11) (2012), and therefore may go unregulated. Also escaping the scrutiny of regulation are foreign private investment advisers and investment advisers to small private funds (Section 203(m) of the Advisers Act, Registration of Inv. Advisers, 15 .U.S.C. § 80b-3(b) (2012)) operating in a host of states, including Texas (7 Tex. Admin. Code § 139.23), Florida (Fla. Stat. § 517.021(14)(b)(7)), Tennessee (Tenn. Admin Reg. 0780-04-03-.05(1)(b)) and Illinois (Ill. Admin. Code tit. 14, § 130.805(b)). Without the Conflict of Interest Rule, there may be no other regulation creating any standard of conduct for these individuals.

Congress and President Carter gave the Department broad authorization encompassing the interpretation and regulation of fiduciary duty. The Conflict of Interest Rule re-defines investment advice, giving meaning to the definition of fiduciary. The Conflict of Interest Rule is designed to protect retirement investors, a function with which the Department has been entrusted since 1974 by Congressional command.

The Department clearly has the authority and the expertise in the area of fiduciary duty. It would be inconsistent with Congressional direction to state that the Department is incapable of determining who is intended to be a fiduciary with respect to retirement investments. This is precisely what the Department was tasked with doing.

II. The Best Interest Contract Exemption Does Not Create a Private Cause of Action For Violation of the Prohibited Transaction Rules.

NAFA argues that the BICE creates a private cause of action in favor of a retirement investor through its requirement to create an enforceable Best Interest Contract ("BIC") to rely upon the exemption. Pl. Br. at 47. This is not the case; if one is to rely on the BICE, it merely mandates the creation of a contract, which requires that certain disclosures be made and in turn, creates a standard of care, not a cause of action.

In addressing the BIC, the BICE states:

> (a) Contracts with Respect to Investments in IRAs and Other Plans Not Covered by Title I of ERISA. If the investment advice concerns an IRA or a Plan that is not covered by Title I of ERISA, the advice is subject to **an enforceable written contract on the part of the Financial Institution**, which may be a master contract covering multiple recommendations, that is entered into in accordance with this Section II(a) **and incorporates the terms set forth in Section II(b)-(d)**.

Best Interest Contract Exemption, 81 Fed. Reg. 21002, 21076 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2550) (emphasis added). Section II(b) requires that the Financial Institution affirmatively state that the Financial Institution and Advisors are acting as fiduciaries with respect to investment advice, the customer and his or her accounts. *Id.* at 21077. Section II(c) requires the BIC to state that the Financial Institution will adhere to the following standards of conduct: (1) that it will provide investment advice that is in the best interest of the customer; (2) that the Advisor and Financial Institution's compensation for recommended transactions will be reasonable; and (3) that statements related to recommended transactions will not be materially misleading. *Id.* Section II(d) discusses warranties that are to be provided for in the BIC. *Id.* at 21077-21078.

In support of its argument that the BIC creates a private cause of action, NAFA cites *Alexander v. Sandoval*, 532 U.S. 275 (2001). The issue in *Sandoval* is "whether private individuals may sue to enforce disparate-impact regulations promulgated under Title VI of the Civil Rights Act of 1964." *Id.* at 278. In *Sandoval*, the United States Department of Justice promulgated a regulation forbidding funding recipients to "utilize criteria or methods of administration which have the effect of subjecting individuals to discrimination because of their race, color, or national origin . . . ." *Id.* Alabama amended its Constitution in 1990 to declare English as the official language of the state. The Alabama Department of Public Safety started giving driver's license exams in English only. Sandoval (the Plaintiff) then sued to enjoin the policy, arguing it violated the regulation because it had the effect of subjecting non-English speakers to discrimination based on their national origin. *Id.* at 278-279.

Ultimately, *Sandoval* concluded that a private cause of action was not created, noting: "[s]o far as we can tell, this authorizing portion of §602 reveals no congressional intent to create a private right of action." *Id.* at 289. The *Sandoval* Court also noted that "[l]anguage in a regulation may invoke a private right of action that Congress through statutory text created, but it may not create a right that Congress has not." *Id.* at 291 (citing *Touche Ross & Co. v. Redington*, 442 U. S. 560, 577 (1979)).[6] In the matter at hand, NAFA argues that no private causes of action for violation of the prohibited transaction rules appear to be created by ERISA or the Code, and thus, the Department has overstepped in the creation of the BICE, which in turn, invalidates the entire Conflict of Interest Rule. Pl. Br. at 49.

The cases cited by NAFA are notably limited in nature and are factually distinct from the

[6] *Touche Ross & Co. v. Redington*, 442 U. S. 560 (1979) involved a lawsuit brought by a liquidating trustee against the former accountant of a defunct brokerage firm that was alleged to have failed to properly audit the firm and its financial statements in violation of § 17 (a) of the 1934 Act, 15 U. S. C. § 78q (a), and the rules and regulations adopted thereunder. 17 CFR § 240.17a-5 (1972). *Id.* at 563-66.

potential application of the BICE and the BIC. In both *Touche Ross & Co.* and *Sandoval,* both Plaintiffs complained of specific violations of regulations. Following the corresponding defendant's violation of the regulation in question, the plaintiff (a private party) sought to enforce the regulation in a civil action though a request for an injunction or damages. However, any cause of action arising from a violation of a BIC arises from the terms of the contract itself, not from a Financial Institution's creation or failure to create a BIC, which would be the only conceivable regulatory violation arising from the BICE.

In order to take advantage of the exemption, a firm must use a BIC. If a Financial Institution fails to use a BIC, the result is the loss of its ability to rely on the exemption. A Financial Institution's failure to use a BIC does not give rise to a private cause of action; it merely results in the loss of the exemption. If a firm uses a BIC and it breaches the underlying contract, the resulting action would be founded in contract, not upon the regulation, as was the case in *Touche Ross & Co.* and *Sandoval.* The cause of action resulting from a breached BIC arises from the terms of the contract itself and state contract law, not from a Financial Institution's failure to adhere to requirements of the BICE or from federal regulations. Thus, no cause of action has been created by the BICE.

A parallel can be drawn between BICE, ERISA and the Code, and suits related to privacy rights created pursuant to the Health Insurance Portability and Accountability Act of 1996, Pub.L. No. 104-191, 110 Stat. 1936 (1996) (hereinafter "HIPAA"). For years, districts have held that violations of privacy provisions of HIPAA did not give rise to a private cause of action. *Acara v. Banks*, 470 F.3d. 569, 571 (5th Cir. 2006) ("While no other circuit court has specifically addressed this issue, we are not alone in our conclusion that Congress did not intend for private enforcement of HIPAA. Every district court that has considered this issue is in agreement that the statute does not support a private right of action.").

In recent years, however, a growing number of states have recognized that while HIPAA and its regulations did not create a private cause of action, it did create a standard of care that should be applied in state court common law claims. *Byrne v. Avery Ctr. for Obstetrics and Gynecology*, 102 A.3d 32, 49 (Conn. 2014). ("We further conclude that, to the extent it has become the common practice for Connecticut health care providers to follow the procedures required under HIPAA in rendering services to their patients, HIPAA and its implementing regulations may be utilized to inform the standard of care applicable to such claims").

The BICE contains no discussion of enforceability of the exemption by a private party and likewise, does not grant statutory damages to an investor who invests without signing a proper BIC. As such, a private cause of action for a violation of the prohibited transaction rules has simply not been created. In the matter at hand, at most, ERISA and the Code and the regulations promulgated pursuant thereto, create a *standard of care*, not a private cause of action.

NAFA's final argument is that the entire rule is invalidated because the rule would not have been enacted without the BICE. Pl. Br. at 51. The case law cited by Plaintiff in support of its argument actually supports the more common method of dealing with a potentially defective rule, which would be to remand for further clarification, rather than vacating the rule in its entirety. *Int'l Union, UMW v. FMSHA*, 920 F. 2d 960, 966-67 (D.C. Cir. 1990).[7] In the matter at hand, like in *Int'l Union, UMW*, the record is simply insufficient to justify the extreme remedy of vacating the Rule. *See id.* at 677. Thus, any inadequacies related to the BICE should first be dealt with through a remand, rather than with vacating the entire rule.

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[7] Moreover, ERISA contemplates that if any provision, or its application to persons or circumstances, is deemed invalid, the remainder of the chapter, or its application to other persons or circumstances, is not implicated. *See* Separability, 29 U.S.C. § 1139. In light of the inclusion of a severability clause, vacating the entire Conflict of Interest Rule in the event there are any deficiencies in the BICE would be improper.

CONCLUSION

The Department has promulgated a necessary and important rule and accompanying exemptions in order to protect retirement investors. The Conflict of Interest Rule properly defines investment advice under ERISA and the Code, and the rule should be upheld. NAFA's claims and request for a preliminary injunction should be denied.

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Respectfully submitted,

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