



PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION

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August 7, 2017

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11933
U.S. Department of Labor
200 Constitution Avenue, N.W., Suite 400
Washington, D.C. 20210

Re: RIN 1210-AB82; Request for Information Regarding the Fiduciary Rule
and Prohibited Transaction Exemptions

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 is examining the Conflict of Interest Rule (the "Rule") and accompanying prohibited transaction exemptions (the "PTEs"). In furtherance of that examination, the Department seeks input that may "form the basis of new exemptions or changes/revisions to the rule and PTEs."¹ PIABA strongly opposes any changes or revisions which would eliminate or minimize the investor protections contained in the current Rule and PTEs.

PIABA has commented on the Department's efforts in connection with the Rule and PTEs several times over the past seven years.² PIABA has also testified during the Department's public

¹ Dep't of Labor, *Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions*, 82 Fed. Reg. 31278 (July 6, 2017) ("Request for Information"), available at <https://www.federalregister.gov/documents/2017/07/06/2017-14101/request-for-information-regarding-the-fiduciary-rule-and-prohibited-transaction-exemptions>.

² See, PIABA, *Comment Letter to the Dep't of Labor* (Feb. 3, 2011), available at https://piaba.org/system/files/comment_letter_pdfs/DOL%20-%20Definition%20of%20the%20Term%20Fiduciary,%20Feb%203%202011.pdf; PIABA, *Comment Letter to the Dep't of Labor* (July 21, 2015), available at https://piaba.org/system/files/comment_letter_pdfs/DOL%20Best%20Interest%20Rule%20Comment,%20RIN%201210-

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hearing on the Rule and PTEs.³ Throughout this time period, PIABA has supported the Department's efforts to ensure that those who provide retirement advice are held to the standards originally contemplated within the Employee Retirement Income Security Act (ERISA). PIABA remains hopeful that the result of those efforts, the Rule and PTEs, will not be undone in response to complaints within the industry that it is not practical to act in the best interests of clients.

The Department has asked a number of questions in its request. We have chosen to focus on four of the questions.

Question 3: Do the Rule and PTEs appropriately balance the interests of consumers in receiving broad-based investment advice while protecting them from conflicts of interest? Do they effectively allow Advisers to provide a wide range of products that can meet each investor's particular needs?

Pursuant to the Rule and PTEs as currently drafted, investors will be able to receive a wide range of investment advice, while also receiving some protection from the myriad conflicts within the financial services industry.

Many of the large brokerage firms will continue to offer commission-based alternatives for their clients, including Merrill Lynch, Morgan Stanley, Wells Fargo Advisors, LPL Financial, Raymond James, UBS and Edward Jones.⁴ Firms have varied on their approach to compliance with the requirements of the Rule and PTEs. Some firms will offer fee-based accounts and allow those who want to pay transaction based fees do so through a self-directed account or with the use of a robo adviser.⁵ Some are tweaking their existing options to ensure compliance with the requirements of the BIC exemption.⁶ Some firms are incorporating the option of robo advice more broadly for retirement accounts.⁷ UBS has announced it will shift how it compensates advisors rather than changing what it offers investors.⁸

[https://piaba.org/system/files/comment_letter_pdfs/DOL%20Best%20Interest%20Rule%20Comment,%20RIN%201210-AB32%20\(July%2021,%202015\).pdf](https://piaba.org/system/files/comment_letter_pdfs/DOL%20Best%20Interest%20Rule%20Comment,%20RIN%201210-AB32%20(July%2021,%202015).pdf); PIABA, *Comment Letter to the Dep't of Labor* (Sept. 24, 2015), available at [https://piaba.org/system/files/comment_letter_pdfs/DOL%20Best%20Interest%20Rule%20Comment,%20RIN%201210-AB32%20\(September%2024,%202015\).pdf](https://piaba.org/system/files/comment_letter_pdfs/DOL%20Best%20Interest%20Rule%20Comment,%20RIN%201210-AB32%20(September%2024,%202015).pdf); PIABA, *Comment Letter to the Dep't of Labor* (Mar. 17, 2017), available at [https://piaba.org/system/files/comment_letter_pdfs/DOL%20Comment%20Letter,%20RIN%201210-AB79%20\(March%2017,%202017\).pdf](https://piaba.org/system/files/comment_letter_pdfs/DOL%20Comment%20Letter,%20RIN%201210-AB79%20(March%2017,%202017).pdf); PIABA, *Comment Letter to the Dep't of Labor* (Apr. 17, 2017), available at [https://piaba.org/system/files/comment_letter_pdfs/DOL%20Comment%20Letter,%20RIN%201210-AB79%20\(April%2017,%202017\).pdf](https://piaba.org/system/files/comment_letter_pdfs/DOL%20Comment%20Letter,%20RIN%201210-AB79%20(April%2017,%202017).pdf); PIABA, *Comment Letter to the Dep't of Labor* (July 21, 2017), available at [https://piaba.org/system/files/comment_letter_pdfs/DOL%20Comment%20Letter,%20RIN%201210-AB82%20\(July%2021,%202017\).pdf](https://piaba.org/system/files/comment_letter_pdfs/DOL%20Comment%20Letter,%20RIN%201210-AB82%20(July%2021,%202017).pdf).

³ Joseph Peiffer, *Statement for the Record Submitted to the United States Department of Labor Employee Benefits Security Administration On Conflict of Interest Proposed Rule Public Hearing* (Aug. 11, 2015), available at <https://piaba.org/piaba-newsroom/congressional-testimony-statement-record-submitted-united-states-department-labor-emp>.

⁴ Michael Wursthorn, "A Guide to Brokers' Retirement-Account Plans," *Wall Street Journal* (May 23, 2017), available at <https://www.wsj.com/articles/a-guide-to-brokers-retirement-account-plans-1495558474?tesla=y&mg=prod/accounts-wsj>.

⁵ E.g., Merrill Lynch and JP Morgan Chase. *See id.*

⁶ E.g., Morgan Stanley, Wells Fargo, LPL Financial, Raymond James, and Edward Jones. *See id.*

⁷ E.g., Wells Fargo, LPL Financial, and Raymond James. *See id.*

⁸ Bruce Kelly, "UBS latest to shift broker compensation ahead of DOL fiduciary rule," *Investment News* (June 2, 2017), available at <http://www.investmentnews.com/article/20170602/FREE/170609979/ubs-latest-to-shift-broker-compensation-ahead-of-dol-fiduciary-rule>.

Indeed, a recent study of representatives affiliated with 14 of the largest independent brokerage firms reflects that 74% of such advisors/firms will continue to allow commission based transactions in retirement accounts after the fiduciary rule goes into effect.⁹ These representatives reported that they believe that they can operate in the best interest of their clients, while still offering commission based products.¹⁰ In fact, the only brokerage firm that has affirmatively stated that it will no longer offer commission based accounts in response to the Rule is Commonwealth Financial Network.¹¹ Commonwealth's shift away from commission based accounts is unlikely to have any significant impact on customers because Commonwealth only employs 1,600 advisors, and derives less than 10% of its revenues from commissions on retirement accounts.¹²

The vast majority of brokerage firms and financial advisors have also stated, without equivocation, that they will continue to offer the full panoply of financial products to small investors, once the fiduciary role goes into effect. For example, Morgan Stanley announced that its transaction based retirement brokerage accounts will continue to offer a broad array of products after the Rule goes into effect, including, but not limited to, mutual funds and exchange traded products.¹³ Similarly, Raymond James has announced that it fully expects to continue to offer a full range of investment options for all of its clients once the Rule goes into effect.¹⁴ Likewise, Edward Jones customers who utilize its transaction based IRAs will be able to invest in a full range of stocks, bonds, certificates of deposits, and variable annuities.¹⁵ A recent survey of representatives affiliated with 14 major independent brokerage firms found that 74% of such advisors/brokerage firms have not reduced the number of products that were available to their transaction – based customers as a result of the Rule.¹⁶ These same representatives reported that, while they are acting as fiduciaries, much of their business is still transaction based and therefore available to small investors.¹⁷

Several brokerage firms have also reduced their fees for small investors and/or account minimums, in response to the Rule. As a result, the Rule has benefitted small investors by providing them with lower fees, and access to services and accounts, which they did not previously have. For example, Merrill Lynch is discounting fees for IRA accounts that are moved over to an advisory relationship in order to equalize the fee level for its low trading brokerage

⁹ Diana Britton, "Delay or not IBDs Moving Toward a Fiduciary Future", WealthManagement.com (Apr. 5, 2017), available at <http://www.wealthmanagement.com/industry/delay-or-not-ibds-moving-toward-fiduciary-future>.

¹⁰ *Id.*

¹¹ Greg Iacurci & Christine Idzelis, "Broker-dealer Split on Commissions in Wake of DOL Fiduciary Rule", Investment News (Oct. 30, 2016), available at <http://www.investmentnews.com/article/20161030/FREE/161029902/broker-dealers-split-on-commissions-in-wake-of-dol-fiduciary-rule>.

¹² *Id.*; Andrew Welsch, "Raymond James Follows Morgan's Lead in Keeping Commissions Under Fiduciary Rule", OnWallStreet.com (Oct. 27, 2016), available at <https://www.onwallstreet.com/news/raymond-james-follows-morgans-lead-in-keeping-commissions-under-dol>.

¹³ Jim Wiggins, "Morgan Stanley to Preserve Client Choice for Retirement Accounts", Morgan Stanley.com/press releases (Oct. 26, 2016), available at <https://www.morganstanley.com/press-releases/morgan-stanley-to-preserve-client-choice-for-retirement-accounts>.

¹⁴ Welsch, *supra* note 12.

¹⁵ Andrew Welsch, "Fiduciary Ready: Edward Jones Unveils Compliance Plans", OnWallStreet.com (Aug. 19, 2016), available at <https://www.onwallstreet.com/news/fiduciary-ready-edward-jones-unveils-compliance-plans>.

¹⁶ Britton, *supra* note 9.

¹⁷ *Id.*

customers.¹⁸ Edward Jones will be reducing the minimum on its fee-based accounts to \$25,000 for clients who want to purchase stocks, mutual funds, or exchange traded funds, and to \$50,000 for clients who want to purchase individual bonds.¹⁹ In addition, Edward Jones will continue to have a minimum investment requirement of \$5,000 for its Guided Solutions Fund Account.²⁰ Similarly, LPL Financial has announced that it will be reducing the account minimum for its Optimum Market Portfolios from \$15,000 to \$10,000, in anticipation of the Rule.²¹ Charles Schwab has also recently announced that it plans to launch a new advisory service in the first half of 2017 that will have an investment minimum of \$25,000, but will offer comprehensive financial and investment planning, ongoing guidance from planning consultants, and fully automated and diversified portfolios comprised of low-cost, exchange traded funds from Schwab and third-party providers such as Vanguard.²²

The lack of any adverse impact to small investors from a fiduciary rule is further borne out by an extensive study that was done in 2012, which examined whether there were differences in the services available to investors in states that have fiduciary standards and those who do not. The study found that customers in the states that have a common law fiduciary rule applicable to broker-dealers and financial advisors [California, Georgia, Florida, Missouri, Puerto Rico, South Carolina, and South Dakota], have full access to investment advice and financial services.²³ This study found no statistical difference between the quantity and diversity of financial and investment services and products that were available in states that impose a fiduciary standard on brokers and brokerage firms, and those that do not.²⁴ This study further found that brokerage firms and advisors operating in states which hold brokers and brokerage firms to be fiduciaries provide the same level of service for lower wealth clients as in states which do not have a fiduciary standard, that they provide a broad range of products to such clients, and that they allow for commission based compensation.²⁵

In short, the anticipation of the Rule has not resulted in any meaningful reduction of options for investors. In fact, it has resulted in firms accelerating their development of robo-advisers, offering additional options for investors. As a result of the Rule and PTEs, brokerage firms will be offering more services and investment products to small investors than they did prior to the enactment of the Rule.

Question 5: What is the likely impact on Advisers' and firms' compliance incentives if the Department eliminated or substantially altered the contract requirement for IRAs? What

¹⁸ Iacurci & Idzelis, *supra* note 11.

¹⁹ Welsch, *supra* note 15.

²⁰ *Id.*

²¹ Janet Levaux, "LPL Cuts Prices, Account Minimums Ahead of DOL Fiduciary Rule", ThinkAdvisor.com (Mar. 16, 2016), available at <http://www.thinkadvisor.com/2016/03/16/lpl-cuts-prices-account-minimums-ahead-of-dol-fidu>.

²² Michael Cianfrocca, "Schwab Announces Schwab Intelligent Advisory", Charles Schwab press release (Dec. 13, 2016), available at <http://pressroom.aboutschwab.com/press-release/schwab-investor-services-news/schwab-announces-schwab-intelligent-advisory>.

²³ Michael Finke and Thomas P. Langdon, "The Impact of the Broker-dealer Fiduciary Standard on Financial Advice" (Mar. 9, 2012), available at <https://www.onefpa.org/journal/Pages/The%20Impact%20of%20the%20Broker-Dealer%20Fiduciary%20Standard%20on%20Financial%20Advice.aspx>.

²⁴ *Id.*

²⁵ *Id.*

should be changed? Does compliance with the Impartial Conduct Standards need to be otherwise incentivized in the absence of the contract requirement and, if so, how?

PIABA strongly opposes the elimination or substantial alteration of the written contract requirement because it provides the *sole* enforcement mechanism to ensure firms' compliance with the Impartial Conduct Standards. The Department recognized after years of research and study that the significant costs to retirees of conflicted advice, combined with the fundamental shift of retirement assets to IRAs and non-ERISA plans, required imposition of fiduciary standards on financial advisors providing retirement investment advice. The Impartial Conduct Standards and related requirements of the PTEs represent an appropriate accommodation between protecting investors and allowing firms to continue receiving most forms of compensation that would otherwise be prohibited under the conflict of interest rule. However, these standards would be rendered meaningless without an enforcement mechanism. The department rightly described this requirement as a "critical safeguard" with respect to investments in IRAs and non-ERISA retirement plans.²⁶

Although the Department has the authority to set the standards for providing retirement investment advice and grant exemptions, it has no enforcement jurisdiction over IRAs. Rather, that jurisdiction is vested in the Internal Revenue Service (IRS), and the sole statutory sanction for engaging in an illegal transaction is the assessment of an excise tax.²⁷ Moreover, the IRS does not actively enforce the prohibited transactions provisions with respect to IRAs. Instead, the excise tax (equal to 15% of the amount involved) is *generally self-enforced*, which means that a financial firm must first realize it has engaged in a prohibited transaction, self-report the violation and pay the tax. The Department recognized that the possible imposition of an excise tax is an inadequate incentive to ensure compliance with the new standards.²⁸

Additionally, unlike participants and beneficiaries of plans covered by Title I of ERISA,²⁹ IRA owners do not have an independent statutory right to bring an action against fiduciaries for violations of the prohibited transactions rules or exemptions. As such, providing retirement investors a mechanism by which to enforce these standards is critical given the Department's lack of jurisdiction to do so.

Establishing standards for retirement investment advice, without more, will not provide investors with a clear-cut, unambiguous, and effective means of seeking redress for their broker's violations of those standards. Firms often argue that there is no private right of action for violations of SRO rules, relying on the holdings in a few cases while ignoring case law that states violations of SRO rules may be evidence of a breach of the applicable standards, supporting a claim for negligence or breach of fiduciary duty, and ignoring FINRA's statements that investors

²⁶ Dep't of Labor, *Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice; Final Rule*, 81 Fed. Reg. 20946, 21,020 (Apr. 8, 2016) ("DOL Final Rule"), available at <http://webapps.DOL.gov/FederalRegister/PdfDisplay.aspx?DocId=28806>.

²⁷ *Id.* at 20,953; 26 U.S.C. § 4975(a)-(b).

²⁸ DOL Final Rule, *supra* note 26 at 21,021.

²⁹ Under Title I, the Department, plan participants may bring civil actions to enforce the fiduciary duty and prohibited transactions. 29 U.S.C. §1132(a)(2), (3) and (5).

can make claims based upon violations of SRO rules in FINRA arbitration.³⁰ Requiring that firms incorporate the Impartial Conduct Standards in an express contract with their customers, however, assures that investors have a remedy in court and in arbitration when fiduciaries fail to comply with those standards. Specifically, investors can bring an action for breach of contract under state law, which would control the enforceability of any and all contractual provisions.³¹

Moreover, the contractual requirement does not impose significant additional litigation risks or costs to firms. Brokerage firms in the U.S. universally enter into written agreements with their customers that are enforceable under state law. The PTE's contractual requirement merely adds terms to contracts that already exist, providing "clarity to the fiduciary nature of the undertaking,"³² ensuring that retirement investors can bring an action for violation of those standards and creating a powerful incentive for financial firms and advisors to adhere to the impartial conduct standards. We strongly urge the Department not to eliminate or dilute the written contract requirement of the BIC exemption.

Question 6: What is the likely impact on Advisers' and firms' compliance incentives if the Department eliminated or substantially altered the warranty requirements? What should be changed? Does compliance with the Impartial Conduct Standards need to be otherwise incentivized in the absence of the warranty requirement and, if so, how?

The elimination or substantial alteration of the BIC exemption's warranty requirements would invariably reduce financial firms' incentives to comply with their obligations to adopt and implement anti-conflict policies and procedures, because there would be no effective enforcement mechanism. The Department recognized that implementation of anti-conflict policies and procedures (and policing for compliance with those procedures) serve as critical safeguards to the exemption's protections.³³ In order to ensure compliance with these

³⁰ See, e.g., *Thompson v. Smith, Barney, Harris, Upham & Co.*, 709 F.2d 1413, 1419 (11th Cir. 1983)(no private right of action based on violations of SRO rules); *Craighead v. E.F. Hutton & Co.*, 899 F.2d 485, 492 (6th Cir. 1990) (same). However, other cases have held that SRO rules may be informative as to the applicable standard of conduct. See, e.g., *Vucinich v. Paine, Webber, Jackson & Curtis, Inc.*, 803 F.2d 454 (9th Cir. 1986)(the court held that "violations of the professional standards of brokers may be the basis for a finding of professional negligence."); *In re Thomson McKinnon Securities, Inc.*, 141 B.R. 559 (Bankr. S.D.N.Y. 1992)(if a stockbroker's conduct violates a rule of the stock exchange, a client who sustains damages as a result of such breach has a claim for breach of the stockbroker's fiduciary duty); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Cheng*, 697 F.Supp. 1224 (D.D.C. 1988)(the violation of SRO rules may be a factor for the consideration by the jury as to whether the stockbroker acted as a reasonable person in his conduct towards his customer and their account). Additionally, FINRA itself has stated that claims may be brought in arbitration for violations of SRO rules. Ms. Fienberg, formerly the president of NASD Dispute Resolution, speaking at the NASAA (North American Securities Administrators Association) presentation entitled "NASAA Listens Forum," in Washington DC on July 20, 2004, stated:

In SRO NASD arbitration, unlike in court, you get an equitable result. You do not have to have a claim that is cognizable under state or federal law. It can be cognizable under NASD rules. So for example, there's only one cause of action under the federal securities laws, that's 10(b), it's very limited, has a short statute of limitations. The rules that are applied by arbitrators looking for equitable relief are much broader than if they had to strictly follow the law.

The import of this statement by the then CEO of FINRA is that arbitration is an equitable proceeding, rather than an action strictly governed by law. Indeed, according to Ms. Fienberg, claimants are not even required to have a claim cognizable at law. This is further supported by FINRA rule. FINRA arbitration rules require only a statement of claim, specifying the relevant facts and remedies requested. FINRA Rule 12302(a)(2).

³¹ DOL Final Rule, *supra* note 26 at 21,008, 21,020.

³² *Id.* at 21,022.

³³ *Id.* at 21,041.

requirements, the BIC exemption further requires that the firm make a warranty in its contract with IRA investors, committing to compliance with its obligations under the exemption, including that it has adopted and implemented anti-conflict policies and procedures. The warranty requirement was promulgated to create “an express enforceable promise of compliance with the policies and procedures condition.”³⁴

The warranty requirement serves as a powerful incentive for firms to adopt and implement anti-conflict policies and procedures, and carefully police conflicts of interest. By requiring an express warranty in the contract between investors and the firm, the warranty provides a mechanism to enforce these requirements in the first place, specifically, through a breach of contract action governed by state law.

Question 11: *If the Securities and Exchange Commission or other regulators were to adopt updated standards of conduct applicable to the provision of investment advice to retail investors, could a streamlined exemption or other change be developed for advisers that comply with or are subject to those standards? To what extent does the existing regulatory regime for IRAs by the Securities and Exchange Commission, self-regulatory bodies (SROs) 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 the prohibited transaction rules?*

The current rules governing brokers and investment advisers do not provide adequate protections for retirement investors. The FINRA suitability rule, governing brokers, requires that a broker only have a “reasonable basis” for making an investment recommendation, and that the recommendation be “suitable” for the investor. Under this suitability standard, a broker may sell a mutual fund with high expenses rather than a functionally identical fund, which may cost the investor less but pay the broker less. These conflicts are not adequately managed by the current rules.

SaveOurRetirement.com estimates that retirement savers lose between \$57 million and \$117 million every day due to conflicted investment advice, amounting to at least \$21 billion annually.³⁵ The Council of Economic Advisers estimate Americans are suffering \$17 billion in losses annually due to conflicted advice they receive from financial advisors.³⁶ The Department has estimated that full compliance with the Rule and PTEs would cost the industry \$16 billion over ten years, but will result in investor gains of between \$33 billion and \$36 billion.³⁷

³⁴ *Id.*

³⁵ See, Save our Retirement, *Comment Letter to the Dep’t of Labor* (May 8, 2015), available at

<http://saveourretirement.com/cms/wp-content/uploads/2015/02/DOL-SOR-Letter-Comment-Period-Request-5-8-15.pdf>.

³⁶ See, White House Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings* (Feb. 2015); available at https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf. “Conflicted advice” refers to advice given on particular investment products where the financial advisor is compensated in fees and commissions that depend on which investment product the customers buys.

³⁷ Dep’t of Labor, *Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice; Proposed Delay of Applicability Date*, 82 Fed. Reg. 12,319, 12,320 (Mar. 2, 2017), available at

<https://www.federalregister.gov/documents/2017/03/02/2017-04096/definition-of-the-term-fiduciary-conflict-of-interest-rule-retirement-investment-advice-best>.

The Rule and PTEs go further than the current FINRA standards in that they require either elimination of conflicts, or adequate management of the conflicts to ensure that the broker adheres to the Impartial Conduct Standards. These steps are needed to ensure that retirement investors are protected, and have an appropriate remedy if a firm or broker fails to adhere to the standards. Under the other rules currently governing brokers and investment advisers, investors will continue to suffer significant losses in their retirement account because of unmitigated conflicts of interest. Accordingly, unless the SEC adopts a standard no less stringent than that adopted by the Department, brokers and investment advisers should be required to adhere to the Rule and PTEs as they were originally adopted.

Conclusion

PIABA thanks the Department for the opportunity to comment on its request for information. PIABA is hopeful that the Department will permit the Rule and PTEs to be fully implemented on January 1, 2018, so that investors will receive the protections they have been promised and are entitled to receive. A great deal of thought was given to the adoption of the Rule and PTEs to ensure that investors would receive these important protections, while ensuring that the industry would continue to have flexibility in how it rendered advice and service. To undo the Rule and PTEs would unfairly skew that balance in the favor of the industry at the expense of investors.

Very truly yours,



Marnie C. Lambert
PIABA President