AS AMERICANS STRUGGLE TO SAVE FOR RETIREMENT, THE DOL OFFERS LITTLE PROTECTION

On July 7, 2020, the Department of Labor (the DOL) released its new investment advice rule. Rather than take steps to protect retirement investors, the DOL chose to reinstate its flawed five-part test, excluding broad swaths of financial professionals from a fiduciary obligation. The DOL will once again allow financial professionals to provide conflicted advice and benefit themselves, rather than requiring that they put retirement investors' interests first.

The DOL has gone even further, and is proposing to *lower* the standard of conduct for financial firms and professionals that manage to be captured by the regulation, from a fiduciary obligation to a "best interest" standard. This represents a dramatic and unprecedented reversal of the intent of Congress in enacting ERISA.

Today, PIABA has filed its comment letter, which may be found here. PIABA urges the DOL to adopt a new regulation, which would eliminate the need to satisfy a five-part test before someone providing investment advice would be deemed a fiduciary. There should be no need to establish that investment advice has been given on a regular basis, or pursuant to a mutual agreement that the advice will serve as the primary basis for the investment decision. Any individual providing investment advice to a retirement investor for a fee should be deemed an Investment Advice Fiduciary and held to the highest fiduciary standards.

To the extent the DOL establishes an exemption which would allow otherwise prohibited conduct, such an exemption should not lower the fiduciary obligations of Investment Advice Fiduciaries. Retirement investors deserve to have their retirement savings protected, as was intended by the enactment of ERISA. PIABA urges the DOL to adopt standards that go beyond those adopted by the SEC as part of Reg. BI, which the SEC itself conceded was not a fiduciary standard. The DOL must adopt true fiduciary obligations, including the duty to mitigate or eliminate conflicts of interest, not the duty to simply disclose them.

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August 6, 2020

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: Application No. D-12011, Docket ID No. EBSA-2020-0003
Improving Investment Advice for Workers & Retirees

To Whom It May Concern:

I write on behalf of the Public Investors Advocate Bar Association ("PIABA"), an international bar association comprised of attorneys who represent investors in disputes with the securities industry and financial advisors. Since its formation in 1990, PIABA has promoted the interests of the public investor in all dispute resolution forums, worked with legislators and regulators to craft the best laws and rules to protect investors, while also advocating for public education regarding investment fraud and industry misconduct.

In 2016, the Department of Labor (the "Department") adopted a final regulation titled "Conflict of Interest Rule—Retirement Investment Advice" (the "Fiduciary Rule"), as well as two new administrative class exemptions from the prohibited transaction provisions of ERISA and the Internal Revenue Code (the "IRC").[1] In 2018, the United States Court of Appeals for the Fifth Circuit vacated the Department's Fiduciary Rule and accompanying class exemptions.[2] In 2019, the Securities & Exchange Commission (the "Commission") adopted two regulations governing investment advice titled, "Regulation Best Interest: The Broker-Dealer Standard of Conduct" (commonly referenced as "Reg. BI"),[3] and "Form CRS Relationship Summary and Amendments to

[1] Dep't of Labor, Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,945 (Apr. 8, 2016) ("Fiduciary Rulemaking"); Dep't of Labor, Best Interest Contract Exemption; Correction, 81 Fed. Reg. 44,773 (July 11, 2016); Dep't of Labor, Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs; Correction, 81 Fed. Reg. 44,784 (July 11, 2016).
[2] *Chamber of Commerce of United States of Am. v. United States Dep't of Labor*, 885 F.3d 360, 388 (5th Cir. 2018), judgment entered sub nom. *Chamber of Commerce of Am. v. United States Dep't of Labor*, No. 17-10238, 2018 WL 3301737 (5th Cir. June 21, 2018).
[3] Securities & Exchange Comm., Regulation Best Interest: The Broker-Dealer Standard of Conduct, 84 Fed. Reg. 33,318 (July 12, 2019) (to be codified at 17 C.F.R. pt. 240) ("Reg. BI").

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Form ADV."[4] Most recently, on July 7, 2020, the Department adopted a final rule, which reinstated the regulation in effect prior to the Fiduciary Rule (the "1975 Regulation").[5] On the same day, the Department proposed a new class exemption (the "2020 Proposal").[6]

PIABA offers this comment, both in response to the Department's reinstatement of the 1975 Regulation and the 2020 Proposal. The Department has only provided thirty days for comment on the 2020 Proposal. On July 8, 2020, PIABA joined with twenty other groups to seek an extension of the comment period.[7] Had additional time been provided, PIABA may have been able to provide a more extensive comment, however, this proposal is significantly important, and hence PIABA has endeavored to submit a meaningful comment within the time period set by the Department.

PIABA is troubled by the lack of protection that will be afforded to workers and retirees by the Department's reinstatement of the 1975 Regulation and by its 2020 Proposal. As has been amply demonstrated by the prior rulemaking referenced above, and in PIABA's prior comments to the past rulemaking, investors rely on those providing investment advice, and expect that those providing advice will be acting in the investors' best interests. Neither the 1975 Regulation, nor the 2020 Proposal meet investors' expectations, which will leave investors vulnerable to the harm that results from improper and conflicted advice.

I. The 1975 Regulation's "Five-Part Test" Should Be Replaced

As mentioned above, the Department recently reinstated the 1975 Regulation. The 1975 Regulation contains a five-part test that must be satisfied before someone will be deemed to be giving investment advice under ERISA and the IRC. If the investment advice is provided for a fee, the person is an Investment Advice Fiduciary. The regulation remained unchanged for 40 years, although the investment advice industry changed drastically. In 2016, when it adopted its Fiduciary Rule, the Department acknowledged that the five-part test had "significantly narrowed the breadth of the statutory definition of fiduciary investment advice."[8] The Department recognized that many who provide investment advice did not meet the five-part test, and as a result, were not investment advice fiduciaries, despite the "critical role they play in guiding plan and IRA investments."[9] As a result, the 1975 Regulation has allowed many advisers to operate with conflicts of interest, conflicts that would be prohibited if they were Investment Advice Fiduciaries.[10]

Now, the Department has reinstated the five-part test where a person shall be deemed to be rendering investment advice under ERISA and the IRC, if the person:

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[4] Securities & Exchange Comm., Form CRS Relationship Summary; Amendments to Form ADV, 84 Fed. Reg. 33,492 (July 12, 2019) (to be codified at 17 C.F.R. pts. 200, 240, 249, 275, and 279) ("Form CRS").
[5] Dep't of Labor, Conflict of Interest Rule-Retirement Investment Advice: Notice of Court Vacatur, 85 Fed. Reg. 40,589 (July 7, 2020).
[6] Dep't of Labor, Improving Investment Advice for Workers & Retirees, 85 Fed. Reg. 40,834 (July 7, 2020) ("2020 Proposal").
[7] PIABA, *et al.*, Letter to Dep't of Labor (July 8, 2020), available at https://consumerfed.org/wp-content/uploads/2020/07/DOL-Advice-Rule-Extension-Request.pdf.
[8] Fiduciary Rulemaking, *supra* n. 1, 81 Fed. Reg. at 20,946.
[9] *Id.*
[10] *Id.*

(1) renders advice with respect to the plan or IRA as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property;
(2) on a regular basis;
(3) pursuant to a mutual agreement, arrangement, or understanding with the plan, plan fiduciary or IRA owner, that,
(4) the advice will serve as a primary basis for investment decisions with respect to plan or IRA assets; and that
(5) the advice will be individualized based on the particular needs of the plan or IRA.[11]

The same conflict issues the Department identified when it first replaced the five-part test in 2016 continue to exist today. Under the 1975 Regulation, many who provide investment advice will not meet all five parts of the test, thereby never being deemed Investment Advice Fiduciaries. Those advisers will continue to be allowed to be influenced by conflicts of interest and engage in transactions that would be prohibited if those same advisers were fiduciaries.

Firms have begun to reintroduce conflicts of interest that were disappearing in the wake of the adoption of the Fiduciary Rule. For example, in 2018, Merrill Lynch launched a program whereby early career advisors would be paid a guaranteed salary, so long as they met certain targets for bringing in new assets.[12] This type of compensation arrangement would not have been permitted under the Fiduciary Rule as it creates an improper incentive for Investment Advice Fiduciaries to place their own interests ahead of investors' interests. This is true because, under this Merrill Lynch program, advisors must acquire new assets if advisors are to continue to receive a salary. The advisors are incentivized to provide advice to rollover assets from a 401(k) or other retirement plan to an IRA to meet those targets.

These conflicts will become more widespread, as firms once again have certainty they will not be deemed to be Investment Advice Fiduciaries. Firms had been able to escape coverage under the 1975 Regulation by ensuring they simply did not meet the five-part test, generally by utilizing account agreements that specifically disclaimed one or more elements of the five-part test. For example, firms would state they were not providing advice on a regular basis, or that there was no agreement that any recommendation made was the primary basis for any investment decision in the account. Now that the 1975 Regulation is reinstated, firms will likely again utilize agreements with investors which set forth their purported understanding that any advice the firm provides is not on a regular basis and is pursuant to a supposed mutual agreement that it is not a primary basis for the investment decision. Accordingly, firms will continue to operate pursuant to conflicts of interest, harming investors and depleting their retirement savings.

[11] *See* 29 C.F.R. § 2510.3-21(c); 26 C.F.R. § 54.4975-9(c).
[12] Stephanie Forshee, "Merrill Sweetens Pay Plan for Upstart FAs," Financial Advisor IQ (July 29, 2020), available at https://financialadvisoriq.com/c/2828893/344913/merrill_sweetens_plan_upstar.

CONFLICTED ADVICE HARMS RETIREES

Grant, 81, and Dorothy, 77, were retirees who turned over their hard-earned retirement funds which they spent a lifetime saving to a broker, Jarrod. They invested $150,000 with Jarrod, who told them he was going to employ the "Bull-Bear Strategy." This strategy involved active trading of an investor's portfolio using primarily individual stocks and exotic Exchange Traded Funds to follow market trends. In the seven months that Jarrod employed this risky strategy, he earned for himself almost $15,000 in commissions, while Grant and Dorothy lost over $25,000 – a sixth of their portfolio.

The Department should adopt a definition of investment advice that conforms with the current economic environment. For example, when the Department first promulgated the five-part test in 1975, Congress had not yet modified the tax code to allow for employees to contribute a portion of their salary to 401(k) plans and most retirement assets were in defined-benefit pension plans. That change came in 1978 and eventually ushered in the current defined-contribution era.[13] The Department should replace the five-part test and remove the inappropriate restrictions it placed on the statutory definition of fiduciary investment advice in 1975. In its place, the Department should promulgate a regulation that will establish that all individuals providing investment advice to plans and IRAs are fiduciaries, regardless of whether that advice is given on a regular basis, and regardless of whether there has been a mutual agreement that the advice will serve as the primary basis for the investment decision. This would be consistent with the statute, and with Congress's intent when it adopted ERISA.

A. Remove the Regular Basis Requirement

The Department could do substantial good by removing the second prong of the five-part test, the requirement that advice must be given "on a regular basis." Single-shot events, like the sale of illiquid securities such as REITs, TICs and private placements; annuities, or other insurance products; or a decision about whether to "rollover" assets from one account type to another have substantial impacts on a person's retirement. When it adopted its Fiduciary Rule in 2016, the Department recognized this issue and found that *trillions* of dollars shifted each year with rollover transactions.[14] The "regular basis" requirement now excludes these transactions from ERISA's scope and allows assets accumulated under ERISA's protection to be dissipated without protection.

The "regular basis" requirement results in applying different standards to identical activities with identical effects. A consultant who regularly provides advice with respect to a series of transactions would be a fiduciary when giving advice about the investment of an entire pool of assets. Yet, if a different consultant were hired to invest an entire pool of assets in a single transaction, the second consultant would not be bound by fiduciary obligations even though they would do the exact same thing with the same effects. Maintaining the "regular basis" requirement effectively allows single-shot transactions to misallocate ERISA-protected assets with impunity.

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[13] Revenue Act of 1978, Pub. L. No. 95-600, § 135, 1978 U.S.C.C.A.N. (92 Stat.) 2763, 2785-87 (codified at IRC § 401(k) (2000)).
[14] *See* Fiduciary Rulemaking, *supra* n. 1, 81 Fed. Reg. at 20,949 ("these rollovers are expected to approach $2.4 trillion cumulatively from 2016 through 2020.").

B. Remove Requirements That an Investor and Advisor Mutually Agree That Advice Will Serve as the Primary Basis for an Investment

The Department should also reaffirm its prior conclusion the "mutual agreement" and "primary basis" requirements should be modified because it does not conform to the current defined-contribution plan environment.[15] Under the five-part test, a person may escape fiduciary status by arguing that there was no "mutual agreement" that their advice would be a "primary basis" for an investment decision. Fine print in sales contracts disclaiming any mutual agreement and claiming that the purchaser warrants that they have made their own decision by signing the agreement are now proffered to rebut the existence of any mutual agreement.

This loophole allows salespeople to exploit the wide financial sophistication gap between Americans and the financial services industry. Americans often struggle to understand even rudimentary financial concepts.[16] The Department should not abdicate its responsibility to protect retirement assets by allowing seemingly harmless word-salad disclaimers to greenlight profiting from shoddy advice.

Moreover, the Department should not allow any financial professional to give substandard or self-serving advice merely because it may not be the "primary basis" for an investment decision. This approach turns investment advice into a predatory trap. Consider one scenario where a retirement saver hears from a friend that the friend's assets have been placed inside some complex annuity contract. The saver may meet with an insurance company's representative to inquire about the product because the friend purchased it. Here, the representative should not be free to give low-quality advice simply because the primary basis for exploring the option was the friend's prior purchase.

Identifying whether financial advice, independent research, or some other reason served as a "primary basis" for an investment decision may be impossible. The persons giving financial advice for a fee should not be able to dispense lower-quality advice on the theory that an investor should not rely on that advice as a primary basis for their investment. Accordingly, PIABA urges the Department to consider replacing the 1975 Regulation with a new regulation that will appropriately protect workers and retirees receiving investment advice and hold those providing investment advice to a true fiduciary standard.

II. The 2020 Proposal Effectively Lowers the Standard of Care Required of Investment Advice Fiduciaries

By reinstating the 1975 Regulation, the Department will ensure that many who should be deemed Investment Advice Fiduciaries will instead be excluded by the regulation. Now, with the

[15] Fiduciary Rulemaking, *supra* n. 1, 81 Fed. Reg. at 20,955.

[16] Seth L. Elan, Fed. Research Div., Library of Cong., Financial Literacy Among Retail Investors in the United States 5 (2011), https://www.loc.gov/rr/frd/pdf-files/Investor_Literacy_Report.pdf(finding that many investors do not understand "the most rudimentary financial concepts: inflation, bond prices, interest rates, mortgages, and risk"); *id*. at 25 (finding that investors also do not understand slightly more advanced topics, including "differences between stocks and bonds, the role of the stock market, and the value of portfolio diversification"); Tess & Jill, (finding that subjects did not know to select an otherwise identical investment based on the lowest cost unless specifically instructed to do so).

2020 Proposal, the Department is going even further, and *lowering* the standard of conduct for financial firms and professionals that are captured by the regulation from a fiduciary obligation to a "best interest" standard. This represents a dramatic and unprecedented reversal of the intent of Congress in enacting ERISA.

The 2020 Proposal would create a new class exemption allowing Investment Advice Fiduciaries, under both ERISA and the IRC, to receive compensation from third parties in connection with transactions involving pension plans and IRAs, and to engage in principal transactions and other conduct that would otherwise be prohibited transactions under ERISA and the IRC, provided that they comply with certain standards. Investment Advice Fiduciaries would be required to (i) adhere to the "Impartial Conduct Standards;" (ii) provide certain disclosures; (iii) establish, maintain and enforce written policies and procedures designed to ensure compliance with the Impartial Conduct Standards; and (iv) conduct an annual *retrospective* review.[17] However, collectively, these requirements do not ensure that Investment Advice Fiduciaries will be held to fiduciary standards. The requirements do little more than replicate existing standards, standards which are not fiduciary obligations. While the existing standards do not apply to all of the individuals who provide investment advice, and in some cases may raise the applicable standards of care, the Department's goal should not be to make brokerage and investment advisory standards the uniform standard of care. Rather, the Department's goal should be to ensure that the ERISA fiduciary standards become the uniform standard for those providing investment advice to retirement investors. The 2020 Proposal falls far short of that goal.

A. The Impartial Conduct Standards are Flawed

The Impartial Conduct Standards require that the Investment Advice Fiduciary comply with three prongs: (i) provide advice in the investor's best interest; (ii) charge only reasonable compensation and seek best execution; and (iii) make no materially misleading statements about the investment transaction and other relevant matters.[18]

The first prong of the Impartial Conduct Standards, the best interest obligation, is to be interpreted and applied consistent with the best interest standard as defined by the Commission's recently enacted Reg. BI.[19] Unfortunately, in developing its Impartial Conduct Standards, the Department has chosen to rely on a regulation which is not a fiduciary standard. In its enactment of the regulation, the Commission explicitly acknowledged that Reg. BI, while drawing on some principles of fiduciary obligations, was something different.[20]

Reg. BI materially differs from a true fiduciary standard in several respects. Reg. BI does not define what is meant by "best interest," but rather, creates a checklist of four obligations a firm must discharge to meet the standard. Those obligations are: (1) providing certain prescribed disclosures before or at the time of the recommendation about the recommendation and the relationship between the customer and the broker-dealer; (2) exercising reasonable diligence, care and skill in making the recommendation; (3) establishing, maintaining and enforcing policies and

[17] 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,842.
[18] *Id.*
[19] *Id.*
[20] Reg. BI, *supra* n. 3, 84 Fed. Reg. at 33,320.

procedures reasonably designed to address conflicts of interest; and (4) establishing, maintaining and enforcing policies and procedures reasonably designed to achieve compliance with Reg. BI.[21]

None of the foregoing obligations actually requires the firm to place the customer's interests ahead of the adviser's.[22] Instead, Reg. BI states that the adviser cannot "place its own interests ahead of the customers' interests. Consequently, Reg. BI allows the adviser to put its own interests on an equal footing with the customers' interests."[23] In baseball terms, a tie goes to the adviser. This is contrary to the fundamental premise of a fiduciary duty: that the investors' interests must always come first. Similarly, the Department has said that the Impartial Conduct Standard will only require that the Investment Advice Fiduciary may not place their interests ahead of the retirement investors' interests.[24] There will not be any requirement that the retirement investors' interests come first.

INVESTORS ARE HARMED WHEN THEIR INTERESTS ARE NOT MADE TO COME FIRST

Bob and Janet met their broker, Shawn, after hearing his radio show. Shawn often talked about alternative investments on his show, touting them as providing safe and secure income without all of the volatility of stocks. As Bob had significant health problems, he was concerned about his ability to provide for Janet into retirement. Bob reached out to Shawn to ask for his help managing the couple's modest savings. Shawn ultimately recommended a number of non-traded REITs and Business Development Companies ("BDCs"). These investments are highly speculative, risky, and illiquid. Shawn presented them as safer and more diverse than the stock market. Shawn did not mention the lucrative fees such investments pay to firms and brokers. These investments often have up-front costs and fees of 10 – 15%, a significant portion of which is passed along to the brokerage firm and its brokers in the form of commissions. It is clear Shawn recommended these products because of the benefits he would receive, not because they were appropriate for Bob and Janet. Shawn knew Bob and Janet were relying on him put Bob and Janet's interests first, but Shawn violated their trust.

The Commission has also made it clear that it will not interpret Reg. BI's non-fiduciary "best interest" standard to require the recommendation of investments which the adviser reasonably believes are the best available option for the investor.[25] Instead, the Commission has interpreted "best interest" in a manner which is virtually indistinguishable from the suitability standard applied to non-fiduciary brokers.[26] It seems the Department will likewise not require that the Investment Advice Fiduciary provide the best advice.[27]

[21] *Id.*
[22] *Id.*
[23] *Id.*
[24] 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,843.
[25] Reg. BI, *supra* n. 3, 84 Fed. Reg. at 33,321.
[26] *Id.*
[27] 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,843.

INVESTORS TRY TO MAKE THE RIGHT CHOICES, BUT INVESTMENT ADVICE FIDUCIARIES OFFER CONFLICTED ADVICE, AND THE INVESTORS END UP PAYING THE PRICE

A New Jersey couple in their late forties opened an account with a broker. The couple thought they were doing something responsible to help prepare them for retirement. The broker placed their funds in a combination of private placements, REITs, and other high-risk alternative investments. The broker told the couple the investments were safe and met their goals of preservation of capital and growth. The couple didn't know that, while the investments may have offered some potential for growth, they were highly risky. No doubt, the broker and his firm were not motivated by the interests of their clients, but rather by the substantial fees earned from these investments. Had the broker recommended truly appropriate investments, the broker would have earned much less. Unfortunately, the only person who benefited from this trading was the broker. Meanwhile, the couple lost a significant amount of their retirement savings.

Moreover, the Department has decided that Investment Advice Fiduciaries will be able to provide investment advice despite having a financial or other interest in the transaction.[28] The core fiduciary obligation – the prohibition of conflicts of interest – has been eliminated, and replaced with a lesser standard.

WHEN INVESTMENT ADVICE FIDUCIARIES HAVE A FINANCIAL INTEREST IN THE RECOMMENDED TRANSACTIONS, THEY MAY BE MOTIVATED TO PROVIDE HARMFUL ADVICE

Tom and Shari were a couple from Kansas. Tom, 71, was working as a facilities engineer. Shari was 69, working as a Program Director for their local church. Tom and Shari were introduced to their broker, Bill, by other members of the church who Bill also advised. Initially, Bill reviewed Tom and Shari's retirement accounts and told them that they were being badly mismanaged, they should sue their old broker, and they should trust his professional management. So, of course, they believed him and transferred their accounts. Over the next five and a half years, Bill excessively traded the accounts. Shari's IRA was worth over $700,000 when it was transferred to Bill. Five and a half years later, it was worth just over $250,000 – a loss of $450,000. Bill earned almost $230,000 in commissions during this time period which accounted for more than half the losses. Tom's IRA was worth just over $250,000 when it was transferred to Bill. At the end, his IRA was worth only $40,000 – a loss of over $200,000. Bill earned $130,000 in commissions on Tom's account. In total, Tom and Shari lost over $600,000 of their retirement funds, while Bill earned $360,000.

Additionally, although a fiduciary usually has the duty to monitor the accounts of its clients (assuming an ongoing relationship), the proposed rule would adopt Reg. BI's approach which does not require monitoring.[29]

[28] 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,843.
[29] Reg. BI, *supra* n. 3, 84 Fed. Reg. at 33,321.

The second prong of the Impartial Conduct Standards replicates pre-existing obligations to charge reasonable compensation and seek best execution. For example, investment advisers and brokers both have obligations to charge reasonable fees.[30] Additionally, brokers have an obligation of best execution.[31] The third prong of the Impartial Conduct Standards prohibits Investment Advice Fiduciaries from making misleading statements. Again, both investment advisers and brokers are already subject to such a prohibition under federal statutes and regulations.[32]

The Impartial Conduct Standards should establish adequate protections to ensure those that are Investment Advice Fiduciaries who will engage in otherwise prohibited transactions do not take advantage of retirement investors. However, the Impartial Conduct Standards do nothing more than articulate standards that already exist in other places. They will not provide retirement investors with the heightened protections those investors are entitled to under ERISA and the IRC. Investment Advice Fiduciaries must be held to a true fiduciary standard and obligated to put the retirement investors' interests first.

B. The Disclosure Obligations are Weak and Duplicative of Existing Law and Regulation

The Department will also require that Investment Advice Fiduciaries acknowledge that they are fiduciaries and provide a written description of the services provided as well as material conflicts of interest arising out of the services and recommendations.[33] Here, again, the Department relies to a large extent on disclosures that Investment Advice Fiduciaries will likely already be making pursuant to other regulatory obligations. For example, brokers and investment advisers must make similar disclosures pursuant to Reg. BI as part of Form CRS.[34] The Department expects that many firms will be able to satisfy their disclosure obligation by relying on the disclosures that will be made in Form CRS.[35]

Moreover, providing disclosure does not adequately mitigate the conflicts of interest inherent in the relationship between Investment Advice Fiduciaries and their clients. Instead, it inappropriately places the burden on the client to fully understand the impact of those conflicts on the future of their retirement savings. Disclosure is particularly meaningless in this context, because many retirement savers are not sophisticated and reasonably rely upon the verbal representations of Investment Advice Fiduciaries.

DISCLOSURES DO NOT ADEQUATELY INFORM INVESTORS WHO RELY ON THE ADVICE OF THE INVESTMENT ADVICE FIDUCIARY

Paul and Ann are two retirees who lost nearly all of their life's savings after placing their trust in their neighbor, Rick, who was also their broker. Together, Paul and Ann built a nest egg of about $250,000, which they held in bank certificates of deposit – until they met and

[30] *See, e.g.*, SEC, "Regulation of Investment Advisers by the U.S. Securities and Exchange Commission," p. 50 (Mar. 2013), available at https://www.sec.gov/about/offices/oia/oia_investman/rplaze-042012.pdf; *see also*, FINRA Rule 2121.
[31] *See, e.g.,* FINRA Rule 5310.
[32] *See, e.g.*, 17 C.F.R. §240.10b-5.
[33] 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,844.
[34] Form CRS, *supra* n. 4, 84 Fed. Reg. at 33,502.
[35] 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,853.

became friendly with Rick. Rick lived nearby and occasionally helped Paul with difficult tasks around the house. Rick touted his investment expertise and told Paul and Ann that he could invest their savings so that they could earn higher returns than the banks paid. Paul and Ann had no prior investment experience and, trusting their friend and broker, Rick, they signed all the account opening and other paperwork that Rick presented to them. The documents included subscription agreements with boilerplate risk disclosures, but given their trust in Rick, Paul and Ann simply signed and initialed all the documents where indicated. Rick placed all of their savings into four high risk private placements that were being pushed by his broker-dealer and which paid high commissions; one of the issuers was in fact seized by an SEC receiver because it turned out to be a Ponzi scheme.

Disclosure cannot be a substitute for adherence to fiduciary obligations.

DISCLOSURES ARE USED TO PROTECT THE FIRMS, NOT INFORM INVESTORS

Kathy, a recently widowed manufacturing employee who lost her job during the financial crises in 2008, contacted broker Herbert to help her establish an investment plan. Kathy's only assets outside of her modest home were approximately $180,000 of savings in annuities and bank certificates of deposit ("CDs"). Herbert recommended to Kathy that she liquidate the annuities and CDs and trust him to place them in investments that would grow and generate income for her expenses. Instead, Herbert placed nearly half of Kathy's limited savings in a non-traded Real Estate Investment Trust ("REIT") and a high-risk oil and gas limited partnership. Both investments paid significant commissions to Herbert. When Kathy sued, the broker-dealer claimed that Kathy understood the risks because she signed the REIT's subscription agreement with risk disclosures – buried in over 30 pages of documents Herbert had provided to Kathy.

Conflicts of interest that will impact an Investment Advice Fiduciary's ability to put a retirement investor's interests first should be eliminated or mitigated, not simply disclosed. Retirement Investors cannot consent to be harmed, and a true fiduciary would not seek such consent.

C. The Written Policies and Procedures Obligations Should be Stronger

The Department's proposed rule will require that Investment Advice Fiduciaries establish, maintain, and enforce written policies and procedures that are designed to ensure that there is compliance with the Impartial Conduct Standards.[36] Yet again, such a requirement does little beyond what many Investment Advice Fiduciaries are already obligated to do under other regulatory schemes. For example, FINRA registered firms have such an obligation under FINRA Rule 3010. Additionally, the Commission adopted a similar obligation under Reg. BI.[37]

[36] 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,845.
[37] Reg. BI, *supra* n. 3, 84 Fed. Reg. at 33,321.

POLICIES AND PROCEDURES ALONE CANNOT PROTECT RETIREMENT INVESTORS

Donna was a 58-year old single person with a high-school education. When her stockbroker of many years transferred her account to another firm, the broker completed the account application paperwork showing Donna as an investor with a six-figure income and extensive investment experience, seeking an aggressive investment strategy, and having a high tolerance for risk. The broker knew none of it was true. Donna signed the paperwork without question or discussion because she trusted her stockbroker. The firm sent her a 40-page "welcome" packet that included her profile information, and informed Donna to contact her broker with questions or corrections. Overwhelmed by the sheer volume, she did not read the false paperwork. After the stockbroker lost most of Donna's money through imprudent, high-risk investments, Donna filed a claim seeking compensation for her losses. The central pillar of the firm's defense was Donna's false customer profile, which the firm argued had given them, in effect, free rein to act contrary to Donna's best interest.

Most importantly, policies and procedures alone are not a substitute for a true fiduciary obligation. Unless the Impartial Conduct Standards require Investment Advice Fiduciaries to adhere to fiduciary standards, the policies and procedures designed to enforce them will necessarily fall short. The Impartial Conduct Standards must create a culture that the retirement investors' interests should come first. Only then will the supervisory structure be capable of protecting retirement investors.

There is one aspect of the policies and procedures requirement where the Department does go beyond existing requirements. The Department explicitly requires written documentation of the rationale supporting recommendations to roll over Plan or IRA assets to another Plan or IRA, and/or to change from one type of account to another (e.g., from a commission-based account to a fee-based account).[38] PIABA supports this provision and agrees that these two types of investment recommendations are important and should require written documentation.

However, this provision is too narrow as currently written. There are many other consequential recommendations concerning retirement savings which frequently arise in a retirement investor/Investment Advice Fiduciary relationship. Such recommendations include, but are not limited to: (1) advising a client to take a lump cash payment in lieu of a pension plan; (2) advising a client to take an early retirement; and (3) advising a client to use retirement assets to purchase high-cost, high-risk, and/or illiquid products such as indexed annuities, indexed universal life insurance, alternative investments, and/or unsecured promissory notes. These recommendations can, and often do, have devastating consequences for retirement savers.

For example, many older investors seek investment advice as they are considering when to retire and/or whether to take a lump sum payment in lieu of a defined benefit pension. These investors place themselves in what they believe are the capable and trustworthy hands of purported retirement planning experts. By cashing out a defined benefit pension plan, the pensioner forever loses a secure benefit that would have provided a guaranteed lifetime income. Likewise, an individual who retires too early loses the ability to generate sufficient income for retirement, and

[38] 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,845.

is often then forced to go back to work for lower pay, or to become dependent upon government assistance. In that regard, it is important to recognize that recommendations to take early retirement, or to elect a lump sum in lieu of a pension, are a necessary precursor to an adviser obtaining control of retirement assets upon which the adviser can earn fees and commissions. As a result, such recommendations should trigger the same documentation requirements as recommendations to rollover an IRA or to convert to a different type of account.

ALL RECOMMENDATIONS IMPACTING RETIREMENT SAVINGS ARE CONSEQUENTIAL AND SHOULD BE DOCUMENTED

In the late 1990s and early 2000s, broker SK gave "retirement planning" seminars onsite at Pacific Bell offices throughout Northern California for Pacific Bell retirees who had been offered early retirement packages. At these seminars and in one-on-one meetings which followed the seminars, SK advised the prospective retirees to take the early retirement packages, elect a lump sum payout in lieu of a pension, and invest the lump sums through the broker-dealer with whom she was affiliated. SK told the prospective retirees that her investment prowess would produce an income stream that was larger than their pensions, but just as safe, while also allowing them to leave an inheritance. SK then recommended to the early retirees that they invest those lump sums into variable annuities and earned significant commissions from those sales while losing large sums of those retirees' savings.

Given the foregoing, PIABA believes the documentation requirement should apply to all forms of advice that an investment advisory fiduciary provides with respect to retirement accounts, including, but not limited to, advising a client to take a lump cash payment in lieu of a pension plan; advising a client to take an early retirement; and all investment advice, including advising a client to use monies in a retirement account to purchase indexed annuities, indexed life insurance and/or private placement investments.

III. The 2020 Proposal Should Provide Clearer Standards For When An Investment Advice Fiduciary May Become Ineligible To Act As Such

The 2020 Proposal provides that individuals who have been provided with an ineligibility notice from the Director of the Office of Exemption Determinations would be ineligible to rely upon the exemption for ten years. The foregoing notice would be provided if an individual has: "(i) engaged in a systematic pattern or practice of violating the conditions of the exemption; (ii) intentionally violated the conditions of this exemption; or (iii) provided materially misleading information to the Department in connection with the Investment Professional's or Financial Institution's conduct under the exemption."[39] The foregoing proposal is so vague that it is essentially meaningless and unenforceable.

Specifically, the 2020 Proposal does not define what is meant by "systematic," nor how many violations need to occur in order for such violations to become "systematic." The proposal also does not explain what type of violations qualify as "intentional," or what type of information would be considered "materially misleading." The proposal provides no guidance as to the type of

[39] 2020 Proposal, *supra* n. 6, 85 Fed. Reg. at 40,849.

circumstances which would cause an Investment Advice Fiduciary to become ineligible to rely on the exemption.

Retirement savers and ethical fiduciaries share a common interest in ferreting out the "bad apples" who abuse their clients' trust. In order for that to occur, there has to be a clear definition of the conduct or type of conduct, and the number of instances of misconduct, that would render an individual ineligible. Other federal regulations, including other regulations promulgated under ERISA, routinely provide such definitions, as well as examples of the type of conduct that would qualify or not qualify. Specificity and clarity are essential in order for investors to have meaningful and enforceable protections from rogue advisers. Clear and specific standards are equally imperative for firms to enforce the rule, and to be able to discharge individuals who violate it.

The proposal also provides the Department with an unfettered amount of discretion to determine what misconduct, and how many instances of misconduct, cause an Investment Advice Fiduciary to become ineligible to rely on the exemption. The proposal, if enacted, would provide the Department with an unprecedented amount of discretion, allow the Department to pick winners and losers among investment advice firms, and deprive Investment Advice Fiduciaries of due process rights to which they are entitled under the Administrative Procedures Act. Certainly, PIABA wants to see bad actors removed from the investment advice business, but creating an unworkable and likely unconstitutional model for doing so means the Department will fail out of the gate to achieve its goal.

For the foregoing reasons, the final rule should clearly and specifically define the types of misconduct, and the number of instances of misconduct, which would render an Investment Advice Fiduciary ineligible to rely upon the exemption. It should also provide for ineligibility to be determined by a fair and neutral administrative process conducted pursuant to the Administrative Procedures Act, rather than by departmental fiat.

IV. **Conclusion**

In sum, the Department should not reinstate the 1975 Regulation. Rather, the Department should adopt a new regulation which eliminates the need to establish that investment advice has been given on a regular basis, or pursuant to a mutual agreement that the advice will serve as the primary basis for the investment decision. Any individual providing investment advice for a fee should be deemed an Investment Advice Fiduciary and held to the highest fiduciary standards. To the extent the Department establishes a class exemption, such an exemption should not lower the fiduciary obligations of Investment Advice Fiduciaries. Retirement investors deserve to have their retirement savings protected, as was intended by the enactment of ERISA. PIABA urges the Department to adopt standards that go beyond those adopted by the Commission in the enactment of Regulation Best Interest, which the Commission itself conceded was not a fiduciary standard.

Respectfully submitted,

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