The Honorable Jay Clayton
Chairman
U.S. Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

Dear Chairman Clayton,

We appreciate the opportunity to respond to your request for public comments from retail investors and other interested parties on standards of conduct for investment advisers and broker-dealers. The Economic Policy Institute (EPI) is a nonprofit, nonpartisan think tank created in 1986 to include the needs of low- and middle-income workers in economic policy discussions.

While we recognize that the SEC has an important role in setting the standards that apply to broker-dealers and investment advisers, many of the questions you ask were satisfactorily answered by the Department of Labor (DOL), the Council of Economic Advisors (CEA), consumer advocates, and other experts representing the interests of retirement savers who submitted comments and testified in the process of crafting the DOL fiduciary rule. Our comments below reflect what we believe to be widely-shared views among consumer advocates.

We urge the SEC to build on the DOL rule addressing conflicts of interest that harm retirement savers to extend protections to other investors. DOL has already made changes to its rule in response to concerns raised by the financial industry. Industry groups have had more than ample opportunity to voice their objections, including filing lawsuits around the country, and their claims have been appropriately rejected. That rule resulting from that robust public comment process can and should serve as the starting point for SEC action.

The administration should not use the SEC's oversight in other markets as an excuse to weaken or delay the DOL rule's protections for retirement savers. While we encourage the SEC to strengthen investor protections for non-retirement accounts, this should be done by leveling up the standards to match the DOL rule requirements rather than by leveling standards down to reflect the lowest common denominator. An incremental approach, in this case, does not create confusion, since there is no ambiguity about who is protected by the DOL rule: all people saving in tax-qualified retirement accounts, regardless of who advises them or what investment products they recommend. To the extent that there are spillover effects from the DOL rule on products and services marketed to other investors in non-retirement accounts, these will only be beneficial.

Need for a Fiduciary Standard

Economists, consumer advocates, and policymakers have long recognized that markets for professional advice do not function like textbook competitive markets because those seeking advice are less informed than the professionals they consult. For this reason, many professionals are required to adhere to regulations and professional standards designed to minimize conflicts of interest in the advice they offer clients. Professionals required to adhere to such standards include doctors, lawyers, registered investment advisers, and certified financial planners—but not, until recently, most broker-dealers and many other financial professionals offering advice to retail and plan investors.

In June, a fiduciary standard of care applying to financial professionals offering advice on tax-preferred retirement plans took effect after a long and exhaustive process. The rulemaking process began in 2010 under the previous administration. Over the next six years, DOL incorporated feedback from four days of hearings, more than 100 stakeholder meetings, thousands of public comments, and a detailed review of the academic literature. A final rule was issued in April 8, 2016, with implementation scheduled for a year later to allow time for affected businesses to adjust to changes. However, the current administration requested an additional 60-day delay, to June 9, 2017, at an estimated cost to investors of $3.7 billion over 30 years.[1] The administration subsequently announced that DOL would not begin enforcing the rule until January 1, 2018, at an additional estimated cost of $3.9 billion.[2] The administration has indicated that it is considering further costly implementation delays.

Conflicted advice is a problem that particularly affects retirement savers, many of whom mistakenly assume that people who present themselves as financial advisers have a duty to act in their clients' best interests. The DOL fiduciary rule focuses on retirement plans subject to the Employee Retirement Income Security Act of 1974 (ERISA), over which the Department has jurisdiction, as well as Individual Retirement Accounts (IRAs), most of which consist of funds rolled over from ERISA plans. It addresses the fact that many investors, especially those saving for retirement, are unaware that financial professionals offering "financial advice" or calling themselves "financial advisers" may not be operating under a fiduciary standard of care. As DOL noted in its Regulatory Impact Analysis (RIA), "asymmetries of information and expertise…characterize interactions between ordinary retirement investors and conflicted advisers."

DOL carefully documented the confusion around conflicted advice and the resulting cost to investors in the process of drafting its fiduciary standard. In developing its regulatory approach, DOL sought extensive input from the SEC and the Financial Industry Regulatory Authority (FINRA), among others. The DOL rule directly addressed difficulties faced by retirement savers in distinguishing between disinterested advice and sales pitches disguised as advice by expanding the definition of fiduciary. The rule effectively prohibits financial professionals from making recommendations that are directed to specific recipients or based on the recipients' particular needs and circumstances, and that, if heeded, enrich the professionals at the expense of retirement savers.

Posing as disinterested advisers, broker-dealers and other financial professionals recommend higher-cost and underperforming financial products and services that pay them more, rather than those that are best for the investor. Until the DOL rule, it was legal for financial professionals to offer advice tainted

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[1] Heidi Shierholz and Ben Zipperer, "Here is what's at stake with the conflict of interest ("fiduciary") rule," Economic Policy Institute Fact Sheet, May 30, 2017 (http://www.epi.org/publication/here-is-whats-at-stake-with-the-conflict-of-interest-fiduciary-rule/).

[2] Heidi Shierholz, "EPI comment on the proposed 18 month delay of key provisions of the fiduciary rule," September 11, 2017 (http://www.epi.org/publication/epi-comment-on-the-proposed-18-month-delay-of-key-provisions-of-the-fiduciary-rule/).

by conflicts of interest as long as they avoided meeting the conditions of a five-part test for determining fiduciary status, typically with fine-print disclaimers stating that any advice offered was not individualized nor intended to serve as the primary basis for investment decisions. This is similar to the regulatory loophole the SEC has created under securities laws by broadly exempting brokers from regulation under the Investment Advisers Act on the grounds that their advice is "solely incidental to" their sales recommendations, even when they hold themselves out as advisers and offer services that are clearly perceived and relied on as advice by investors.

Financial professionals not deemed fiduciaries are held to a weaker "suitability" standard. This prevents them from recommending products or services that are clearly ill-suited for a client, but does not require them to act in the client's best interest. Non-fiduciary advisors cannot, for example, encourage excessive trading to generate commissions. However, they can recommend a high-cost fund over a very similar low-cost fund or a proprietary product over a better performing, lower-cost non-proprietary alternative. In short, the suitability standard allows financial professionals to recommend the least suitable of all the suitable options available rather than the option that is best for the investor.

The DOL rule addressed the problem of conflicted advice by expanding fiduciary status to cover more of the advice offered to retirement savers and retirement plan officials. Under ERISA, fiduciary advisers are required to act with undivided loyalty to plan participants and beneficiaries and are prohibited from engaging in certain transactions in which advisers' and investors' interests might conflict. This generally means that fiduciary advisers cannot receive compensation that varies depending on whether a client follows their advice. However, the DOL rule grants certain exemptions to prohibited transactions if specific consumer protections are in place. Specifically, advisers are required to acknowledge their fiduciary status, act in their customers' best interests, eliminate practices that are likely to encourage advice that is not in customers' best interest, and charge only reasonable fees. We believe this provides an excellent framework for SEC rulemaking under the securities laws to better protect non-retirement investors from the harmful impact of conflicted advice.

High Cost of Conflicted Advice

Conflicted advice costs retirement savers billions of dollars. As DOL summarized in its Regulatory Impact Analysis (RIA), conflicts of interest "can bias the investment advice that some render and erode plan and IRA investment results." DOL estimated that IRA holders receiving conflicted advice could expect their investments to underperform by approximately one percentage point (100 basis points) per year, a seemingly small difference which in the aggregate costs IRA investors an estimated $210 billion over 10 years.[3] Similarly, the Council of Economic Advisers (CEA), after reviewing a range of studies, concluded in a 2015 report that, "taken together, the evidence suggests that conflicted advice leads to underperformance of roughly 100 basis points per year." CEA estimated an aggregate annual cost to

[3] U.S. Department of Labor, "Regulating Advice Markets: Definition of the Term 'Fiduciary' Conflicts of Interest - Retirement Investment Advice; Regulatory Impact Analysis For Final Rule And Exemptions," April 2016 (https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf).

investors of $17 billion.[4] Because the estimates are based on only a subset of affected assets, we believe the actual harm to investors from conflicted advice is much greater.

Limits vs. Disclosure

Problems associated with information asymmetry are only partly addressed through better disclosure. As DOL emphasized in its RIA, extensive research has demonstrated that "disclosure alone has proven ineffective to mitigate conflicts in advice." Disclosure requirements existing prior to the DOL rule have been shown to be ineffective, in part because investors fail to read the fine print. Even if investors do read conflict disclosures, it is unrealistic to expect them to understand the nature and extent of the conflict, given the complex compensation structures that pervade the broker-dealer business model. It is equally unrealistic to expect that investors will be capable of independently assessing the quality of the recommendations they receive irrespective of the conflict. After all, there is a reason they are seeking advice in the first place.

Even if disclosures could be made more salient, research reviewed by DOL found that disclosures can backfire. For example, investors can interpret disclosures as evidence of an advisor's transparency and honesty. Disclosures can also cause investors to be more reluctant to ask questions that appear to call into question an adviser's integrity. For these reasons, DOL concluded that certain transactions must be prohibited and not simply disclosed, a conclusion we strongly support.

DOL Took Appropriate Action to Protect Retirement Savers

The DOL rule only applies to retail investors saving in IRAs or ERISA plans. Workers saving for retirement, most of whom have no special financial expertise, are among the investors most vulnerable to conflicted advice. Retirement savers typically make investment decisions when they are new at their jobs, between jobs, or entering retirement—often stressful times in people's lives when they are more susceptible to bad advice about where and how to invest their savings. As senior advocates have noted, cognitive declines associated with old age make older workers and retirees especially vulnerable to conflicted advice.[5] The DOL rule appropriately recognizes that vulnerability and the SEC should do nothing to undermine those protections.

The federal government has a responsibility to ensure that tax subsidies for qualified retirement plans promote saving as intended, and do not simply enrich the financial industry. Though we agree that all taxpayer-subsidized savings plans should be regulated to ensure that they serve the needs of savers and not industry, full implementation and enforcement of the DOL rule protecting retirement savers should not await broader oversight by the SEC, especially since the SEC has no jurisdiction over fiduciary advice to plan sponsors or insurance products marketed to retirement savers.

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[4] White House Council of Economic Advisers, "The Effects of Conflicted Investment Advice on Retirement Savings," February 2015. (https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf).

[5] Maame Gyamfi, Mary Ellen Signorille, and William Alvarado Rivera, "Memorandum For AARP and AARP Foundation as Amici Curiae in Support of Defendants Urging Denial of Preliminary Injunction," July 12, 2016 (http://www.aarp.org/content/dam/aarp/aarp_foundation/litigation/pdf-beg-02-01-2016/NAFA-v-Perez-memorandum.pdf).

Impact of DOL Rule

Industry groups frame their opposition to the DOL rule by claiming that it will hurt those it is intended to help. In particular, they argue that the fiduciary rule will limit the availability or drive up the cost of advice, particularly for small savers. This argument is not supported by the evidence. It also ignores the fact that all "advice" is not created equal. On the contrary, sales recommendations designed to serve the brokers' financial interests rather than the investors' best interests are not advice in any true sense of the word. Even if the fiduciary rule were to limit access to conflicted sales recommendations presented as advice, it does not follow that investors will be harmed.

If the DOL rule succeeds in limiting brokers' ability to provide self-interested sales recommendations instead of helpful advice, investors will benefit from these limits. Conflicted "advice" of this type is of low quality or even harmful, and makes it less likely that investors will follow useful advice available, often at very reasonable or no cost, from unconflicted sources. Only in areas where industry and investor interests happen to be aligned—in countering retirement savers' myopia and encouraging saving, for example—is free advice offered by conflicted advisors potentially useful. However, this must be balanced against the much greater harm done when conflicted advisers recommend products and strategies that are not in investors' best interests. Moreover, the financial industry has an incentive to urge people to save more even after the fiduciary rule is fully in force.

Many retirement savers and other investors are confused about how to manage their money, but conflicted advice only exacerbates the problem. Many investors, for example, views the standard disclaimer that "past performance is no guarantee of future results" as a statement of the obvious—that nothing is guaranteed—rather than a reminder that in efficient markets, past risk-adjusted returns provide little or no information about future returns, except possibly when high returns suggest that an asset or asset class may be overvalued. Similarly, there is a near-consensus among economists that actively-managed funds are generally not worth their higher cost compared with index funds and other passive investments. Though some investors have caught on, index funds still represent only a quarter of assets in equity mutual funds.[6] Many long-term investors also erroneously believe that cumulative returns average out over time, and therefore do not adequately diversify across asset classes or periodically rebalance to reduce risk and maximize risk-adjusted returns.[7] Rather than correct these misconceptions, conflicted advisors have an incentive to reinforce them in order to sell risky and high-cost products and services. The SEC should follow the DOL's lead by adopting a rule that works to eliminate the incentives brokers have to recommend products that expose investors to unnecessary costs and risks.

Investing for retirement is not rocket science. Most small savers should invest in broadly-diversified low-cost index funds or target-date funds that automatically adjust portfolio allocations as workers approach

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[6] Investment Company Institute, "Investment Company Fact Book 2017" (https://www.ici.org/pdf/2017_factbook.pdf).

[7] The time diversification myth was debunked over a half-century ago by Nobel Prizewinner Paul Samuelson ("Risk and Uncertainty: A Fallacy of Large Numbers," *Scientia*, April-May 1963).

retirement.[8] This simple, sound advice has been drowned out by conflicted advice fueled by an industry that profits from selling high-cost products and services to retirement savers. This is not to suggest that no investors benefit from individualized advice or no actively-managed funds add value. However, investors benefit only if they pay for advice directly, not by being unwittingly lured into higher-cost and underperforming products and services in order to cover the cost of that "advice." Similarly, to the extent that active management adds value, these funds will be more competitive if they are not loaded down with fees to cover the cost of sales commissions.

Industry opponents of a strong fiduciary standard have also argued that it will reduce investor access to investment products. But shrinking the market for products and services that are not in retirement savers' best interests promotes innovation and expands the market for better products and services. Despite delays, the DOL rule has already had a positive impact on services and products marketed to retirement savers. According to Morningstar, the rule has prompted investment management companies to create new mutual fund share classes that increase transparency and ensure that financial advisors do not receive compensation that varies based on the investment products or strategies they recommend.[9] In a comment letter to the SEC, Morningstar also noted that the DOL rule had accelerated the growth of passive investment strategies, robo-advisors, and fee-based rather than commission-based accounts.[10] These are positive developments that a strong SEC rule can and should reinforce.

Innovations are making it easier for unsophisticated investors to employ smart investment strategies. The market for robo-advisors has grown rapidly in recent years, making it easier for investors to follow tried-and-true strategies, such as diversification and rebalancing, while avoiding market timing and other mistakes. While these innovations appear to have benefited investors, robo-advisors are and should remain fiduciaries, since conflicted advice is harmful whether it comes from a computer algorithm or a person.

In summary, while we encourage the SEC to work with DOL to extend the protections in DOL's fiduciary rule to other investors, this should not interfere with the full implementation and enforcement of the DOL rule. In particular, the SEC should follow DOL's lead in treating all advice the same regardless of source, rather than allowing some professionals, such as broker-dealers, to operate under weaker standards. Under no circumstances should the SEC adopt a weaker, disclosure-based rule in order to have that watered-down standard substitute for compliance with the DOL rule.

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[8] Target-date funds, also called lifecycle funds, automatically adjust portfolio allocations to become more conservative as investors approach retirement age, usually by reducing the share invested in equities and increasing the share in fixed-income investments. This is a useful strategy, though target-date funds are often unnecessarily expensive or inappropriately aggressive, with high equity allocations over much of the "glide path" to retirement.

[9] Aron Szapiro and Paul Ellenbogen, "Early Evidence on the Department of Labor Conflict of Interest Rule," Morningstar, April 13, 2017. (https://corporate1.morningstar.com/ResearchLibrary/DownloadRPSpdf.aspx?url=http://rps.morningstar.com/api/v2/654566632/documents/802119/file)

[10] Aron Szapiro, "Fiduciary Rule Should Be Largely Positive for Investors," comment letter to SEC, Morningstar (http://news.morningstar.com/articlenet/article.aspx?id=825208).

This sort of shared jurisdiction among agencies is not unprecedented. The Federal Motor Carrier Safety Administration (FMCSA) has placed limits on the use of handheld devices in response to accidents involving commercial drivers, for example.[11] The Department of Transportation's failure to place similar limits on non-commercial drivers was not a reason to delay or weaken the FMCSA standard. In a similar vein, the DOL standard protecting retirement savers should be implemented without further delay, whether or not the SEC is considering taking action to protect other investors. Retirement savers should not be harmed because the SEC has failed to act in a timely manner. Instead, the SEC should build on what the DOL has already achieved to extend those protections to non-retirement accounts.

There is no evidence to support the claim by industry opponents of a strong fiduciary standard that it will limit investors' access to useful advice. On the contrary, the DOL rule is forcing brokers to convert conflicted sales pitches into true advice that savers can trust. Making it easier for people to get good advice is unequivocally a good thing. Instead of watering down that standard, as industry hopes, the SEC should follow the DOL's lead.

Sincerely,

Monique Morrissey, Ph.D.
Economist at the Economic Policy Institute

Heidi Shierholz, Ph.D.
Economist and Director of Policy at the Economic Policy Institute

[11] FMCSA, Mobile Phone Restrictions Fact Sheet, " May 2012 (https://www.fmcsa.dot.gov/driver-safety/distracted-driving/mobile-phone-restrictions-fact-sheet).