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

RE: Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers

Dear Chairman Clayton:

We are writing today on behalf of a wide range of firm clients, including brokerage firms, mutual funds, insurance companies, and banks. We would like to thank you for the opportunity to submit comments on the appropriate standards of conduct applicable to broker-dealers when they provide investment advice to retail investors.

With the decline in the nation's pension system, individuals' savings and investment decisions are increasingly important. More than ever, individuals are responsible for making complicated decisions regarding how much to save, how to invest those savings, and how to draw down those savings. Accordingly, it is more important than ever for investors to have access to the best assistance possible.

Unfortunately, the Department of Labor's (DOL's) fiduciary rule and related prohibited exemptions (collectively referred to here as the "Fiduciary Rule") have moved the market in the opposite direction: the individuals who most need assistance have far less access to such assistance, as discussed later in this letter. And many of those with access to assistance must pay materially more for that assistance, again as discussed below.

In this context, we strongly believe that the Commission has an opportunity to materially help investors by taking the lead on a coordinated set of revised standards of conduct for broker-dealers. Such standards should further the interests of investors in all respects, including by (1) ensuring that the assistance they receive is in their best interests, and (2) preserving affordable access to that assistance.

EXECUTIVE SUMMARY

I. Best interest standard. We strongly support the application of a best interest standard to recommendations provided to retail investors by broker-dealers. Under a best interest standard, a broker-dealer should be required to satisfy all of the following with respect to a "best interest recommendation" (as defined below): duty to put the customer's interest above the broker-dealer's interest, duty of care, full disclosure (of, e.g., fees, services, duties, and conflicts of interest), maintenance of policies and procedures reasonably designed to achieve compliance, a prohibition on the receipt of more than reasonable compensation, and a prohibition on making misleading statements. A broker-dealer shall not be treated as failing to satisfy the best interest standard solely by reason of the type of compensation received, or by reason of providing assistance regarding proprietary products. (page 4)

II. Definition of a best interest recommendation. In our view, the best interest standard should only be applicable where there is a mutual understanding between the parties that there will be material reliance on an individualized recommendation of the broker-dealer, referred to in this letter as a "best interest recommendation."

Under this definition, the best interest standard described above would not apply to other assistance, such as selling (as opposed to investment assistance) or the provision of general guidance on investment and savings principles. Selling should generally remain subject to a suitability standard, so as to prevent inevitable confusion about the nature of sales activity, as explained below. (page 6)

III. Preemption. DOL's Fiduciary Rule and the reactions from the states, like Nevada and New York, have placed the Commission at a crossroads with respect to the standards of conduct applicable to investment assistance to retail customers. Right now, the predominant rule governing IRA assistance (and indirectly non-retirement assistance in many cases, as discussed below) is the Fiduciary Rule, not applicable SEC or FINRA guidance. This is the case because the Fiduciary Rule is the more restrictive rule, so that compliance with the Fiduciary Rule generally will mean compliance with less stringent rules.

If state fiduciary rules, like Nevada's and New York's, proliferate, then America's retail investment assistance regime under the brokerage model will be governed overwhelmingly by a patchwork of inconsistent rules, including the Fiduciary Rule. The result will be severely adverse effects on the low and middle-income savers as a result of the widespread abandonment of the brokerage model as the country's predominant retail investment assistance regime serving such savers.

DOL should issue guidance on the bedrock principle of ERISA preemption and how state fiduciary laws like Nevada's cannot have any application to ERISA plans and participants. We would ask the Commission to coordinate with DOL on this guidance.

We also urge the Commission to issue guidance stating that laws that establish broker-dealer fiduciary obligations are preempted under the National Securities Markets Improvement Act of 1996. (page 8)

<u>IV. Right to arbitration</u>. As discussed below, the plaintiffs' bar has, in the last several years, discovered the retirement plan arena and has begun paralyzing plan sponsors with litigation. The point of bringing this up is that we need to learn from the problems in the retirement plan area and not let the same problems infect the retail investment market. In connection with the establishment of a best interest standard, the potential for an explosion in harmful baseless litigation is very real.

This issue can be addressed by working with FINRA and the state insurance regulators to establish a broad uniform rule permitting waivers of class actions in favor of arbitration. (page 12)

<u>V. Coordination</u>. Investors are best served by having their advisers subject to a simple, workable uniform set of rules. It is important for the Commission to coordinate with DOL, FINRA, and the state insurance regulators to ensure that there is a uniform workable rule applicable to all investment accounts, regardless of whether the accounts are retirement or non-retirement accounts. If one regulatory agency issues an unworkable rule, like the Fiduciary Rule, it can have adverse effects throughout the system, as illustrated below. (page 15)

<u>VI. Transition issues</u>. In our view, the best interest standard described above will require significant implementation efforts. We recommend a two-year period between finalization of any final rule.

Also, under the Fiduciary Rule, there was a great need for a rule grandfathering existing relationships. This was necessary but not done; as a result, a huge number of investment assistance relationships were forced to terminate, leaving investors in the middle of an investment strategy with no help regarding next steps. We would ask the Commission to grandfather existing relationships from its new rule. (page 18)

<u>VII.A. Harm created by the DOL Fiduciary Rule: in general</u>. Attached in Appendix A is a sample of the extensive data showing the great harm produced by the Fiduciary Rule. Set forth in the body of this letter are highlights from that data. (page 18, Appendix A)

<u>VII.B. Harm created by the DOL Fiduciary Rule: annuities</u>. It has been clear that the market most harmed by the Fiduciary Rule is the annuity market, largely leaving most individuals with insufficient access to a private source of guaranteed income for life. Just when the need for such guaranteed income is the greatest, with private pensions declining rapidly and individuals living longer, the Fiduciary Rule has devastated the annuity market, as illustrated in Appendix B, with highlights from Appendix B set forth in the body of this letter. (page 20, Appendix B)

DISCUSSION

I. Best interest standard.

We strongly support the application of a best interest standard to best interest recommendations provided to retail investors by broker-dealers. Under a best interest standard, a broker-dealer should be required to satisfy all of the following with respect to a "best interest recommendation" (as defined below):

- **Duty to put the customer's interest above the broker-dealer's interest.** The broker-dealer should be required to put the investor's interest above his or her own interest. Whether this has occurred should not be determined with hindsight, based on whether a recommended investment has performed well. Rather, the determination should be based on the process used by the broker-dealer in arriving at a best interest recommendation. The issue should be whether the process used demonstrated a commitment to putting the interest of the investor ahead of the broker-dealer's interest.

- **Duty of care.** The best interest recommendation should be required to reflect reasonable care, skill, prudence, and diligence, based on the available information about the investor. Like the duty of loyalty, the determination of whether this requirement has been met should be based on the process used to make the recommendation, not the performance of a recommended investment.

    - The scope of this duty should be defined pursuant to the disclosure requirement below. In other words, the broker-dealer should be permitted to define, for example, whether the best interest obligation is ongoing or transactional. Except as otherwise required to satisfy applicable "Know Your Customer" rules, the best interest obligation shall not require a broker-dealer to (1) take into account the customer's financial situation, other assets, income, liabilities, and other circumstances to the extent not communicated in writing to the broker-dealer or (2) provide assistance with respect to any assets for which assistance is not requested.

- **Disclosure.** The broker-dealer should be required to disclose:

    - The services that are provided.
    - The best interest duty that is owed to the investor.
    - The scope of that duty, as discussed above. This includes, for example, whether the duty is ongoing and comprehensive, or limited to a particular transaction, period of time, or portion of the investor's portfolio.

- The types of compensation payable to the broker-dealer firm or any affiliate, including any applicable formulas under which the compensation is payable, with respect to a best interest recommendation and related transactions. Because it can be very difficult to translate formulae into dollar amounts, there should be no requirement to disclose any actual dollar amounts that are not charged as dollar amounts.
- Any material conflict of interest.

These disclosures should be provided upfront at the commencement of a relationship and should be provided again annually (or within a reasonable period after a material change to any of the information previously disclosed). In order to be effective, it is critical that these disclosures be kept short and simple. Increasingly, individuals are being underserved and deprived of transparency by disclosure requirements that result in long unreadable disclosures that are simply disregarded.

- **Nature of compensation.** There should be no restrictions on the type of compensation that a broker-dealer can receive in connection with a best interest recommendation. This is an area where the Fiduciary Rule went seriously astray. By severely discouraging transaction-based compensation arrangements, the Fiduciary Rule led many financial institutions to eliminate or severely limit the use of the brokerage model as a channel for assisting investors. This leads in turn to (1) many smaller accounts losing access to any personalized assistance, and (2) many other accounts having a choice between (a) no personalized assistance or (b) higher cost fee-based advisory relationships.

  If the SEC rules are similarly structured to discourage transaction-based pay, or make it more risky to provide such pay, the same adverse results would certainly follow.

  For this purpose, transaction-based pay means any payments based on transactions, including commissions, third-party payments, bonuses, and incentive arrangements.

- **Proprietary products.** Just as there should be no ban on transaction-based pay, it should be permissible to provide best interest recommendations with respect to proprietary products, subject to all the other best interest rules, such as disclosure and oversight. This situation can arise, for example, when a broker-dealer provides assistance regarding both proprietary and non-proprietary products. In addition, as discussed below, persons acting purely as salespersons -- e.g., selling only proprietary products -- should not be subject to the best interest standard.

- **Oversight of assistance provided.** Pursuant to FINRA Rule 3110, a broker-dealer should be required to maintain policies and procedures that are reasonably designed to achieve compliance with this best interest standard. This is a critical element of a best interest standard.

There are those who argue that transaction-based pay is inherently inconsistent with a best interest standard. That is a theoretical argument pursued by the DOL in constructing the Fiduciary Rule. That argument has been shown to lead to great harm, as evidenced by the widespread loss of access to investment assistance caused by the Fiduciary Rule.

The SEC can do better by relying on established oversight requirements that preserve access to investment assistance while at the same time ensuring compliance with a best interest standard.

- **Reasonable compensation.** A broker-dealer should be prohibited from receiving more than reasonable compensation for its services. For this purpose, if a broker-dealer is widely receiving similar amounts with respect to similarly situated customers, and such compensation is disclosed as required, the compensation should be deemed to be reasonable in the absence of clear evidence to the contrary.

- **Prohibition on misleading statements.** As part of the best interest standard, as under current law, broker-dealers should be prohibited from making misleading statements.

II. Definition of a best interest recommendation.

There is a fundamental threshold question: what is a best interest recommendation that should trigger a best interest standard? Clearly, not all interactions between a broker-dealer and its customer should be subject to the rigorous disclosure and other requirements applicable to a best interest recommendation. In our view, the best interest standard should only be applicable where there is a mutual understanding between the parties that there will be material reliance on an individualized recommendation of the broker-dealer, referred to in this letter as a "best interest recommendation."

Under this definition, the best interest standard described above would not apply to other activities, such as selling (as opposed to investment assistance) or the provision of general guidance on investment and savings principles:

- ***Selling would generally remain subject to a suitability standard, rather than a best interest standard, so as to prevent inevitable confusion about the nature of the sales "recommendation," as explained below.***
- General guidance regarding investing would not give rise to any liability under a best interest standard, so as not to chill the educational process on issues like diversification, compound interest, and asset allocation. Moreover, unlike under DOL's ineffective education regime, financial professionals providing general guidance regarding asset allocation need to be able to provide investors with examples of investment options within each asset allocation category; otherwise, the education becomes just an abstract and unhelpful discussion for many investors.

<u>Selling is not recommending</u>. One of the fundamental flaws in the Fiduciary Rule is that it tried to eliminate the line between selling and recommending in a way that is simply unworkable, as illustrated below, and contrary to fundamental principles of law.

Assume that salesperson S works for insurer company C, and S' only job is to sell C's annuities to individuals, either in their IRA or in a non-retirement account. How could a best interest standard ever apply in a realistic manner to someone whose sole job is to sell one company's annuities? In this example, S cannot consider other companies' annuities or other non-annuity products. S has no expertise with respect to those other products and she has no authority to promote or sell those other annuities or products.

DOL resolved the selling issue in an odd and actually harmful manner.

- **<u>No restriction on selling investment services</u>.** The Fiduciary Rule exempts selling one's own investment *services* from all regulation. So if a broker-dealer promotes its investment advisory services, no rule requires that those services be even suitable for the investor.

- **<u>Misleading restriction on selling investment products</u>.** The Fiduciary Rule goes to the other extreme with the sales of investment *products*, but does so in a way that is very misleading. On the one hand, the seller is required by the Fiduciary Rule to tell the investor that the seller is a fiduciary who will act only in the investor's best interest. On the other hand, the seller is permitted to disregard all products other than the one or more proprietary products that the seller sells.

  Investors who are told that the seller is a fiduciary acting in their best interest would have a right to expect some objectivity in the recommendation. But the seller has no ability to be objective. She only sells one product. It is true that the Fiduciary Rule requires the seller to explain the fact that she only sells proprietary products. But this explanation can and will pale next to the clear and required statement that the seller is acting as a fiduciary in the best interest of the investor.

The right answer is that sellers are simply not fiduciaries and, because of the constraints of their job, simply cannot be subject to a best interest standard. What is needed is a rule under which financial professionals are permitted to act as sellers, who are then required to disclose to investors that they are ***not*** fiduciaries and ***not*** required to act in their best interest. We recommend a new suitability rule under which it is clear that a broker-dealer is selling, not purporting to act in the best interest of the customer.

<u>Sales positions legally incompatible with fiduciary status</u>. Very simply, DOL's strained effort to treat sellers as fiduciaries is incompatible with longstanding fundamental principles of law. A fiduciary relationship is one where there is "a special intimacy" or "trust and confidence." *See* Bogert's Trusts and Trustees § 481; Black's Law Dictionary 702 (9th ed. 2009) (defining a "fiduciary" as one owing duties of trust and confidence); In Re Arleen Hughes, Exchange Act Release No. 4048, 27 S.E.C. 629 (Feb. 18, 1948) (concluding that the registrant was a fiduciary because she "created a relationship of trust and confidence with her clients"). To legally characterize a pure seller, whose job is selling, not advising, as a fiduciary is inconsistent with clear legal principles and requires the type of legal gymnastics described above. In other words, to treat a pure seller as fiduciary is to make the term " fiduciary" meaningless, because a person who only sells a single product and is prohibited by her job from being objective is not a fiduciary in any real sense.

DOL's distortion of the concept of a fiduciary somehow survived scrutiny at the district court level when challenged. In fact, it took some legal gymnastics to achieve this. For example, in *National Association for Fixed Annuities v. Thomas E. Perez*, the court very carefully avoided addressing this issue by finding that the plaintiff had no standing to raise it. 217 F. Supp. 3d 1, 31 (D.D.C. 2016). In *Chamber of Commerce of the United States of America v. Edward Hugler*, all the court was able to say was that "The Fiduciary Rule is Not Unambiguously Foreclosed by ERISA." 231 F. Supp. 3d 152, 168 (N.D. Tex. 2017).

The issue before the Commission is not whether the law can be stretched to bizarre lengths to treat sellers as fiduciaries. The issue before the Commission is whether a person required by her job to act only as a seller will be treated as fiduciary, thereby watering down the term "fiduciary" to meaninglessness and triggering extreme confusion for investors. Investors naturally will believe that a fiduciary acting in their best interest is actually doing that, rather than acting as a seller restricted to selling one or more proprietary products.

III. Preemption.

DOL's Fiduciary Rule and the reactions from the states, like Nevada and New York, have placed the Commission at a crossroads with respect to the standards of conduct applicable to investment assistance to retail customers. Right now, the predominant rule governing IRA assistance (and indirectly non-retirement assistance in many cases, as discussed below) is the Fiduciary Rule, not applicable SEC or FINRA guidance. This is the case because the Fiduciary Rule is the more restrictive rule, so that compliance with the Fiduciary Rule generally will mean compliance with less stringent rules.

If state fiduciary rules, like Nevada's and New York's, proliferate, then America's retail investment assistance regime under the brokerage model will be governed overwhelmingly by a patchwork of inconsistent rules, including the Fiduciary Rule. The result will be a widespread abandonment of the brokerage model as America's predominant retail investment assistance regime. Who could possibly afford to provide personalized assistance to small accounts in a world where inconsistent and possibly even conflicting rules govern one's every action? The losers in this new regime will be the low- and middle-income investors who do not have enough assets to qualify for an advisory account and thus will lose all access to personalized investment assistance.

There are those Fiduciary Rule supporters who long argued that such an abandonment of low- and middle-income investors would never happen because the financial services industry would not walk away from small accounts. But that is exactly what has happened and what will happen even more if the challenges of the brokerage model are exacerbated by countless state rules.

It is in this context that we urge the Commission to act to protect small investors and issue regulations under statutes designed to prevent exactly this type of regulatory chaos through preemption. The discussion below is focused exclusively on state laws that regulate fiduciary behavior generally, like Nevada's; the discussion does not relate to state insurance-based regulation.

ERISA Preemption. We recognize that ERISA preemption is not within the Commission's jurisdiction, but in your work with DOL on a uniform set of rules, ERISA preemption is a major factor. ERISA is a comprehensive federal statute regulating employer-sponsored retirement and welfare benefit plans. When Congress passed ERISA, it included an explicit and far-reaching preemption provision. According to that provision and, except as otherwise provided by law, title I and title IV of ERISA "*shall supersede any and all State laws insofar as they may now or hereafter relate to any employee benefit plan.* [1] Importantly for this discussion, title I of ERISA defines who is a fiduciary with respect to an employee benefit plan and establishes a federal standard of care for them. Accordingly, ERISA preempts any state law that would purport to define or regulate any individual in his or her capacity as a fiduciary to a retirement plan subject to ERISA.[2] ***As one court put it, ERISA's preemption provision is "the most sweeping federal preemption statute ever enacted by Congress."***[3]

When drafting ERISA, Congress was clear about how it wanted ERISA's preemption clause to apply broadly. In fact, ERISA's legislative history is full of commentary explaining how the law is intended to be the exclusive authority governing the entire field of employee benefit plans, including any enforcement mechanism for the regulation of retirement plan fiduciaries. For example, the text of ERISA itself says that ERISA is intended "to protect interstate commerce and the interests of participants in employee benefit plans and their beneficiaries, by . . . establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans and by providing for appropriate remedies, sanctions, and ready access to the Federal courts."[4] As the Supreme Court has said, "any state-law cause of action that duplicates, supplements, or supplants the ERISA civil enforcement remedy conflicts with the clear congressional intent to make the ERISA remedy exclusive and is therefore pre-empted."[5]

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[1] ERISA § 514.

[2] *See Dudley Supermarket Fiduciary Litigation*, 302 F.3d 1, 3 (1st Cir. 2002).

[3] *California Hospital Association v. Henning*, 569 F. Supp. 1544, 1546 (C.D.Cal.1983).

[4] ERISA § 2(b).

[5] *Aetna Health Inc. v. Davila*, 542 U.S. 200, 209 (2004).

For purposes of this discussion, it is important to emphasize that courts considering ERISA's preemption provision have dismissed non-ERISA state law claims involving the provision of investment advice to an ERISA-covered plan, among other state law claims related to ERISA-covered retirement plans. ***For example, the First Circuit has said "there can be no doubt" that, if a plaintiff's state law claim for breach of fiduciary duty arises while an investment adviser is acting as an ERISA fiduciary, ERISA completely preempts the plaintiff's claims.***[6] Moreover, courts have also consistently held that state claims arising out of the common law of trusts, including breach of fiduciary duty, are preempted in the context of ERISA-covered retirement plans.

ERISA's preemption provisions also contain what is known as the "savings clause" – a carve-out from preemption for state laws regulating *insurance, banking, or securities*. States trying to develop their own laws in response to possible changes to the Fiduciary Rule may try to argue that their efforts are not expressly preempted by ERISA because they are regulating "insurance, banking, or securities." This argument, however, is inconsistent with current jurisprudence interpreting ERISA's savings clause. The case law on ERISA's savings clause interprets it very narrowly. And in the case of insurance, the Supreme Court has explained that the savings clause is not applicable unless a state law is "specifically directed toward" the regulation of insurance.[7] Applying similar logic to the carve-out for securities and banking regulation, it is difficult to argue that ERISA's savings clause would protect any state's fiduciary rule from federal preemption. This is because state efforts to create their own fiduciary rules have primarily focused on the provision of investment advice, rather than the regulation of insurance, banking, or securities.

In short, ERISA's powerful preemption provision expressly reflects Congress's unambiguous intent for the federal government to regulate all matters relating to retirement plans, including the provision of investment advice. ERISA defines who is a fiduciary, details that standard of care, and creates its own enforcement mechanisms through DOL, the IRS, and federal courts. States cannot add any new or additional requirements to that comprehensive system if their regulation "relates to" an employee benefit plan. Nevada's law and similar laws would clearly be preempted with respect to ERISA plans and participants.

DOL should issue clear guidance on this bedrock principle of preemption and on how state fiduciary laws like Nevada's cannot have any application to ERISA plans and participants. We would ask the Commission to coordinate with DOL on this guidance.

Federal Securities Laws. Like the ERISA preemption principles discussed above, Congress has also expressly indicated its intent to preempt certain state regulation of investment advisers and broker-dealers through its robust framework of federal securities law. For purposes of this discussion, we focus on two important provisions included in the National Securities Markets

[6] *Dudley Supermarket Fiduciary Litigation*, 302 F.3d at 3.

[7] *Kentucky Ass'n of Health Plans, Inc. v. Miller*, 538 U.S. 329, 334 (2003).

Improvement Act of 1996 ("NSMIA") – a federal law that clearly reflects Congress's intent to preempt the state regulation of securities, investment advisers, and broker-dealers. As the congressional managers of the Conference Committee for that law explained, NSMIA's preemption provisions are intended to "eliminate duplicative and unnecessary regulatory burdens [imposed by the states] while preserving important investor protections ***by reallocating responsibility over the regulation of the nation's securities markets in a more logical fashion between the Federal government and the states."***[8]

NSMIA added a new provision to the Investment Advisers Act of 1940 that is specifically intended to reorganize the role of the states and the federal government with regard to the regulation of investment advisers. As a result of that change in 1996, ***section 203A of the Advisers Act now says that states are preempted from regulating investment advisers registered with the SEC, except in a few limited areas expressly permitted by Congress.*** Although section 203A permits states to bring enforcement actions with respect to fraud or deceit, to require notice filings, and to require state registration and licensing of individual representatives doing business in the state, all other matters regarding the regulation of SEC-registered investment advisers are "off limits" to the states. Moreover, the SEC's interpretation of section 203A clearly prevents states from indirectly regulating an SEC-registered investment adviser's business practices as a means of enforcing a state's anti-fraud rules in the absence of any fraudulent or dishonest business practices.[9] As the SEC has previously explained, Congress created this division because it was concerned about the "cost imposed on investment advisers and their clients by overlapping, and in some cases, duplicative, regulation" by the states.[10] Accordingly, Congress chose to deny states "the ability to reinstitute the system of overlapping and duplicative regulation of investment advisers."[11]

We ask the Commission to issue guidance stating that states generally cannot regulate investment advisers registered with the SEC, except to the extent noted above.

Through NSMIA, Congress also expressly indicated its intent to preempt certain state regulation of broker-dealers. Through the addition of section 15(i) of the Securities Exchange Act of 1934, Congress prohibited states from subjecting broker-dealers to any state requirement involving "financial responsibility" or the "making and keeping [of] records," if such requirements "differ from, or are in addition to," the requirements already imposed by federal law.[12]

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[8] H.R. REP. NO. 104-864, at 39-40 (Conf. Rep.).

[9] 62 Fed. Reg. 28112, 28126 (May 22, 1997).

[10] 62 Fed. Reg. at 28113.

[11] 62 Fed. Reg. at 28126.

[1212] 15 U.S.C. § 78o.

State laws that create a new cause of action against broker-dealers, as Nevada's law does, inherently affect a broker-dealer's financial responsibility to their clients. And although the federal preemption of state recordkeeping requirements for broker-dealers may seem benign to proponents of Nevada's law, that specific preemption concern drew the attention of at least one Nevada State Senator who noted during debate that a "federal statute preempt[s] how bookkeeping and records are addressed," and therefore, she could not support the Nevada law given the uncertainty over any potential state enforcement activity.[13]

This express Congressional directive on broker-dealer financial responsibility and recordkeeping was clearly intended to preempt any state investment advice regulation that would effectively create new financial responsibility or require broker-dealers to collect and keep records to document compliance with the law, both of which Nevada's law or any similar law in another state would clearly do. After all, any case brought by states or individual plaintiffs to enforce a fiduciary rule (1) will trigger broker-dealer financial responsibility, and (2) will be highly dependent on the broker's books and records regarding compliance steps – which have been declared "off limits" to the states by Congress. Even if a state sought to defend against a preemption challenge by permitting verbal communications to satisfy its disclosure requirement, broker-dealers would necessarily have to keep a record of such disclosures in an attempt to limit litigation risk. Any argument suggesting otherwise would frustrate the intent of NSMIA's limitations on the state regulation of a broker-dealer's records.

We urge the Commission to issue guidance stating that laws that establish broker-dealer fiduciary obligations are preempted under NSMIA.

IV. Right to arbitration.

Sadly, as discussed below, the plaintiffs' bar has, in the last several years, discovered the retirement plan arena and has begun paralyzing plan sponsors with litigation. The point of bringing this up is that we need to learn from the problems in the retirement plan area and not let the same problems infect the retail investment market. In connection with the establishment of a best interest standard, the potential for an explosion in harmful baseless litigation is very real in the retail market unless the reforms described below are adopted.

Background on retirement plan litigation. As discussed in a recent trade association letter to DOL regarding the pleading standards for ERISA class action cases, class-action plaintiffs' attorneys are increasingly filing lawsuits against the sponsors of defined contribution retirement plans, and their service providers, alleging that plan fiduciaries breached their fiduciary duties by selecting poor-performing and expensive investment options for their participant-directed retirement plans' investment lineups. This spike in litigation is not the result of an organic groundswell of disaffected employees and retirees. Rather, it is the creation of plaintiffs'

[1313] Nevada State Senator Heidi S. Gansert, Minutes of the Nevada Senate Committee on Commerce, Labor, and Energy (April 14, 2017), 12.

attorneys that may be driven by the large dollar amounts that can accrue in the employer-sponsored retirement plan system, and the belief that many large employers will settle litigation if class-action plaintiffs' claims survive a motion to dismiss and reach discovery.

Attorneys pursuing breach of fiduciary duty claims against retirement plan sponsors and service providers often commence litigation by filing complaints with few, if any, specific facts regarding how or why a plan fiduciary selected or retained investments for the plan. Plaintiffs' attorneys have successfully pursued class-action claims by filing literal "cookie-cutter" complaints that state the legal basis for their claims in vague generalities founded on impermissible hindsight. It has not been uncommon to see multiple complaints filed within days of one another that are functionally identical, except for the names of the parties, the investments' performance and costs, and the duration for which such investments were made available by the plan.

In some of those cases, employers have chosen to reach multi-million dollar settlements rather than proceed with what can be even more expensive litigation. According to one recent study, the cost of defending a breach of fiduciary duty lawsuit through the motion to dismiss stage can cost up to $750,000, and discovery can cost affected companies between $2.5 and $5 million dollars.[14] Even if plaintiffs are successful in reaching a settlement, a significant portion of the settlement amounts ultimately ends up in the pockets of the plaintiffs' attorneys, not the accounts of retirement investors. From the period of 2009 to 2016, attorneys representing plaintiffs in breach of fiduciary duty lawsuits are estimated to have collected roughly $204 million for themselves, while only securing an average per participant award of $116.[15]

This recent spike in ERISA class-action litigation is an overall drain on the private retirement system. The potential benefits for participants resulting from this litigation are far outweighed by the costs and other harms created by this litigation. These lawsuits create significant costs that are ultimately passed on to plans and participants in the form of fees and other charges assessed when accessing retirement products and services. The lawsuits are also significantly inhibiting innovation and the development of new services and benefits, as employers and service providers are forced to be extremely cautious to avoid potential liabilities and lawsuits. One key example of the "policy cost" of the excessive litigation is the pronounced reluctance of 401(k) plan sponsors to offer distributions options with guaranteed income for life, for fear of litigation over the selection of an annuity provider. In the context of participants' need for guaranteed income for life, this policy cost is very significant.

In short, the modest recoveries by some participants in some lawsuits are vastly outweighed by the cost participants bear as a result of these suits.

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[14] LOCKTON COMPANIES, *Fiduciary Liability Claim trends* (February 2017), http://www.lockton.com/whitepapers/Boeck_Fiduciary_Liability_Claim_Trends_Feb_2017.pdf.

[15] Tom Kmak, *Fiduciary Benchmarks: Protect yourself at all time*, DC DIMENSIONS (Summer 2016), https://us.dimensional.com/-/media/Dimensional/Documents/US/Auxiliary/Defined-Contribution/Summer-2016/02-Fiduciary-Benchmarks-Protect-Yourself-at-All-Times.pdf.

<u>Concerns that the retail market could be the next target for plaintiffs' lawyers.</u> The question for the Commission and all of those concerned about retail investors is whether the retail market could be the next target for the plaintiffs' bar. If so, we can expect the same explosion in litigation and costs, and the same pressures not to innovate or develop new services.

In this context, we urge the Commission to take the lead in ensuring that this explosion does not happen. With a new best interest standard, there is significant potential for such an explosion.

The key issue is whether advisers and investors have the right to agree to waive the right to bring class actions and agree to arbitrate all disputes.

The Fiduciary Rule includes a prohibition on waiving class actions in the prohibited transaction exemption called the "Best Interest Contract Exemption." But to its credit, DOL has now recognized the counterproductive nature and doubtful legal authority of such a prohibition and has announced that it will not enforce the prohibition:

> Sections II(f)(2) of both the BIC Exemption and the Principal Transactions Exemption, which are currently scheduled to become applicable on January 1, 2018 [now July 1, 2019], make the exemptions unavailable if, *inter alia*, the financial institution's contract with a retirement investor includes a waiver or qualification of the retirement investor's right to bring or participate in a class action or other representative action in court. Sections II(g)(5) of both the BIC Exemption and the Principal Transactions Exemption applies this condition to investment advice provided to ERISA plans. In light of the position adopted by the Acting Solicitor General in an amicus brief in *NLRB v. Murphy Oil USA, Inc. ("Murphy Oil")*, the United States Government is no longer defending these specific provisions as applied to arbitration agreements preventing investors from participating in class-action litigation (the Arbitration Limitation). Thus, in a brief filed in the United States Court of Appeals for the Fifth Circuit in *Chamber of Commerce v. Acosta*, Case No. 17-10238 (5th Cir.), the Department of Labor took the position that the Arbitration Limitation should be vacated insofar as it applies to arbitration clauses because it cannot be harmonized with the Federal Arbitration Act and *AT&T Mobility LLC v. Concepcion*, 563 U.S. 333 (2011).
>
> Accordingly, the Department of Labor will not pursue a claim against any fiduciary based on failure to satisfy the BIC Exemption or the Principal Transactions Exemption, or treat any fiduciary as being in violation of either of these exemptions, if the sole failure of the fiduciary to comply with either the BIC Exemption or the Principal Transactions Exemption, is a failure to comply with the Arbitration Limitation in Section II(f)(2) and/or Section II(g)(5) of the exemptions.[16]

[16] DOL Field Assistance Bulletin No. 2017-03.

We are aware of no policy or legal reason why other rulemaking entities should not adopt the same approach.

Arbitration is an effective, federally favored mechanism to resolve disputes without excessive cost and without the types of "lawsuits in search of a settlement" that have plagued the retirement plan area and so many other areas. The SEC has the opportunity to herald in a new era of efficiency and effectiveness in the dispute resolution area, an era that serves investors, not trial lawyers.

This new approach can be achieved by working with FINRA and the state insurance regulators to establish a broad uniform rule permitting waivers of class actions in favor of arbitration. As noted, DOL has recognized that prohibiting class action waivers is inappropriate and causes far more harm than good. FINRA and state insurance regulators need to revise their rules in the same way.

V. Coordination.

The coordination on arbitration is just one component of a far broader need to coordinate among the Commission, DOL, FINRA, and the state insurance regulators. As has been observed on many occasions, investors are best served by having their advisers subject to a simple, workable, and uniform set of rules.

Why coordination is so important. DOL's failure to coordinate with the Commission, FINRA, and the state insurance regulators was yet another powerful reason for the failure of the Fiduciary Rule. Consider, for example, the situation of a middle-income investor who goes to a financial professional for assistance investing $40,000 of IRA assets and $30,000 of non-retirement funds. Set forth below are two very common current scenarios because of the Fiduciary Rule.

- **Scenario A: utter confusion, very possibly leading to investor mistakes.** The financial professional has ceased providing financial assistance to small retirement accounts, an approach that is rampant, as discussed below. But the financial professional, using the brokerage model, is still providing assistance with respect to small non-retirement accounts. So the financial professional provides assistance on the investment of the non-retirement funds, but stresses that nothing she says should be considered with respect to the investment of the IRA assets.
    - **Investor reaction.** The investor has to be confused. Why shouldn't the non-retirement assistance be considered with respect to the IRA assets? Is it because the assistance would be ill-advised with respect to the IRA assets? This could lead the investor to believe that the sound diversification and asset allocation guidance provided to the investor with respect to the non-retirement assets would be inappropriate with respect to the IRA assets. This could obviously lead to bad results. Or the investor could simply be confused and worry that there are some unknown issues about how to invest IRA assets. This could lead to a form of

    - investment paralysis, where the investor stops investing IRA assets, keeping them in cash equivalents, and possibly stops even contributing to the IRA.

- **Scenario B: no help at all.** In order to avoid confusion and to maintain a uniform approach to all investors, many financial professionals are adopting their IRA approach for non-retirement accounts. Such financial professionals are simply not providing any assistance to small accounts, regardless of whether the accounts are retirement or non-retirement.

- **DOL Rule undoes helpful aspects of FINRA rule on rollover advice.** Another example of the need to coordinate is assistance regarding rollover decisions. As FINRA notes in Regulatory Notice 13-45, an employee terminating employment may have up to four choices regarding his or her 401(k) account: leave the assets in the old employer's plan, roll over the assets to the new employer's plan, roll over to an IRA, or take the account assets in cash. In almost all cases, the last option is by far the worst, and employees very much need help and education on which of the other three options suits them. FINRA's Notice contains a very thoughtful array of issues that broker-dealers must consider in making recommendations regarding possible rollovers.
    - **Compliance with FINRA can violate DOL Rule.** The problem is that in many cases the DOL Fiduciary Rule renders FINRA's thoughtful approach moot. A recommendation that is fully compliant with FINRA Notice 13-45 would not only be fiduciary advice under the DOL Fiduciary Rule, but it would also be a prohibited transaction under ERISA, giving rise to enormous liability unless the Best Interest Contract Exemption ("BICE") is used. The BICE is not only burdensome, but contains very vague standards that can be the subject of class action lawsuits. So many financial institutions have declined to use the BICE, leaving employees without access to the important information contained in FINRA Notice 13-45. Without assistance, these employees are far more likely to cash out their 401(k) account, as discussed below.
    - **Adverse effects of losing assistance regarding rollover process.** During the DOL process, we considered the effect of cutting off participants from assistance regarding the rollover process. To address this issue, we, on behalf of a coalition of financial services organizations, commissioned a study by Quantria Strategies, LLC, a nonpartisan group of former staff of Congress' Joint Tax Committee, consisting of two former revenue estimators and one former Deputy Chief of Staff. Their study of this issue is available if it would be helpful. In brief, their basic conclusion is that in the absence of guidance from broker/dealers or call centers regarding keeping money in the plan or rolling it over, participants will be much more likely to cash out their plan savings, with very adverse consequences, ***including a possible increase in plan leakage of $20 billion to $32 billion***.

In short, it is not enough for the Commission to issue a sound and workable best interest standard. It is important for the Commission to coordinate with DOL, FINRA, and the state insurance regulators to ensure that there is a uniform workable rule applicable to all investment accounts, regardless of whether the accounts are retirement or non-retirement accounts. If one regulatory agency issues an unworkable rule, like the Fiduciary Rule, it can have adverse effects throughout the system, as illustrated above.

How to coordinate. In our view, coordination among the Commission, DOL, FINRA, and the state insurance regulators means (1) a single definition of which broker-dealer/customer relationships are subject to a best interest standard, (2) a uniform set of duties owed by such broker-dealers to customers, and (3) a coordinated enforcement mechanism to prevent inconsistent application of uniform rules.

- **Definition of which relationships are subject to a best interest standard.** We believe that any broker-dealer that provides a "best interest recommendation," as we define it above -- and no other entities -- should be subject to a best interest standard.

- **Uniform set of duties.** We believe that the best interest standard described above -- and no other duties -- should apply to all broker-dealers that provide a best interest recommendation. This means, for example, that DOL would need to issue a broad prohibited transaction exemption that deems the prohibited transaction rules satisfied by a broker-dealer that adheres to the best interest standard. This approach requires coordination with DOL, FINRA, and state insurance regulatory agencies.

- **Coordinated enforcement mechanism.** Perfect coordination among the Commission, DOL, FINRA, the Internal Revenue Service (IRS), and the state insurance regulatory agencies will be difficult to achieve regarding enforcement, but important steps can be taken.
  - **Interpretive guidance.** Interpretive guidance regarding the relationships subject to a best interest standard and the meaning of the best interest standard should not be issued without coordination among the Commission, DOL, FINRA, and state insurance regulatory agencies.[17]
  - **Enforcement actions.** As a practical matter, there is a range of different types of enforcement actions, including routine actions, important precedent-setting actions, and actions between these two ends of the spectrum. Agencies frequently also establish enforcement priorities. With respect to enforcement actions regarding the relationships subject to a best interest standard and the application of that standard, we recommend that the Commission, DOL, FINRA, the IRS, and state insurance regulators provide each other with advance notice regarding

[17] Pursuant to Reorganization Plan No. 4 of 1978, the Treasury Department's interpretive authority in this area has generally been delegated to DOL. Nevertheless, because of the IRS' ongoing enforcement authority, it would be prudent for the Commission and DOL to include the IRS in its coordinated efforts.

- the setting of enforcement priorities and the initiation of precedent-setting enforcement actions. This does not mean by any means that all agencies need to establish the same priorities, but advance notice is critical to avoid inconsistent application of the law.

VI. Transition issues.

DOL made critical errors regarding transition issues when it promulgated the Fiduciary Rule. First, DOL provided only 12 months for the financial services industry to restructure itself to comply with the Fiduciary Rule. This 12-month period paled beside a 22-month transition period for participant fee disclosure,[18] which required a tiny fraction of the work and restructuring required by the Fiduciary Rule. We are not aware of any meaningful explanation for this inexplicably short transition period. DOL stated that the "benefits" of the Fiduciary Rule needed to be delivered as quickly as possible. Given that those "benefits" have turned out to be illusory, the short transition period was simply a mistake.

Second, DOL did not grandfather ongoing relationships from the Fiduciary Rule, which resulted in many thousands of investors receiving letters informing them that they could no longer receive personalized assistance with respect to their account. This was extremely harmful to small accounts across the country. Investors were unable to obtain assistance on investments that may cease to be appropriate for them, all attributable to a DOL failure to design a workable grandfather rule.

In our view, the best interest standard described above will require significant implementation efforts and a need to grandfather existing relationships so as not to cut off investors from help in the middle of an investment strategy. Accordingly, we recommend a two-year period between finalization of the final rule and its effective date, with a grandfather rule for existing relationships.

VII.A. Harm created by the DOL Fiduciary Rule: in general.

There was a significant debate about whether the Fiduciary Rule would have the adverse effects predicted by the industry. Indeed it has, and for the very reasons flagged by the industry: primarily due to the following attributes of the Fiduciary Rule:

- The severe disfavoring of transaction-based compensation, which is (1) the primary means by which low- and middle-income investors can access personalized investment assistance, and (2) a cost-effective means for any buy-and-hold investor to obtain personalized investment assistance.

[18] DOL Regulation § 2550.404a-5 was published on October 20, 2010, but did not become applicable until August 30, 2012.

- The overbroad definition of a fiduciary that includes pure salespersons and sweeps in persons making casual suggestions, thus depriving investors of huge amounts of information.

- The imposition of debilitating liabilities by encouraging class action lawsuits based on very vague standards. (Please note that despite the delay of the most onerous elements of the Best Interest Contract Exemption, class actions are permissible today under the Fiduciary Rule, such as in the case of advice to a plan participant regarding rolling over his or her account to an IRA or another plan.)

Attached in Appendix A is a sample of the extensive data showing the great harm produced by the Fiduciary Rule. Set forth below are highlights from that data.

1. **Deloitte & Touche Study (August 9, 2017), as described in SIFMA's August 9, 2017 comment letter**
    a. *Description: a study of a cross-section of SIFMA's members, consisting of 21 financial institutions that represent 43% of U.S. financial advisors and 27% of the retirement savings assets in the market.*
    b. "[A]s of the Rule's first applicability date on June 9th, 53% of study participants reported limiting or eliminating access to brokerage advice for retirement accounts, which the firms estimate impact 10.2 million accounts and $900 billion AUM."

2. **Harper Polling (July 2017), as described in the Financial Services Roundtable's August 10, 2017 comment letter**
    a. *Description: a national survey of 600 financial professionals conducted by phone and through online interviews from July 7-12, 2017 (July 17, 2017).*
    b. "75% of respondents whose "typical clients have starting assets under $25,000 report that they will take on fewer small accounts due to increased compliance costs and legal risks."

3. **Survey of Insured Retirement Institute (IRI) Member Firms (July 2017), as described in IRI's August 7, 2017 comment letter**
    a. *Description: IRI surveyed a representative sampling of its insurance company and distributor members from July 18-31, 2017.*
    b. "More than 60 percent of the distribution firms that participated in the Survey have, are planning to, or are considering exiting or de-emphasizing target markets such as small IRA holders and small retirement plan sponsors."

4. **Chamber of Commerce company interviews, as described in the Chamber's April 17, 2017 comment letter**
    a. *Description: In-depth, structured interviews of two to five persons with about 10 investment-advisory companies, broker-dealers, insurance companies, and others affected directly or indirectly by the Fiduciary Rule.*
    b. "The majority of companies interviewed have also either already raised the minimum account amounts to qualify for advisory services or have plans to do so upon applicability of the rule. Some firms have raised the minimum for advisory accounts to $100,000 or more, clearly excluding from their services small beginning savers."

5. **A.T. Kearney Study (October 2016), as described in comment letter and attachment submitted by Kent Mason (August 3, 2017)**
    a. *Description: a study of the effects of the Fiduciary Rule published in connection with a discussion of how the global management consultant can help financial institutions adjust to the rule.*
    b. Recommends that broker/dealers should "[a]ccelerate the transition to fee-based services and advisory, and evaluate account thresholds to continue serving (for example, accounts greater than $200,000)."
    c. By 2020, broker-dealer firms will collectively stop serving the majority of the $400 billion currently held in low-balance retirement accounts.

VII.B. Harm created by the DOL Fiduciary Rule: annuities.

It has been clear that the market most harmed by the Fiduciary Rule is the annuity market, largely leaving many individuals without access to a private source of guaranteed income for life. Just when the need for such guaranteed income is the greatest, with private pensions declining rapidly and individuals living longer, the Fiduciary Rule has devastated the annuity market, as illustrated in Appendix B, with highlights from Appendix B set forth below.

1. **LIMRA Secure Retirement Institute's *Second Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in an August 23, 2017 LIMRA press release**
    a. Total annuity sales for the first half of 2017 decreased 10% over the first half of 2016, *the lowest first half sales since 2001*.
    b. Q2 2017 is the:
        i. 5th consecutive quarter of decline in overall annuity sales.
        ii. 6th consecutive quarter in which fixed annuity sales have been greater than variable annuity sales, which "hasn't happened in almost 25 years."
    c. "A closer look at what's driving the drop in VA sales reveals qualified VA sales have experienced a more significant decline than non-qualified VAs…. *VA qualified sales were down 16 percent in the second quarter, while nonqualified sales were actually up 5 percent. This could be in reaction to the DOL fiduciary rule*," (emphasis added) according to the director of annuity research.

d. Variable annuity sales are forecast to drop 10-15% in 2017, returning to levels not seen since 1998.

2. <u>LIMRA Secure Retirement Institute's *First Quarter 2017 U.S. Retail Annuity Sales Survey*</u>, as described in a May 18, 2017 LIMRA <u>press release</u>

a. Indexed annuity sales are forecast to decline 5-10% in 2017 and "another 15-20 percent in 2018 when the BICE goes into effect," referring to the "Best Interest Contract Exemption" under the DOL fiduciary rule.

3. <u>LIMRA Secure Retirement Institute Study (2017)</u>, as described in NAIFA's August 4, 2017 comment letter

a. "LIMRA estimates that access to guaranteed income products will decline 29% under the [DOL Fiduciary] Rule/PTEs." (The reference to "PTEs" is to the exemptions from the application of the Fiduciary Rule, which substantially all qualified annuities must use.)

4. <u>A.T. Kearney Study (October 2016)</u>, as described in <u>comment letter and attachment</u> submitted by Kent Mason (August 3, 2017)

a. *Description: a study of the effects of the Fiduciary Rule published in connection with a discussion of how the global management consultant can help financial institutions adjust to the rule.*
b. States that "[c]ertain high-cost investment products (such as variable annuities) will be phased out as the business model is no longer viable under the new rule…."

5. <u>Independent Insurance Agents & Brokers of America, Inc. (IIABA) Member Survey (July 2017)</u>, as described in IIABA's August 3, 2017 <u>comment letter</u>

a. "38%, or 315 respondents, answered that they personally and/or the insurance agency they work for had stopped selling or giving advice related to products impacted by the fiduciary rule, or planned to do so on or before January 1, 2018 when the [fiduciary] rule takes full effect."
b. "[M]ore than one third of independent insurance agents who responded to the survey will exit the market on or before January 1, 2018; and for those that remain some will offer more limited services to clients."

6. <u>ACLI (August 7, 2017 comment letter)</u>

a. "One ACLI member informed us that it has reduced its proprietary insurance product offerings by 54 percent and its non-proprietary variable annuity offerings available through its broker-dealers by 76 percent."
b. Consequences of the Fiduciary Rule as reported by ACLI members:
    i. "Some banks are no longer offering access to fixed and indexed annuities, even when they are used outside the context of an employee benefit plan or IRA."

ii. "Some broker-dealers are no longer offering variable annuities even to savers and retirees with non-qualified assets not subject to the Regulation."

We thank you for your consideration of the issues addressed in this letter.

Sincerely,

Kent A. Mason

cc: The Honorable Michael S. Piwowar
The Honorable Kara M. Stein
John Cook
Dalia Osman Blass
Paul G. Cellupica
Brett Redfearn

APPENDIX A: GENERAL HARM CREATED BY THE FIDUCIARY RULE

1. **Deloitte & Touche Study (August 9, 2017), as described in SIFMA's August 9, 2017 comment letter (study attached to letter as Appendix I)**
   a. *Description: a study of a cross-section of SIFMA's members, consisting of 21 financial institutions that represent 43% of U.S. financial advisors and 27% of the retirement savings assets in the market.*
   b. "[A]s of the Rule's first applicability date on June 9th, 53% of study participants reported limiting or eliminating access to brokerage advice for retirement accounts, which the firms estimate impact 10.2 million accounts and $900 billion AUM."
   c. "Roughly 95% of study participants indicated that they have reduced access to or choices within the products offered to retirement savers because of efforts to comply with the Rule. Products affected include mutual funds, annuities, structured products, fixed income, private offerings, and more, impacting an estimated 28.1 million accounts. Examples of the reduction in mutual fund availability include: 1) the elimination of no-load funds from brokerage platforms; 2) the elimination of mutual funds held directly at the mutual fund company; 3) reduced product offerings; and 4) elimination of other share classes."
   d. "Across the industry, broker-dealers will have spent more than $4.7 billion in start-up costs relating to the Rule, much of which has already been spent."
   e. "The ongoing costs to comply are estimated at over $700 million annually…."

2. **Harper Polling (July 2017), as described in the Financial Services Roundtable's August 10, 2017 comment letter (report and survey slides attached to letter)**
   a. *Description: a national survey of 600 financial professionals conducted by phone and through online interviews from July 7-12, 2017 (July 17, 2017).*
   b. A majority of respondents reported the Rule is restricting them from serving their clients' best interests.
   c. "Only 12% of respondents report the Rule is helping them to serve their clients best interest and 33% report there has been no impact, yet those respondents still report more complicated paperwork and fewer small accounts." "For those who reported the Rule is helping or has had no impact on their ability to serve their clients best interests, many reported negative changes to client services by (i) servicing fewer small accounts, (ii) offering fewer investment options, (iii) including fewer mutual fund options, and (iv) higher compliance costs, including additional fees for Retirement Investors."
   d. "Only 10% of Certified Financial Planners (CFP) report that the Rule is helping them to serve their clients best interests, and 55% report the Rule is restricting them from serving their clients best interests. This runs counter to the claim by the CFP Board of Standards that the Rule is workable for their members."
   e. 75% of respondents whose "typical clients have starting assets under $25,000 report that they will take on fewer small accounts due to increased compliance costs and legal risks."
   f. 63% reported that "the fiduciary standard will definitely/probably/or has already limited investment options/products they can provide to clients."
   g. 56% said "their firms would offer fewer mutual fund products to consumers."

h. "…68% reported that they or their institutions will take on fewer small accounts."

3. **American Action Forum (AAF) (March 16, 2017 comment letter)**
   a. *Description: AAF's comments are based on: (1) an AAF staff survey of the available literature in 2015 on the likely impact of the DOL rule, as discussed in an August 4, 2015 article; (2) a September 17, 2015 AAF article; and (3) AAF research as discussed in a February 22, 2017 article.*
   b. Found reported compliance costs of at least $106 million in 2016, representing up-front costs from just four companies.
   c. "[A]lmost all retail investors will see their costs increased by 73 to 196 percent due to a mass shift toward fee-based accounts."
   d. "[F]irms providing investment advice will see an average of $21.5 million in initial compliance costs and $5.1 million in annual maintenance costs."
   e. "[U]p to 7 million Individual Retirement Accounts (IRAs) would fail to qualify for an advisory account due to the balance too low to be sustainable for the advisor. In the shorter term, we found that the fiduciary rule, as written, will result in over $1500 of duplicative fees charged per household retirement account."
   f. "…the fiduciary rule would cost $31.5 billion in total costs and $2 billion in annual burdens, making it the most expensive rule of 2016 and the second most expensive non-EPA rule since 2005."

4. **Meghan Milloy / American Action Forum (AAF) Research (April 2017), as stated on AAF's website**
   a. *Description: a research article by Meghan Milloy, Director of Financial Services Policy.*
   b. The Rule will result in additional charges to retirement investors of approximately $816 annually per account or over $46 billion in aggregate.
   c. "Although the rule has not yet become effective, AAF research has found that three major companies have left part of the brokerage business, and six more are drawing down their business or switching to a fee-based arrangement. From these companies alone, reported compliance costs have already topped $100 million, affecting 92,000 investment advisors, $190 billion in assets, and at least 2.3 million consumers."

5. **Chamber of Commerce's Monitoring of Rule's Impact, as described in the Chamber's August 16, 2017 comment letter**
   a. *Description: outreach conducted by the Chamber to 14 firms that collectively manage $10 trillion in assets.*
   b. "[N]early all of the institutions reported excluding some investment products from retirement investors in response to the rule, largely due to concerns about the pending 'level' fee requirements of the 'full' BIC Exemption."
   c. "Most of the institutions also reported using the 'grandfathering' provisions included in the final rule, meaning that a substantial number of investors would be prevented from receiving new investment advice going forward, unless they decide to change the type of account they have (e.g. change from a transaction-based account to a fee-based account)."

6. **NAIFA Survey of 1,093 Members (April 2017)**
    a. Nearly 75% of financial professionals have experienced or expect to experience an increase in the minimum account balances for the clients they serve.
    b. Nearly 90% of advisors believe consumers will need to pay more for their financial advice services.
    c. More than 90% of financial professionals have already experienced or expect to experience restrictions of product offerings to their clients.
    d. 68% of NAIFA's members have been told that they cannot recommend certain mutual fund classes or types to clients, and almost 70% say they cannot recommend certain annuities.

7. **LIMRA Secure Retirement Institute's *Second Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in an August 23, 2017 LIMRA press release**
    a. Total annuity sales for the first half of 2017 decreased 10% over the first half of 2016, the lowest first half sales since 2001.
    b. Q2 2017 is the:
        i. 5th consecutive quarter of decline in overall annuity sales.
        ii. 6th consecutive quarter in which fixed annuity sales have been greater than variable annuity sales, which "hasn't happened in almost 25 years."
    c. "A closer look at what's driving the drop in VA sales reveals qualified VA sales have experienced a more significant decline than non-qualified VAs…. VA qualified sales were down 16 percent in the second quarter, while nonqualified sales were actually up 5 percent. This could be in reaction to the DOL fiduciary rule," according to the director of annuity research.
    d. Variable annuity sales are forecast to drop 10-15% in 2017, returning to levels not seen since 1998.

8. **LIMRA Secure Retirement Institute's *First Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in a May 18, 2017 LIMRA press release**
    a. Indexed annuity sales are forecast to decline 5-10% in 2017 and "another 15-20 percent in 2018 when the BICE goes into effect."

9. **LIMRA Secure Retirement Institute Study (2017), as described in NAIFA's August 4, 2017 comment letter**
    a. "LIMRA estimates that access to guaranteed income products will decline 29% under the Rule/PTEs."

10. **Morningstar Report (2017), as described in the Insured Retirement Institute's April 17, 2017 comment letter**
    a. Variable annuity sales declined nearly 22% from 2015 to 2016 despite a rising stock market.

11. **Survey of Insured Retirement Institute (IRI) Member Firms (July 2017), as described in IRI's August 7, 2017 comment letter**

a. *Description: IRI surveyed a representative sampling of its insurance company and distributor members from July 18-31, 2017.*
b. "More than 60 percent of the distribution firms that participated in the Survey have, are planning to, or are considering exiting or de-emphasizing target markets such as small IRA holders and small retirement plan sponsors."
c. A number of distributors reported that "approximately 155,000 of their clients have already been 'orphaned,' and a number of our insurer members told us that both the adviser and the firm have dissociated from the accounts of hundreds of their annuity contract owners. Far more accounts are expected to be impacted as implementation of the Rule proceeds."

12. CoreData Report, CoreData Research UK (2016), as described in comment letter and attachment submitted by Kent Mason (August 3, 2017)

a. *Description: a non-commissioned report based on an October 2016 survey of 552 U.S. financial advisors.*
b. 71% of financial professionals will disengage from at least some retirement savers because of the Fiduciary Rule.
c. 64% of financial professionals think the Fiduciary Rule will have a large negative impact on their mass-market clients (i.e., investors with less than $300,000 in net investable assets).
d. On average, financial professionals estimate they will no longer work with 25% of their mass-market clients, creating an advice gap for low-balance investors.
e. 39% of advisors believe the cost of personal financial advice will become too expensive for most investors.
f. 32% of advisors believe that shifting away from certain products, such as annuities and non-traded REITs, is one of the biggest challenges posed by the fiduciary rule.
g. 57% of advisors "believe increased paperwork stemming from reporting and disclosure requirements will be one of the top three challenges of the fiduciary rule."
h. 18% of advisors "believe preparing for potential litigation will be one of the biggest challenges they must overcome."

13. A.T. Kearney Study (October 2016), as described in comment letter and attachment submitted by Kent Mason (August 3, 2017)

a. *Description: a study of the effects of the Fiduciary Rule published in connection with a discussion of how the global management consultant can help financial institutions adjust to the rule.*
b. Concludes that "[a]s firms move toward fee-based advisory, many low-balance accounts will no longer be served, shifting many assets to formats such as robo-advice and self-directed."
c. Recommends that broker/dealers should "[a]ccelerate the transition to fee-based services and advisory, and evaluate account thresholds to continue serving (for example, accounts greater than $200,000)."

   d. States that "[c]ertain high-cost investment products (such as variable annuities) will be phased out as the business model is no longer viable under the new rule…."
   e. By 2020, broker-dealer firms will collectively stop serving the majority of the $400 billion currently held in low-balance retirement accounts.
   f. Implementing the DOL's new fiduciary rule for retirement accounts will cost the brokerage industry $11 billion over the next four years.

14. <u>Large Mutual Fund (2017 data)</u>, as described in the Chamber of Commerce's April 17, 2017 [comment letter]()
   a. *Description: an interview the Chamber conducted with a large mutual fund provider.*
   b. One mutual fund's number of orphaned accounts (i.e., accounts without an advisor) nearly doubled in the first three months of 2017, and the average account balance in these orphan accounts is just $21,000. The fund projects that "ultimately 16% of the accounts it services will be orphaned this year because of the Fiduciary Rule." "Extrapolating this prediction suggests that at least 1.6 million small retirement savers have already lost access to investment assistance since January 2017, and an additional 1.6 million are likely to lose access after the Rule becomes applicable."

15. <u>Fidelity Clearing & Custody Solutions Poll (August 2016)</u>, as described in September 28, 2016 ThinkAdvisor [article]()
   a. *Description: A blind online poll of 459 advisors conducted from August 18-26, 2016. Respondents consisted of 30% independent broker-dealer reps, 21% RIAs, 19% regional BD reps, 15% from wirehouse firms, 11% insurance BD reps, and 3% from banks.*
   b. 10% of advisors responding to the survey reported they are planning to leave or retire from the field earlier than expected because of the rule, and another 18% said they are "reconsidering their careers as advisors."

16. <u>2016 Global Survey of Financial Advisors commissioned by Natixis Global Asset Management</u>, as described on Natixis [website]() and in survey [whitepaper]()
   a. *Description: a survey of 2,550 advisors (including 300 in the U.S.) in 15 countries in Asia, Europe, the United Kingdom, and the Americas conducted in July 2016. The online quantitative survey was developed and hosted by CoreData Research.*
   b. 38% of respondents said they will likely "disengage with smaller clients" as a result of new regulations.
   c. Almost 80% of respondents are "concerned that more stringent regulations could limit access to financial advice for lower balance and mid-tier clients."
   d. More than 75% of advisors surveyed "believe increased regulations could even lead to higher costs for clients."

17. <u>The Cerulli Report – U.S. Broker/Dealer Marketplace 2016</u>, as described in Lincoln Financial Group's March 17, 2017 [comment letter]()

a. *Description: an "in-depth analysis of broker/dealers (B/Ds) with financial advisors serving retail investors." Available for purchase.*
b. 66% of advisors believe that small investors will have less access to professional financial advice as a result of the rule.

18. NERA Economic Consulting's comment on the Department of Labor Proposal and Regulatory Impact Analysis (July 17, 2015)

a. *Description: SIFMA retained NERA Economic Consulting to review and comment on the proposed fiduciary rule. To conduct its cost study of the proposal, NERA gathered account-level data from several financial institutions, representing tens of thousands of IRA accounts that were observed from 2012 through Q1 2015.*
b. "Using [a] conservative minimum account balance of $25,000, over 40% of commission-based accounts in our dataset would not be able to open fee-based accounts. Using a $50,000 threshold, over 57% of accounts would not meet minimum balance requirements for a fee-based account. If the effective threshold is $75,000, two-thirds of account holders would be left without any professional investment advice."

19. Chamber of Commerce company interviews, as described in the Chamber's April 17, 2017 comment letter

a. *Description: In-depth, structured interviews of two to five persons with about 10 investment-advisory companies, broker-dealers, insurance companies, and others affected directly or indirectly by the Fiduciary Rule.*
b. Interviewed companies "uniformly report that they have already restricted the choices of investment products available to retirement savers through their fee-based advisory channels, or they intend to do so when the Fiduciary Rule becomes applicable. The majority of companies interviewed have also either already raised the minimum account amounts to qualify for advisory services or have plans to do so upon applicability of the rule. Some firms have raised the minimum for advisory accounts to $100,000 or more, clearly excluding from their services small beginning savers."
c. "[E]ven when the financial institution itself has not increased account minimums, individual brokers may implicitly discourage enrollment of smaller accounts and ration their time to larger accounts to earn better pay and to reduce time spent on compliance associated with smaller, transaction-based accounts."
d. Insurance costs could exceed two to three times the cost estimated by the Department. Some respondents cited numbers as high as $10,000 per professional per year for Errors and Omissions coverage.
e. The Chamber is unaware of any "robo-advisor" that recommends annuity products to generate retirement income, despite the clear need for these products and the Department's reliance on robo-advisors to alleviate the potential loss of access to retirement advice for small savers.

20. **<u>SIFMA survey</u>, as described in document "New Data Shows DOL Fiduciary Rule Harming Small Retirement Savers" (available as attachment to Kent Mason's August 3, 2017 [comment letter])**
    a. *Description: a survey of 25 member financial firms impacted by the Fiduciary Rule.*
    b. "More than half the firms are considering moving IRA brokerage clients to call center services only."
    c. "44% of the respondents anticipate that more than half of their clients could see a change in services (e.g., limitation of product choice, shift to fee-based account, or shift to online only, etc.). More than 50% of responding firms anticipate offering only advisory services to a subset of their current IRA brokerage customers."
    d. "… more than 60% of the responding firms stated that they anticipate that some or all of the costs resulting from the potential increase in litigation and liability insurance may be passed on to clients."

21. **<u>Wall Street Journal Reports (February and April 2017)</u>, as described in the Financial Services Roundtable's April 17, 2017 [comment letter]**
    a. Firms have responded to the Rule by taking actions that include: (1) moving clients to fee-based accounts; (2) eliminating commission-based IRAs; (3) raising investment minimums for commission-based IRAs; (4) eliminating variable annuity products; and (5) excluding certain products from commission-based IRAs (e.g., annuities, mutual funds, and exchange-traded funds).

22. **<u>Jonathan Reuter updated analysis</u>, as described in the American Bankers Association's (ABA) March 15, 2017 [comment letter]**
    a. *Description: ABA recommendations of key developments that an updated DOL analysis of the Fiduciary Rule should account for.*
    b. The author of one of the academic studies cited by the Council of Economic Advisers (CEA), Jonathan Reuter, "issued an updated analysis that looked at more recent mutual fund performance (from 2003 to 2012) and concluded that broker-sold funds underperform no-load funds by an average of 18 basis points, significantly narrower than the 100-basis point difference cited by CEA."

APPENDIX B: HARM TO THE ANNUITY MARKET FROM THE FIDUCIARY RULE

1. **LIMRA Secure Retirement Institute's *Second Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in an August 23, 2017 LIMRA press release**
   a. Total annuity sales for the first half of 2017 decreased 10% over the first half of 2016, *the lowest first half sales since 2001*.
   b. Q2 2017 is the:
      i. 5th consecutive quarter of decline in overall annuity sales.
      ii. 6th consecutive quarter in which fixed annuity sales have been greater than variable annuity sales, which "hasn't happened in almost 25 years."
   c. "A closer look at what's driving the drop in VA sales reveals qualified VA sales have experienced a more significant decline than non-qualified VAs…. *VA qualified sales were down 16 percent in the second quarter, while nonqualified sales were actually up 5 percent. This could be in reaction to the DOL fiduciary rule*," (emphasis added) according to the director of annuity research.
   d. *Variable annuity sales are forecast to drop 10-15% in 2017, returning to levels not seen since 1998.*

2. **LIMRA Secure Retirement Institute's *First Quarter 2017 U.S. Retail Annuity Sales Survey*, as described in May 18, 2017 LIMRA press release**
   a. Indexed annuity sales are forecast to decline 5-10% in 2017 and "another 15-20 percent in 2018 when the BICE goes into effect," referring to the "Best Interest Contract Exemption" under the DOL fiduciary rule.

3. **LIMRA Secure Retirement Institute Study (2017), as described in NAIFA's August 4, 2017 comment letter**
   a. "LIMRA estimates that access to guaranteed income products will decline 29% under the [DOL Fiduciary] Rule/PTEs." (The reference to "PTEs" is to the exemptions from the application of the Fiduciary Rule, which substantially all qualified annuities must use.)

4. **Morningstar Report (2017), as described in the Insured Retirement Institute's April 17, 2017 comment letter**
   a. Variable annuity sales declined nearly 22% from 2015 to 2016 despite a rising stock market, which "has traditionally led to increased sales" of VAs.

5. **Insured Retirement Institute (IRI) member survey (July 2017), as described in IRI's August 7, 2017 comment letter**
   a. "Half of the participating insurance companies reported that some of their distribution partners have already dropped the insurer's products from their shelf as part of their efforts to implement the [Fiduciary] Rule."
   b. "Nearly 60 percent of the participating insurance companies expect that fee-based annuities manufactured in response to the [Fiduciary] Rule will result in higher overall fees to the consumer."
   c. "[A] number of our distributor members reported that approximately 155,000 of their clients have already been 'orphaned,' and a number of our insurer members

told us that both the adviser and the firm have dissociated from the accounts of hundreds of their annuity contract owners. Far more accounts are expected to be impacted as implementation of the Rule proceeds."

6. **Independent Insurance Agents & Brokers of America, Inc. (IIABA) Member Survey (July 2017), as described in IIABA's August 3, 2017 comment letter**
    a. "38%, or 315 respondents, answered that they personally and/or the insurance agency they work for had stopped selling or giving advice related to products impacted by the fiduciary rule, or planned to do so on or before January 1, 2018 when the [fiduciary] rule takes full effect."
    b. "[M]ore than one third of independent insurance agents who responded to the survey will exit the market on or before January 1, 2018; and for those that remain some will offer more limited services to clients."

7. **ACLI (August 7, 2017 comment letter)**
    a. "One ACLI member informed us that it has reduced its proprietary insurance product offerings by 54 percent and its non-proprietary variable annuity offerings available through its broker-dealers by 76 percent."
    b. Consequences of the Fiduciary Rule as reported by ACLI members:
        i. "Some banks are no longer offering access to fixed and indexed annuities, even when they are used outside the context of an employee benefit plan or IRA."
        ii. "Some broker-dealers are no longer offering variable annuities even to savers and retirees with non-qualified assets not subject to the Regulation."
        iii. "Some broker dealers are reducing the number of insurers and annuity products available on their platforms."
        iv. "Some firms are inquiring how quickly they can be removed as the broker dealer of record from existing annuity business."
    c. "[T]he Regulation has already resulted in a dramatic increase of 'orphaned' accounts. Several ACLI member companies have already been notified by distribution partners that they will resign as agent of record to IRA and ERISA plan annuity holders. For example, one ACLI member has informed us that, since the Regulation's June 9, 2017 applicability date, it has received 'disassociation' requests for 84 annuity contracts, and the reason provided for each action was the Regulation. By comparison, this member received only 3 disassociation notices during 2016, none of which included the Regulation as the basis for the disassociation."
    d. One member reported that it has "identified over 250 small retirement plans that have lost access to guidance and advice as a result of the Regulation."

8. **NAIFA Survey of 1,093 Members (April 2017)**
    a. 70% of NAIFA's members say they cannot recommend certain annuities.

9. **CoreData Report, CoreData Research UK (2016), as described in comment letter and attachment submitted by Kent Mason (August 3, 2017)**

a. *Description: a non-commissioned report based on an October 2016 survey of 552 U.S. financial advisors.*
b. 32% of advisors believe that shifting away from certain products, such as annuities and non-traded REITs, is one of the biggest challenges posed by the fiduciary rule.

10. A.T. Kearney Study (October 2016), as described in comment letter and attachment submitted by Kent Mason (August 3, 2017)

a. *Description: a study of the effects of the Fiduciary Rule published in connection with a discussion of how the global management consultant can help financial institutions adjust to the rule.*
b. States that "[c]ertain high-cost investment products (such as variable annuities) will be phased out as the business model is no longer viable under the new rule…."

11. Chamber of Commerce (April 17, 2017 comment letter)

a. The Chamber is unaware of any "robo-advisor" that recommends annuity products to generate retirement income, despite the clear need for these products and the Department's reliance on robo-advisors to alleviate the potential loss of access to retirement advice for small savers.

12. Wall Street Journal Reports (February and April 2017), as described in the Financial Services Roundtable's April 17, 2017 comment letter

a. Firms have responded to the Rule by taking actions that include: (1) moving clients to fee-based accounts; (2) eliminating commission-based IRAs; (3) raising investment minimums for commission-based IRAs; (4) eliminating variable annuity products; and (5) excluding certain products from commission-based IRAs (e.g., annuities, mutual funds, and exchange-traded funds).

13. Cerulli Associates Research, as reported in December 15, 2016 ThinkAdvisor article

a. "U.S. variable annuity and fixed indexed annuity sales are expected to decline by at least 10% through 2018 as the industry struggles to adapt to upcoming regulations put forth by the Department of Labor."
b. Cerulli views insurers' "biggest challenge for the foreseeable future" as being the Fiduciary Rule.

14. Insured Retirement Institute (IRI) First-Quarter 2017 Annuity Sales Report, as described in June 6, 2017 press release

a. *Description: sales results based on data reported by Beacon Research and Morningstar, Inc.*
b. Industry-wide annuity sales declined 18% in the first quarter of 2017 as compared to the first quarter of 2016.
c. Fixed annuity sales during the first quarter of 2017 declined 13.9% as compared to the first quarter of 2016, and variable annuity sales declined 10.2% for the same period.

15. <u>Insured Retirement Institute (IRI)</u>, as reported in December 15, 2016 ThinkAdvisor <u>article</u>

a. IRI "found that industrywide annuity sales in the third quarter totaled $51.3 billion, an 8.2% drop from sales of $55.9 billion during the second quarter of 2016, and a 12.3% decline from $58.5 billion in the third quarter of 2015."