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NASAA

July 21, 2015

Via email to e-ORI@dol.gov

Phyllis C. Borzi
Office of Regulations & Interpretations
Employee Benefits Security Administration
Attn: Conflicts of Interest Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue
Washington, DC 20210

Re: RIN 1210-AB32 – Definition of the Term "Fiduciary" – Conflicts of Interest Rule – Retirement Investment Advice, and related proposals published on April 20, 2015 in Volume 80 of the Federal Register.

Dear Ms. Borzi,

The North American Securities Administrators Association, Inc. ("NASAA")[1] welcomes the opportunity to comment on the Department of Labor ("the Department") Employee Benefits Securities Administration's ("EBSA") proposed rulemaking defining the term "fiduciary"[2] "(the "fiduciary duty proposal") and related proposed rulemaking initiatives published alongside the fiduciary duty proposal, including the Best Interest Contract Exemptions[3] ("BIC proposal") and Prohibited Transaction Exemption (PTE) 84-24[4] ("variable annuities proposal," collectively, "the EBSA proposal" or "the proposal" or "the proposed rule").

The NASAA membership includes all U.S. state securities regulators. U.S. state securities regulators have long-standing experience in applying the fiduciary standard of care in investment adviser oversight. To this end, NASAA offers the enclosed comments to inform this important EBSA regulatory initiative as applied to retirement accounts, which will serve to further protect retirement investors, as identified by the proposal. In parallel, NASAA continues to advocate for extending the fiduciary duty standard of care currently applicable to investment

[1] NASAA is the association of the 67 state, provincial, and territorial securities regulatory agencies of the United States, Canada, and Mexico. NASAA serves as the forum for these regulators to work with each other in an effort to protect investors at the grassroots level and to promote fair and open capital markets.
[2] 80 Fed. Reg. 21928 (April 20, 2015).
[3] 80 Fed. Reg. 21960 (April 20, 2015).
[4] 80 Fed. Reg. 22010 (April 20, 2015).

advisers to broker-dealers, as provided in Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act").[5] While the EBSA proposal is a rulemaking initiative distinct from any U.S. Securities and Exchange Commission ("SEC"), rulemaking under its Dodd-Frank Act Section 913 authority, NASAA emphasizes the importance of continuing to raise the standard of care available to investors through multiple initiatives. Any progress towards an increased duty of care that addresses the problems associated with the significant conflicts of interest present in today's marketplace is a productive step in the right direction.

By broadening the definition of investment advice and who is a fiduciary, the EBSA proposal would significantly raise the standard of care available to investors in retirement plans, or retirement investors. Specifically, the proposal would treat those who provide investment advice or recommendations to an employee benefit plan, plan fiduciary, plan participant or beneficiary, individual retirement account ("IRA") or IRA owners as fiduciaries under the Employee Retirement Income Security Act ("ERISA") and the Internal Revenue Code ("the Code"). NASAA supports the proposed definition of investment advice also extending to IRAs. IRAs, a widely used retirement tool today, had only just begun to exist in 1975 when the Department promulgated the existing ERISA fiduciary duty regulations, and therefore were likely not considered extensively as part of the 1975 rulemaking. NASAA notes the proposed definition of fiduciary will extend to IRAs as a result of the parallel structure between Title I of ERISA and Section 4975(e)(3)(B) of the Code. However, the remedies under each regulatory framework differ, despite the parallel structure. While the ERISA Title I provisions generally authorize recovery of losses and imposition of civil penalties, the Code can only impose excise taxes on persons engaging in the prohibited transactions. As outlined below, explicitly preserving remedies available under state securities laws would enhance this unavoidable discrepancy between remedies available to IRAs under the Code in comparison to Title I plans.

NASAA appreciates that the new general definition of investment advice avoids many of the weaknesses of the current EBSA framework. Such weaknesses include the narrow definition and applicability of the framework. NASAA supports the proposal's goal to avoid sweeping in relationships that are not appropriately regarded as fiduciary in nature and that the Department does not believe Congress intended to cover as fiduciary relationships. NASAA also supports the Department's inclusion of new exemptions designed to preserve certain transaction-based compensation models as part of its proposal, including the BIC proposal and the proposed amendments to existing exemptions to ensure workability. To contribute to the workability of the proposed rule, NASAA offers below a few suggestions to enhance the proposal while continuing to protect investors and preserving the remedies available to investors outside of binding arbitration.

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[5] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

The Importance of a Fiduciary Duty of Care

The proposal is a positive step towards raising the standard of care for retirement accounts, though NASAA notes the importance of raising the standard of care for investors on all accounts, not solely retirement accounts. The proposal would ensure that many broker-dealer relationships currently governed by the suitability standard would become retirement accounts under the proposal and, therefore, subject to a conduct standard meant to prohibit conflicts of interest. The proposal is appropriate considering the evolution of retirement accounts since 1974 as well as ERISA's scope and intent. ERISA is a comprehensive statute and the broad public interest in ERISA-covered plans is reflected in ERISA's imposition of stringent fiduciary responsibilities on parties engaging in important plan activities, as well as in the tax-favored status of plan assets and investments.

NASAA has also long advocated for a true, undiluted, fiduciary duty standard applicable to broker-dealers when providing investment advice to customers. An important benefit of a fiduciary duty regime for investors in general is that the fiduciary duty standard is not exclusively a conflicts disclosure regime, but one where the provider of advice must act in the best interest of the investor. While disclosing and managing conflicts of interest is a component of fiduciary duty, a true fiduciary duty standard also contemplates conflicts that cannot be disclosed and are therefore prohibited. To this end, NASAA has continued to emphasize that certain significant conflicts of interest must be prohibited, rather than allowed through disclosure. To the extent that the Department's rulemaking will inform other regulatory initiatives to raise the standard of care available to investors, NASAA is pleased that the Department has designed a rule that is meant to preserve certain traditional compensation models while significantly narrowing the exemptions to ensure the protection of investors.

NASAA also appreciates that the Department has coordinated with the SEC, and would encourage continued consultation with the SEC and state securities regulators. Continued coordination serves to minimize any confusion that may result on behalf of either investors or industry members as the rule is implemented. To this end, NASAA has also sent a comment letter to the SEC noting the importance of coordinating with the Department to ensure that the standard of care available to investors is a fiduciary standard for retirement accounts, but also for non-retirement accounts at broker-dealers. The SEC, under the grant of authority of Section 913 of the Dodd-Frank Act, has the discretion to ensure that the standard of care that broker-dealers owe to customers be raised to a fiduciary standard on all account relationships, with very limited carve-outs for commissions and principal transactions. SEC rulemaking can and should occur in close coordination with the Department's rulemaking, though regulatory harmony should not delay either the Department's or the SEC's rulemaking.

Extending Fiduciary Duty to IRAs Will Result in Greater Investor Protection

The proposal's extension of the fiduciary duty standard to IRAs would provide significant and much needed protection to retirement investors. The Department's reliance on economic evidence supporting a finding of the negative impact of conflicts of interest on retirement investment outcomes demonstrates the need for the rule under consideration. The Department cites to substantial failures in the market for retirement advice, noting that IRA holders receive conflicted advice and can expect the investments to underperform by an average of 100 basis points per year over the next 20 years. The proposal seeks to remedy this adverse impact on the performance of IRAs with investments from a wide range of products. Products held in IRAs can include mutual funds, insurance products, exchange traded funds (ETFs), individual stocks and bonds, and other products which are all sold by agents and brokers.

Rollovers and account transfers are an area where state securities regulators routinely see abuse, such as in cases where an investor is advised to liquidate a well-balanced portfolio in exchange for an over-concentration in a high-fee product. That same fact pattern can occur in IRA rollovers. Furthermore, even if a specific IRA rollover may be an *adequate* transaction for the investor, it may not be the transaction in the investor's *best interest*. Therefore, NASAA is supportive of the greater breadth of application of fiduciary duty that the proposed rule can afford, as long as remedies available under the state securities laws are explicitly preserved under the proposal. State securities regulators have active enforcement programs that contribute to investor protection and would supplement the few remedies available to IRA holders under the Code, particularly in contrast with the remedies available to Title I plans.

State securities enforcement programs address both registered and unregistered activities. In its most recent report on state securities enforcement activities, NASAA reported that investigations conducted by state securities regulators led to nearly 2,200 enforcement actions across 51 jurisdictions, including administrative, civil, and criminal actions against 3006 respondents or defendants.[6] Those actions targeted both registered and unregistered activity and resulted in state securities regulators levying $71 million in fines and penalties and the ordering of $616 million in restitution to investors.[7] State securities regulators also took steps to deny licenses to bad actors and imposed restrictions on the activities of licensees with significant disclosure history. As noted in the most recent report on state securities enforcement activities, a total of 169 licenses were denied due to state action, a 36 percent increase in denials over last year.[8] In addition, 394 licenses were conditioned, a 48 percent increase over last year.[9]

<u>Adoption of the Proposal Should Include Explicit Acknowledgment of the ERISA Savings Clause for State Securities Laws and Enforcement</u>

The proposal notes that enforcement of the fiduciary standard varies depending on the type of plan. Specifically, the remedies for IRA plans are limited to excise tax remedies and contractual remedies under the BIC. Therefore, it remains important that state securities regulators maintain their authority to pursue a registered person who may have engaged in violative conduct involving an IRA or other transaction covered by ERISA fiduciary duty. We

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[6] *See* NASAA 2014 Enforcement Report *available a*t http://www.nasaa.org/wp-content/uploads/2011/08/2014-Enforcement-Report-on-2013-Data_110414.pdf.
[7] *Id.*
[8] *Id.*
[9] *Id.*

urge the Department to include language in its final rule that explicitly acknowledges that state securities laws are not superseded or preempted in any way and remain subject to the ERISA Section 514(b)(2)(A) savings clause.[10]

Explicit acknowledgement of the savings clause ensures that state enforcement actions can supplement the current remedies under ERISA and the Code, which vary by type of plan. Participants in plans covered by Title I of ERISA have a statutory right of action to bring suit against fiduciaries under ERISA for violation of the prohibited transactions. In contrast, while the proposal includes IRAs in terms of extending fiduciary duty to IRAs, the sole statutory sanction available under the Code is an excise tax enforced by the Internal Revenue Service. The proposal bolsters these remedies for IRA owners through the addition of contractual remedies for transactions that include use of the BIC exemption. The proposal essentially empowers enforcement of the BIC exemption through the retirement investor, noting "the Department intends that all the contractual obligations (the Impartial Conduct Standards and the warranties) will be actionable by IRA owners."[11] While NASAA supports empowering the retirement investor, state securities regulators know from long-standing experience and active enforcement programs that deterrence and enforcement of remedies cannot rest on investors alone.

The ERISA "pre-emption clause" (Section 514(a))[12] provides that ERISA supersedes all state laws insofar as they "relate to any employee benefit plan," but acknowledges the importance of certain state laws through ERISA's "saving clause" (Section 514(b)(2)(A))[13] that excepts from the pre-emption clause any state law that "regulates insurance, banking, or securities." As the proposal represents a significant regulatory shift, explicit acknowledgement that state securities laws are not superseded in any way and remain subject to the ERISA Section 514(b)(2)(A) savings clause is an important and clear indication of the Department's support for state securities regulators' mission to protect investors who may have engaged in ERISA-covered transactions, such as becoming IRA owners.

<u>Adoption of the Proposal Should Prohibit Pre-Dispute Binding Arbitration Agreements</u>

NASAA urges the Department to revise the proposal's endorsement that institutions entering into agreements with retirement investors would be able to include pre-dispute binding arbitration agreements with respect to individual contract claims.[14] We appreciate and agree with the Department's position that waivers for class actions should not be part of the

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[10] 29 U.S.C. 1144(b)(2)(A).
[11] BIC proposal, 80 Fed. Reg. at 21972.
[12] 29 U.S.C. 1144(a).
[13] 29 U.S.C. 1144(b)(2)(A).
[14] BIC proposal, 80 Fed. Reg. at 21973:

> As proposed, this section would not affect the ability of a Financial Institution or Adviser, and a Retirement Investor, to enter into a pre-dispute binding arbitration agreement with respect to individual contract claims. The Department expects that most individual arbitration claims under this exemption will be subject to FINRA's arbitration procedures and consumer protections.

agreements, but remain concerned that the regulation would allow the use of binding pre-dispute arbitration provisions for *individual* claims. Prohibiting binding, or mandatory, pre-dispute arbitration clauses would ensure retirement investors' access to the courts, provide an important measure of investor protection, and uphold the original purpose of the Federal Arbitration Act ("FAA"). If the Department declines prohibiting pre-dispute binding arbitration agreements, NASAA urges that the Department consider revising its assent to such agreements by including in the adopting release a discussion on these agreements' inherent conflict with investor choice of forum and protection.

The FAA was enacted in 1925 to honor agreements to arbitrate between mutually consenting parties. The "principal purpose" of the FAA was to "require courts to enforce privately negotiated agreements to arbitration, like other contracts, in accordance with their terms."[15] Form contracts or "contracts of adhesion" where one party offers terms on a non-negotiated, "take-it-or-leave-it" basis are contrary to the intended purpose of the FAA. Unfortunately, these types of agreements are an endemic part of brokerage "form" contracts between institutions and investors, requiring investors to agree, in advance of any dispute, to mandatory arbitration. NASAA has a long-standing position opposing such mandatory pre-dispute arbitration agreements and has supported the Arbitration Fairness Act of 2013[16] and the Investor Choice Act,[17] as well as other efforts to curtail these agreements. Investors should not be forced into an arbitration forum, but rather should have a choice of forum, whether arbitration or the traditional court system.

NASAA notes that Congress recognized the potential harm to investors raised by mandatory pre-dispute arbitration agreements when it enacted Section 921 of the Dodd-Frank Act. Section 921 provides the SEC with the authority to prohibit or impose limitations on the use of mandatory pre-dispute arbitration clauses in broker-dealer and investment adviser customer contracts. It is unfortunate that the SEC has not yet exercised this authority, but in light of the importance of coordination between the Department and the SEC, the Department could take an important step towards investor protection by opposing mandatory pre-dispute arbitration agreements as part of the BIC proposal's requirements for contracts with retirement investors.

Additional Comments Regarding the Proposal

In addition to the above comments regarding some of the larger policy aspects of the proposal, NASAA offers the following comments to enhance the proposal's application and workability.

- *Explicit retroactive application of the BIC's fiduciary obligations once the written contract is signed.* The BIC proposal notes that the contract is the cornerstone of the proposed

[15] *Volt Info. Scis., Inc. v. Bd. of Trs. of Leland Stanford Junior Univ*., 489 U.S. 468, 478 (1989).
[16] *See* Letter from NASAA to Representative Hank Johnson (May 20, 2013), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Letter-Supporting-AFA-Rep-H-Johnson-May-2013.pdf.
[17] *See* Letter from NASAA to Senator Al Franken (May 20, 2013), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Letter-Supporting-AFA-Sen-A-Franken-May-2013.pdf.

exemption but, as it is a written contract, it will be signed after the relationship with the Adviser and Financial Institution has begun. Account opening is a crucial time to ensure that the investor understands the relationship, the type of account, and the long term strategy. Here, a retirement investor may receive advice about the various types of retirement accounts, including differences between these accounts with regard to commissions, tax consequences, and fee structure. Retroactive application of the fiduciary standard prior to the written contract being ratified would be analogous to the attorney-client confidentiality and privilege rules in the majority of states, where discussions leading up to the decision of a client to retain an attorney are nevertheless covered by obligations of confidentiality and privilege. The BIC proposal should be revised to note that the provisions of the written contract cover the relationship with the retirement investor retroactively.

- *Investment and retirement education.* NASAA appreciates that the fiduciary duty proposal includes a carve-out for the provision of investment education information and materials. NASAA especially appreciates the proposal's equal application of this carve-out to information provided to plan fiduciaries as well as information provided to plan participants and beneficiaries and IRA owners, including equal application to participant-directed and other plans. While this type of investment and retirement education is important for investors, this type of education differs from the unbiased investor education that federal and state securities regulators provide. Therefore, while it is appropriate for the Department to provide guidance on what constitutes education in comparison to advice, allowing some specificity within educational materials may provide a service to retirement investors. Such specificity should be balanced, however, with requiring materials to prominently note that they are part of the marketing process of a plan and could present biases or conflicts.

- *Narrow exemptions.* NASAA supports the general narrowing of exemptions contemplated in the proposal, including the amendment in the variable annuities proposal that would revoke relief for insurance agents, insurance brokers, and pension consultants to receive a commission in connection with the purchase by IRAs of variable annuity contracts and other annuity contracts that are securities under federal securities laws. Revoking this exemption through application of the BIC exemption provides an important measure of investor protection. NASAA has identified problems in the sale of variable annuities as a persistent threat to all retail investors.[18] The regulatory and investor protection issues surrounding variable annuities have been documented over the years in regulatory warnings, governmental enforcement actions, private lawsuits, and media accounts.[19] The problematic sales practices surrounding variable annuities include: (1) misrepresentations about the annuities' liquidity; (2) unsuitable sales to customers for whom a variable annuity's long

[18] *See* NASAA Enforcement Report (Oct. 2012), *available at* http://www.nasaa.org/wp-content/uploads/2012/10/2012-Enforcement-Report-on-2011-Data.pdf; s*ee also* NASAA Enforcement Report (Oct. 2011), *available at* http://www.nasaa.org/wp-content/uploads/2011/08/2010-Enforcement-Report.pdf.

[19] *See* Comment Letter from Karen Tyler, NASAA President and North Dakota Securities Commissioner regarding the SEC's Proposed Rule That Would Subject Certain Equity-Indexed Annuities to Regulation Under the Federal Securities Laws (Sept. 10, 2008), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/29-NASAA_Comment_Letter_on_SEC_Proposed_Rule_151A.pdf.

timeline is inappropriate; (3) lack of disclosures about steep surrender charges; (4) lack of disclosures about commission structures; and (5) lack of choices for customers, as firms usually sell only a limited number of variable annuity products. Several state securities regulators have brought enforcement actions involving the offer and sale of variable annuities.

In closing, NASAA reiterates its support towards the Department's important goal of enhancing the standard of care available to retirement investors, including those who invest through IRAs. The proposal is an important step in raising the standard of care available to retirement investors and paves the way for additional regulatory initiatives to raise the standard of care for investors in general. NASAA particularly urges the Department to explicitly preserve remedies available under state securities laws, as they would serve to enhance the more limited remedies available under ERISA and the Code. NASAA is also pleased to have an opportunity to comment on other aspects of the proposal, such as arbitration agreements and investment education.

Should you have any questions regarding the comments in this letter, please do not hesitate to contact Joseph Brady, NASAA's Executive Director, at jb@nasaa.org, or A.Valerie Mirko, NASAA's Deputy General Counsel, at vm@nasaa.org, or 202-737-0900.

Sincerely yours,

William Beatty
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