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Office of Exemption Determinations
Employee Benefits Security Administration
United States Department of Labor
Washington, DC 20210

**Re: Docket ID Number EBSA-2020-0003:
Improving Investment Advice for Workers & Retirees**

To Whom It May Concern:

I am writing on behalf of the North American Securities Administrators Association, Inc. ("NASAA")[1] in response to the notice of proposed class exemption published by the U.S. Department of Labor ("DOL"), entitled *Improving Investment Advice for Workers & Retirees*, 85 Fed. Reg. 40834 (July 7, 2020) (the "Proposal").[2] NASAA opposes the Proposal and encourages the DOL to rescind it because the Proposal jeopardizes the security of retirement investors.[3] However, if the DOL is determined to move forward with the Proposal, NASAA

[1] Organized in 1919, NASAA is the oldest international organization devoted to investor protection. NASAA's membership consists of the securities administrators in the 50 states, the District of Columbia, Canada, Mexico, Puerto Rico, and the U.S. Virgin Islands. NASAA is the voice of securities agencies responsible for grass-roots investor protection and efficient capital formation.

[2] The Proposal is available at https://www.govinfo.gov/content/pkg/FR-2020-07-07/pdf/2020-14261.pdf.

[3] As a threshold matter, NASAA objects to the DOL's process for issuing the Proposal and requesting comments. The Proposal deals with foundational standards for millions of retirement accounts covered by the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code (the "Code"). Yet the DOL has permitted commenters only 30 days to review, consider, and respond to the Proposal. This comment period is woefully inadequate, and it will ensure that the resulting record will be an insufficient basis on which to enact regulation. In addition to numerous commentators, members of Congress have taken up this issue and have written to Secretary Scalia to extend the comment period. *See* Letter from Hon. Robert Scott and Hon. Patty Murray to Sec'y Eugene Scalia (July 2, 2020), *available at* https://www.help.senate.gov/imo/media/doc/FINAL%20Comment%20Period%20Extension%20Letter%20070220.pdf. Further, the fact that no comments are yet available on regulations.gov, notwithstanding the

President: Christopher Gerold (New Jersey)
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Kevin Hoyt (New Brunswick)
Travis Iles (Texas)
Tanya Solov (Illinois)

believes that the revisions outlined below are essential in order to protect investors and promote industry compliance.

I. Introduction

NASAA has been previously involved in the DOL's attempts to update its regulatory regime for investment advice fiduciaries, including through NASAA's three comment letters[4] in support of the DOL's 2016 fiduciary duty rule (the "2016 Fiduciary Rule").[5] Unfortunately, the 2016 Fiduciary Rule was vacated by the United States Court of Appeals for the Fifth Circuit in 2018,[6] and this administration chose not to challenge that decision. Now, the DOL is proposing to return to the standards that existed prior to the 2016 Fiduciary Rule.

The Proposal would reimplement the DOL's five-part test for investment advice fiduciaries promulgated in 1975.[7] The Proposal would also create a new prohibited transaction class exemption that would allow investment advice fiduciaries to provide conflicted investment advice and receive compensation (*e.g.*, commissions, trailing fees, Rule 12b-1 fees and revenue sharing) for providing such advice, including advice to roll over a participant's account from an employee benefit plan to an individual retirement account ("IRA") or from one IRA to another. Under the proposed exemption, an investment advice fiduciary could meet its obligations under ERISA by complying with the following "impartial conduct standards": (1) a best interest standard, (2) a reasonable compensation standard, including a duty to seek best execution, and (3) a requirement to make no materially misleading statements about recommended investment transactions and other relevant matters. The proposed exemption

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fact that 37 comments have been filed to date, stifles effective debate about the Proposal. *See* Docket Id: EBSA-2020-0003, Regulations.gov (last visited Aug. 6, 2020), https://www.regulations.gov/docket?D=EBSA-2020-0003. The DOL should extend the comment period and provide additional time for participants to meet with DOL staff to discuss the Proposal and its potential implications.

[4] *See* Letter from NASAA President William Beatty to Phyllis C. Borzi, Assistant Sec'y, Emp. Benefits Sec. Admin. (July 21, 2015), *available at* https://www.nasaa.org/wp-content/uploads/2011/07/2015-07-21-NASAA-Comment-to-DOL.pdf; Letter from NASAA President William Beatty to Phyllis C. Borzi, Assistant Sec'y, Emp. Benefits Sec. Admin. (Sept. 24, 2015), *available at* http://nasaa.cdn.s3.amazonaws.com/wp-content/uploads/2011/07/2015-09-24-NASAAComment-2-RIN-1210-AB32.pdf; Letter from NASAA President Judith Shaw to Phyllis C. Borzi, Assistant Sec'y, Emp. Benefits Sec. Admin. (Oct. 5, 2015), *available at* https://www.nasaa.org/wp-content/uploads/2011/07/2015-10-05-NASAA-DOL-Comment-Letter-3-RIN-1210-AB32.pdf.

[5] *Definition of the Term "Fiduciary,"* Dept. of Labor, 81 Fed. Reg. 20946 (Apr. 8, 2016), *available at* https://www.govinfo.gov/content/pkg/FR-2016-04-08/pdf/2016-07924.pdf.

[6] *See Chamber of Commerce v. Dept. of Labor*, 885 F.3d 360 (5th Cir. 2018).

[7] *See Definition of the* Term "Fiduciary," Dept. of Labor, 40 Fed. Reg. 50842 (Oct. 31, 1975), *available at* https://tile.loc.gov/storage-services/service/ll/fedreg/fr040/fr040211/fr040211.pdf.

would also provide broad relief from ERISA's limitations on the ability of firms to engage in principal transactions with customers.

Taken together, the various aspects of the Proposal will create outcomes that are the opposite of the fiduciary protections that retirement investors deserve, and that Congress intended under ERISA. Retirement savers will be misled into believing that the advice they receive adheres to fiduciary standards because financial institutions will represent, as required under the Proposal, that they and their investment professionals are fiduciaries under ERISA and the Code. But this will not always be the case. For instance, under Section II(b) of the Proposal, a party discloses that its fiduciary status is "as applicable," and the Proposal imposes no requirements to describe to investors when fiduciary status does or does not apply.[8] While the Proposal itself goes to great lengths to describe the circumstances under which fiduciary obligations would not apply to investment advice, it is likely that firms will frame their disclosures to obscure rather than clarify these facts.

Even in those instances where a financial institution and its investment professionals trigger ERISA fiduciary status, they will remain free to offer conflicted, self-interested advice. Under the Proposal, a firm and its representatives could earn higher compensation from an investor by recommending proprietary products, products from a limited menu, or a whole host of high cost, high risk, low return products, so long as they disclose their conflicts of interest in making such recommendations and reach a "reasonable conclusion" that doing so does not create a misalignment of interests.[9] Such conclusions would be memorialized in internal policies and procedures, and it stands to reason that, policies and procedures aside, these conflicts of interest will taint their judgment. It is also certain that their self-interested reasoning will not be revealed unless and until examinations, enforcement actions, or protracted litigation uncover them, all of which are beyond of the abilities of individual retirees.

Also of serious concern is the fact that, under the Proposal, a firm and its representatives could decide to limit their advice to rollover recommendations or other limited scope transactions, which could be characterized under the Proposal's loose guidance as discrete and therefore not subject to the "regular basis" or "primary basis" prongs of the 1975 test. Many if not most retirees want to make a limited number of investment decisions, and they want to do so with the comfort that such decisions are based on advice provided by persons acting with true fiduciary loyalty and care. That is what ERISA was designed to achieve, and that is what the Proposal as offered undermines.

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[8] Proposal at 40842.

[9] *Id.* at 40847.

Further, should a self-interested firm and its representatives enrich themselves by saddling a retirement investor with a high cost, low performance investment vehicle that removes the investor from the protections of an ERISA plan and places the investor in an IRA or other account established under the Code, the Proposal goes to pains to emphasize repeatedly that the investor will not have any new or expanded means to seek relief against the offending party.

Under ERISA, the Secretary may not grant an exemption from a prohibited transaction without finding that the exemption is protective of the rights of participants and beneficiaries of a plan.[10] No such finding can reasonably be made here because the Proposal creates a dangerous new regulatory landscape for retirees in the name of investment "flexibility."[11] Unfortunately, the only clear beneficiaries will be the firms and representatives who stand to reap fees and commissions by advising a growing wave of retirees. The Proposal will distort the standards of care required so utterly in favor of industry – through complicated tests, permissive disclosure arrangements, and self-determined controls – as to undermine the very concept of fiduciary advice itself.

II. <u>The 1975 Test Should be Updated with a Simplified Test That Benefits Investors by Eliminating Harmful Loopholes</u>.

The DOL's 1975 test states that a person is an investment advice fiduciary under ERISA Section 3(21)(A)(ii)[12] if that person: (1) renders advice to a retirement plan as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property; (2) on a regular basis; (3) pursuant to a mutual agreement, arrangement, or understanding with the plan, plan fiduciary or IRA owner; (4) the advice will serve as a primary basis for investment decisions with respect to plan or IRA assets; and (5) the advice will be individualized based on the particular needs

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[10] *See* ERISA Section 408(a)(3) [29 U.S.C. § 1108(a)(3)].

[11] *See* Proposal at 40844.

[12] ERISA Section 3(21)(A) [29 U.S.C. § 1002(21)(A)] states:

> Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan to the extent
>
> > (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets,
> >
> > (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or
> >
> > (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 1105(c)(1)(B) of this title.

of the plan or IRA.[13] Returning to this test would be a mistake because it is harmful to beneficiaries and sponsors of retirement accounts.

The DOL's 2016 Fiduciary Rule adopting release aptly articulated why the five-part test is bad policy. While well intentioned when it was first implemented, the five-part test did not stand the test of time. As noted in the 2016 Fiduciary Rule adopting release, the 1975 test was created in a very different environment than exists today; *i.e.*, "prior to the existence of participant-directed 401(k) plans, the widespread use of IRAs, and the now commonplace rollover of plan assets from ERISA-protected plans to IRAs."[14] Indeed, the entire investment landscape has changed dramatically over the course of the last forty-five years, with the proliferation of products of increasing complexity mired in financial incentives tied to their marketing and distribution. The DOL needs a new rule that adequately addresses the challenges facing today's retirement savers.[15] The DOL need not start from scratch; rather, it should revisit and build upon the extensive work already done in this area through the development of the 2016 Fiduciary Rule.

NASAA supported the general goals and contours of the 2016 Fiduciary Rule and there are at least two features of that rule that remain imperative and should be part of the DOL's current regulatory effort. First, any new rule must eliminate the glaring loopholes in the 1975 test. Financial professionals advising retirement plans should not be able to evade their fiduciary obligations by artificially minimizing the nature of their roles; *i.e.*, by representing that they are providing advice on a "periodic basis." That was their tactic to avoid the 1975 test, and that is what they will continue to do if the 1975 test is reinstated. Financial professionals will engage in the same malfeasance that gave rise to the 2016 Fiduciary Rule; namely, they will "give imprudent and disloyal advice; steer plans and IRA owners to investments based on their own, rather than their customers' financial interests; and act on conflicts of interest in ways that would be prohibited if the same persons were fiduciaries."[16] Rather than return to the flawed 1975 test, an appropriate standard for the DOL to adopt would be to define a person as an investment advice fiduciary under ERISA Section 3(21)(A)(ii)

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[13] *See* Proposal at 40834-35.

[14] *See* 2016 Fiduciary Rule at 20946.

[15] As the DOL's own data show, defined contribution plans now significantly exceed defined benefit plans, both in terms of the numbers of these plans in use and the total assets maintained by employees in these plans. *See* Private Pension Plan Bulletin Tables and Graphs, U.S. Dept. of Labor Employee Benefits Security Administration, Table E1 and Table E10 (Sept. 2019), *available at* https://www.dol.gov/sites/dolgov/files/ebsa/researchers/statistics/retirement-bulletins/private-pension-plan-bulletin-historical-tables-and-graphs.pdf. A significant number of retirees are also opening self-directed IRAs, for which they will assume the risk of loss or mismanagement. *See Investor Alert: Self-Directed IRAs and the Risk of Fraud*, SEC Office of Investor Education and Advocacy (Aug. 8, 2018), *available at* https://www.sec.gov/investor/alerts/sdira.html.

[16] *See* 2016 Fiduciary Rule at 20946.

whenever that person makes a "recommendation" regarding a retirement plan or account.[17] This standard is well understood in the securities industry and aligns with the transactional approach taken by the SEC in defining conduct standards under Regulation Best Interest.

The second issue any new DOL rule must address is conflicted advice. Conflicted advice costs consumers billions in real retirement dollars every year.[18] It would be irresponsible for the DOL to reinstate conflicted advice loopholes that existed under the 1975 test. Even if the DOL does not wish to follow the path outlined by the 2016 Fiduciary Rule, it has an obligation to the investing public at a minimum to address the most notorious and harmful forms of self-promotion by financial professionals. Sales contests, proprietary and high commission products, and limited menu platforms generally are not utilized by professionals aspiring to act as true fiduciaries. The conflicts that come with such practices, products, and strategies offend basic principles of trust in an advisory relationship.

III. If the DOL Insists on Returning to the 1975 Five-Part Test, Certain Modifications to the Proposal are Essential.

As explained above, NASAA opposes a return to the DOL's 1975 five-part test. If the DOL insists on doing so, though, certain revisions must be made to the Proposal to ensure the DOL protects retirement savers from fraud and abuse by avaricious financial service providers.

A. The DOL Should Make Clear that Providing Investment Advice Regarding Rollovers is Always a Fiduciary Act.

For a great number of Americans, their retirement account represents the lion's share of their financial assets. The DOL appropriately recognizes that "[t]he decision to roll over assets from an ERISA-covered Plan to an IRA may be one of the most important financial decisions that Retirement Investors make, as it may have a long term impact on their retirement security."[19] Investors who rely on financial professionals for advice on key investment decisions, such as where to custody their retirement account and what investments to make, expect that the advice they receive is offered by a financial professional who is required to put

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[17] *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, SEC Release No. 34-86031, at 87-91 (June 5, 2019) (outlining standards for when a recommendation has been made), *available at* https://www.sec.gov/rules/final/2019/34-86031.pdf.

[18] *See The Effects of Conflicted Investment Advice on Retirement Savings*, Executive Office of the President of the United States (Feb. 2015), *available at* https://obamawhitehouse.archives.gov/sites/default/files/docs/cea_coi_report_final.pdf; Joseph Peiffer, *Major Investor Losses Due to Conflicted Advice: Brokerage Industry Advertising Creates the Illusion of a Fiduciary Duty*, St. John's Univ. School of Law Faculty Pubs (2015), *available at* https://scholarship.law.stjohns.edu/cgi/viewcontent.cgi?article=1274&context=faculty_publications.

[19] Proposal at 40845.

their interests first, even if it means recommending a less lucrative product or strategy. The DOL should make clear in the Proposal that any person who provides advice about such fundamental decisions is acting as an investment advice fiduciary – always.

While the Proposal suggests that providing advice about a rollover of a retirement account will often make a person an investment advice fiduciary under ERISA Section 3(21)(A)(ii),[20] the DOL's discussion makes clear that rollover recommendations do not necessarily create or lead to fiduciary advice relationships. This ambiguity is a disservice to savers.

The DOL should mandate that any time a person provides advice on a potential rollover of a retirement account that person is acting as an investment advice fiduciary. Retirement account holders should be able to trust that this advice will be required by law to adhere to ERISA's strict fiduciary standards. Permitting even a fraction of such instances to escape ERISA fiduciary duties would open retail investors to potential abuse and undermine confidence in a system that should be designed to encourage Americans to save and invest for retirement.

Financial services firms seeking to act in the best interests of their customers should not fear such an unambiguous rule. Firms seeking to encourage customers to roll over assets should be able to provide clear reasons why it is in the customer's interest to do so based on all relevant information about the customer's financial situation. Unfortunately, permitting ambiguity in the regulation of rollover advice, as the Proposal currently does, will open the door to abuse by firms seeking to drive customers into proprietary products, or products offering higher fees and commissions, regardless of the customers' circumstances. This is a particular problem in the annuity space where not only investors, but also salespersons, often are unable to understand the fees, costs, and restrictions associated with these products.

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[20] *See id.* at 40840 (stating that "the regular basis prong of the five-part test *would be satisfied* when an entity with a pre-existing advice relationship with the Retirement Investor advises the Retirement Investor to roll over assets from a Plan to an IRA. Similarly, for an investment advice provider who establishes a new relationship with a Plan participant and advises a rollover of assets from the Plan to an IRA, the rollover recommendation *may be seen* as the first step in an ongoing advice relationship that could satisfy the regular basis prong of the five-part test depending on the facts and circumstances . . .") (emphasis added).

B. The DOL Should Tighten the Proposal's Standards on Investment Advice Related to Sales Contests, Proprietary Products, and Limited Product Menus.

Under the Proposal, financial services firms can comply with their duties under ERISA by recommending only high commission or proprietary products, or by offering investments from a very limited product menu.[21] Rather than requiring investment professionals to maintain the highest duties of care and loyalty, which Congress expected to impose in ERISA,[22] the Proposal will allow firms to comply with their ERISA duties merely by making disclosures and adopting policies and procedures designed to prevent conflicts.[23] This approach is insufficient to protect retail investors and is far from "the highest duties known to the law," the legal standard set by courts.[24] Both financial services providers and investors would benefit from more specificity regarding the Proposal's restrictions on sales of costly complex products, proprietary products, and use of limited investment menus.

The DOL should consider the SEC's development of Regulation Best Interest. When the SEC initially proposed Regulation Best Interest, it identified practices whose validity would be questionable, including sales contests and preferential treatment in the allocation of investment opportunities, but the SEC did not expressly prohibit these practices in its regulatory proposal.[25] The SEC intended to evaluate these practices on a case-by-case basis to determine whether they were appropriate under the SEC's new regime. NASAA and other investor advocates opposed this imprecise regulatory approach, however, and advocated that the SEC should instead adopt clear, bright-line rules about what would and would not be permissible.[26] The SEC ultimately agreed.

In its Regulation Best Interest adopting release, the SEC amended its proposal and expressly required broker-dealers to implement policies and procedures to "identify *and eliminate* any sales contests, sales quotas, bonuses, and non-cash compensation that are based

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[21] *See id.* at 40847.

[22] *Edmonds v. Hughes Aircraft*, 145 F.3d 1324, 1330 (4th Cir. 1998) ("Congress intended ERISA's fiduciary responsibility provisions to be a codification of the common law of trusts [] and the duties of care and integrity demanded of a fiduciary were among the highest, if not the very highest, known to the common law.") (internal citation omitted).

[23] *Id.*

[24] *See*, *e.g.*, *Braden v. Wal-Mart Stores*, 588 F.3d 585, 598 (8th Cir. 2009) (quoting *Donovan v. Bierunrth*, 680 F.2d 263, 272 n.8 (2d Cir. 1982)).

[25] *See* Regulation Best Interest, SEC Release No. 34-83062, at 53-54 (Apr. 18, 2018), *available at* https://www.sec.gov/rules/proposed/2018/34-83062.pdf.

[26] *See* Letter from NASAA President Joseph Borg to SEC Secretary Brent J. Fields, at 9-10 (Aug. 23, 2018), *available at* https://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Reg-BI-Comment-Letter-8-23-2018.pdf.

on the sales of specific securities or specific types of securities."[27] While NASAA believes that even product-agnostic contests and quotas should be prohibited (since such practices are related solely to compensation rather than investor interest), it is important for the DOL to recognize that the SEC agreed that it should expressly prohibit broker-dealers from "pushing" securities on customers and that the issuance of mere guidance for broker-dealers to follow would be insufficient.[28]

In addition, if the DOL moves forward with the Proposal, it should enumerate clear lines of prohibited conduct. Issuing general guidance on these issues is insufficient, as it will open the door to gamesmanship by unscrupulous firms or individuals. Given that the Proposal purports to align with the SEC's standards of conduct, the DOL should follow the SEC's lead by expressly prohibiting certain incentive practices (and ideally, all forms of sales contests) as such practices are inconsistent with an adviser's fiduciary duties.

C. The DOL Should Strengthen and Clarify the Minimum Disclosure Requirements.

The Proposal states that financial services firms can comply with their disclosure obligations as ERISA fiduciaries "through any disclosure, or combination of disclosures, required to be provided by other regulators so long as the disclosure required by" the proposed rule is met.[29] This standard is woefully insufficient.

The SEC has already found problems with its new Form CRS disclosures instituted as part of Regulation Best Interest. The SEC staff recently conducted a review of Form CRS disclosures to determine whether those disclosures were meeting the standards expected by the Commission under Regulation Best Interest. The SEC staff was not impressed. As the staff explained, "initial reviews have identified examples that may lack certain disclosures or could be clearer or otherwise improved."[30] Moreover, given that Form CRS was never intended by the SEC to establish compliance with ERISA, nor to warn investors of the limits of the proposed exemption, the DOL should not allow firms to rely on Form CRS disclosures to comply with their disclosure obligations under ERISA. To the contrary, the DOL should establish clear, ERISA-focused disclosure obligations. This will require substantial revisions to the Proposal before it could be implemented.

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[27] *See* Regulation Best Interest: The Broker-Dealer Standard of Conduct, SEC Release No. 34-86031, at 768 (June 5, 2019) (emphasis added), *available at* https://www.sec.gov/rules/final/2019/34-86031.pdf.

[28] *Id.* at 353.

[29] *See* Proposal at 40844.

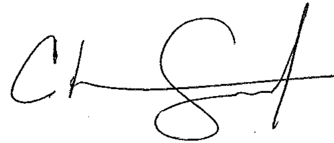
[30] *See* Statement by the Staff Standards of Conduct Implementation Committee Regarding New Form CRS Disclosures (July 27, 2020), *available at* https://www.sec.gov/news/public-statement/staff-form-crs-2020-07-27.

IV. <u>Conclusion</u>

For the reasons outlined above, NASAA cannot support the Proposal. The DOL should rescind the Proposal and establish new standards as described above or, at the very least, revise the Proposal to curtail obvious paths to abuse and forms of conduct prohibited by the SEC under Regulation Best Interest. Thank you for considering these views.

Should you have questions, please contact either the undersigned or NASAA's Executive Director, Joseph Brady, at (202) 737-0900.

Sincerely,



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