WOODSTOCK INSTITUTE

Advancing Economic Security and Community Prosperity

July 20, 2015

Office of Regulations and Interpretations
Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave, N.W.
Washington D.C., 20210

RE: Conflict of Interest Rule, RIN 1210-AB32; Proposed Best Interest Contract Exemption, ZRIN: 1210-ZA25

Dear Secretary Perez,

I am writing on behalf of Woodstock Institute concerning the Department of Labor's (DOL) Notice of Proposed Rulemaking on the Definition of the Term "Fiduciary"; Conflict of Interest Rule (RIN 1210-AB32). Woodstock Institute strongly supports the DOL's proposed rule to clarify that financial advisers and their firms must provide advice and guidance that is in the best interest of the investor and avoid conflicts of interest. The retirement savings landscape has changed dramatically since 1975 when the Department first issued regulations, and the proposed rule strikes the right balance by prioritizing consumer protections while still allowing advisers to receive common forms of compensation as long as they do not create conflicts of interest.

About Woodstock Institute

Woodstock Institute is a leading nonprofit research and policy organization in the areas of equitable lending and investments; wealth creation and preservation; and safe financial products, services, and systems. Woodstock Institute works locally and nationally to create a financial system in which lower-wealth persons and communities of color can safely borrow, save, and build wealth so that they can achieve economic security and community prosperity. Our key tools include: applied research; policy development; coalition building; and technical assistance. Woodstock Institute has been a recognized economic justice leader and bridge-builder between communities and policymakers in this field since it was founded in 1973 near Woodstock, Illinois.

Woodstock Institute has been engaged in research and policy efforts to expand access to retirement savings tools and ensure that more low- and moderate-income workers can easily and safely save for retirement. We published research[i] in 2012 documenting the lack of access to employment-based retirement savings accounts for private-sector workers in Illinois. To address this problem, we worked with policymakers, businesses, and advocates to create the Illinois Secure Choice Savings Program, which was signed into law in January 2015. Over the course of the next two years, Woodstock will assist the Illinois Treasurer, Governor, and the Secure Choice Board as they implement and launch the program. The program will enable workers to automatically save their own money into a Roth Individual Retirement Account (IRA), which will be invested and managed by a private investment company chosen by the Secure Choice Board. Employers with 25 or more employees will automatically enroll workers (who have the option to opt-out) into the program. The default is a three percent payroll deduction into a target date fund. Participants in the program will be putting their hard-earned money into an IRA, and their interests will be protected by the Secure Choice Board's selection and oversight of the investment company managing the funds. Most workers who invest in IRAs, however, don't have such protection, and they badly need it. Those workers deserve to know that when they call the company managing their investment, the financial advice or guidance that they receive is in their best interest and is not just to maximize company profits or the advisor's income. With states across the country considering how to increase access to IRAs and other retirement accounts for workers, it is imperative that DOL close the existing loophole that allows financial advisers to act in their own interest and not in the best interest of investors. If and when programs like Illinois Secure Choice proliferate, millions more Americans will be saving their own money in IRAs. Those investors need to feel confident that they are receiving responsible and sound advice from investment firms and financial advisers.

Existing regulations are weak and do not adequately protect consumers saving for retirement.

The current rule governing fiduciary responsibility was created in 1975 with very different financial market landscape. IRAs had just recently been authorized and were not nearly as widespread as they are today, and 401(k) plans did not even exist. The majority of retirement plans were defined benefit (DB) plans, meaning most workers were not responsible for their own investments and required far less personalized investment advice. According to the DOL, private-sector DB plan participants have declined from 27.2 million in 1975 to 15.7 million in 2012, while the number of participants in private-sector defined contribution (DC) plans increased from only 11.2 million in 1975 to 75.4 million in 2012.

The existing DOL rule includes a five-step test, in which all five steps must be met, to determine whether a financial adviser has fiduciary status. This narrow definition makes it very easy for financial advisers to avoid fiduciary status and the requirements that go along with it. For example, one provision of the test states that an adviser must provide advice "on a regular basis," meaning that if financial advisers are hired by an individual or business for one-time advice, they may not have fiduciary status and could steer the investors towards products and services that benefit the advisers and not necessarily the client. This can be extremely dangerous given that individuals or businesses may be seeking advice on a major financial decision that could have a significant impact on their long-term retirement savings needs. The regularity with which a financial adviser gives advice to an individual or company should not determine whether that adviser has a fiduciary obligation.

Another portion of the five-part test states that there must be a mutual agreement or understanding between the consumer and financial adviser that the advice will be the primary basis for the consumer's investment decisions. This narrow definition allows financial advisers to market advice that appears to be personalized to the individual investor with a statement in fine print disclaiming any such mutual understanding. For average investors, the lack of transparency can be misleading and may lead them to accept and act on advice that is not in their best interest.

Consumers need advice they can trust.

This shift from DB plans to DC plans, with a significant increase in the use of 401(k) plans or IRAs to save for retirement, means more people than ever before are responsible for their own retirement investments. Consumers are faced with complex and confusing systems and a multitude of decisions that can become easily overwhelming. At a minimum, most consumers saving for retirement need to decide how much to save, what type(s) of retirement accounts to use, and which products are best considering their life expectancy, costs, benefits, and risk tolerance.

A recent study by the Securities and Exchange Commission shows that many Americans lack the level of financial literacy to understand important concepts necessary for investing and managing retirement accounts. The study noted that this lack of financial literacy has serious negative implications for people's ability to adequately save for retirement, especially given the increased use of DC plans.[ii] Because many investors are aware of their own lack of expertise, they seek out advice or council from investment firms and financial advisers. Unfortunately, many of these advisers have no fiduciary obligation to the investors, but it is very difficult for the average investor to know who has fiduciary status and who does not. Investors often cannot distinguish between a registered investment adviser, who has fiduciary obligations, and other professionals marketing themselves as financial advisers, retirement planners, and financial managers, who do not.[iii]

Accepting advice from financial advisers who do not act as a fiduciary can be extremely costly for investors. The negative impact of small decisions and costs can add up over time, and investors may be unaware that they are depleting their savings or costing themselves money on long-term investments. The DOL's Regulatory Impact Analysis estimated that underperformance due to these conflicts of interest could cost IRA investors between $210 billion and $430 billion over the next ten years, and between $500 billion and one trillion dollars over the next 20 years. Those estimates are based solely on investments in mutual funds for IRAs, so the overall costs to investors are likely even higher.

The current rule is too narrow and outdated, and threatens the retirement security of millions of Americans. Fortunately, the DOL's proposed rule defining fiduciary status more accurately reflects the statutory definition and ensures that investors seeking financial advice will receive information that is in their best interest.

DOL's proposed rule will benefit consumers.

The proposed rule differs significantly from the current rule. It eliminates the five-part test and makes clear that a person is providing investment advice, thus having fiduciary status, when he or she receives a fee or other compensation for providing advice, or when he or she provides recommendations that are individualized or specifically directed to an employee benefit plan, a plan participant or beneficiary, or an IRA owner or fiduciary. The new rule eliminates the narrow definition that carved out one-time advice and the language referencing the need for mutual agreement on advice being the primary basis for an investor's decisions. The new regulation also clarifies that rollover recommendations are considered investment advice and so would be covered by fiduciary obligations. The new rule ensures that financial advisers cannot evade fiduciary obligations on technicalities and protects consumers seeking critical financial advice.

Because the new definition is quite broad, the DOL rule includes specific carve-outs to distinguish between certain relationships that are not fiduciary in nature. These include:

- *Seller's Carve-Out* – This proposed rule allows financial advisers to make sales recommendations to a fiduciary of a large employer-sponsored plan (one with at least 100 participants or at least $100 million in assets) without imposing a fiduciary duty. The carve-out acknowledges that large plan fiduciaries have enough expertise to determine potential sales-related conflicts of interest. The carve-out does not apply to smaller plan fiduciaries or retail investors.

- *Education Carve-out* – This exemption is a modification of the existing rule. Similar to the status quo, the proposed rule allows firms and financial advisers to provide educational information and materials without triggering a fiduciary status. This sort of information could include materials describing products, costs, benefits, risks and information on historical returns, or asset allocation models that display different individuals with varying time profiles and risk profiles. The new rule clarifies, however, the distinction between general information and specialized, individualized information that an investor can reasonably expect to act upon.

- *Best Interest Contract Exemption (BICE)* – This particular exemption provides key protections for consumers with IRA plans, while still allowing advisers and firms to collect commission and other sales-related compensation. Advisers and firms must agree by contract that any advice or recommendations are in the consumer's best interest, and fees charged must be reasonable and based on the services provided. In addition, firms will be required to have policies and procedures in place to avoid any harmful effects of conflict of interest, including ensuring that an advisers' pay is not structured to reward them for providing advice that is not in the consumer's best interest. Firms and advisers can be held liable for failure to meet these requirements.

We agree with DOL's position that the proposed rule: creates a definition of fiduciary investment advice that better reflects the statutory language of ERISA and the Internal Revenue Code; accounts for the significant changes that took place in the financial market since 1975; better protects consumers, plan participants, beneficiaries, and IRA owners; and, enacts a reasonable set of exemptions that accommodate current business practices and models, while preventing the harmful effects of conflicts of interest on the quality of advice.

DOL should strengthen its proposed rule by banning mandatory arbitration clauses.

While we support the proposed regulations, we encourage DOL to strengthen the rules by banning mandatory arbitration clauses in investment contracts. These sorts of clauses deprive investors of their right to a trial by judge or jury. Arbitrators are not required to explain their decisions and their decisions are almost impossible to appeal. Arbitration should be an option that is used voluntarily when both parties decide it is the best option. Binding, mandatory arbitration, leads to an opaque and unfair process that benefits the brokerage industry and not retail investors, and should be banned from investment contracts.

Conclusion

Woodstock Institute appreciates the opportunity to comment on the DOL's proposed rule. We believe that the existing rule defining a fiduciary standard is outdated and too narrow, and can cause investors to make financial decisions that are not in their best interest. We support the proposed rule and believe it institutes important and necessary consumer protections without eliminating an adviser's ability to receive common forms of compensation without conflicts of interest. We do believe the rule would be even stronger if it banned mandatory arbitration clauses and allowed investors their right to a trial. The millions of Americans who save for retirement need these protections. We urge the DOL to finalize and implement this rule as quickly as possible.

Sincerely,

Courtney Eccles
Vice President of Policy
Woodstock Institute

[i] Spencer Cowan. Coming Up Short: The Scope of Retirement Insecurity Among Illinois Workers. Woodstock Institute. September, 2012. http://www.woodstockinst.org/sites/default/files/attachments/comingupshort_sept2012_cowan_0.pdf

[ii] Study Regarding the Financial Literacy Among Investors, As Required by Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act. Staff of the Office of Investor Education and Advocacy of the U.S. Securities and Exchange Commission. August, 2012. http://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf

[iii] Angela A. Hung*, et al.,* Investor and Industry Perspectives on Investment Advisers and Broker-Dealers. Rand Corporation, sponsored by the U.S. Securities and Exchange Commission. January, 2008. https://www.sec.gov/news/press/2008/2008-1_randiabdreport.pdf