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Fiduciary Responsibility

House Democrats Seek Dialogue With DOL On Conflict-of-Interest Rule Re-Proposal

Thirty House Democrats have requested to have a “dialogue” with Secretary of Labor Thomas E. Perez about the agency’s re-proposal of the rules expanding the definition of fiduciary before the rules are submitted to the Office of Management and Budget.

The representatives, members of the New Democrat Coalition, including coalition Chairman Rep. Ron Kind (D-Wis.), said in a Jan. 13 letter that they have two main concerns to discuss with Perez regarding the yet-to-be proposed rules, also called the conflict-of-interest rules. The first concern is that any new definition of “fiduciary” should not “limit access to investment education and information.”

The representatives also said that all regulatory efforts on the fiduciary front need to be coordinated with other regulators “in a way that serves retirement savers effectively.”

“With respect to fiduciary standards, a key objective of the Dodd-Frank Act was to protect investors while reducing confusion. That should be an important consideration in the Department’s coordination with other regulators.”

—LETTER FROM DEMOCRATS TO LABOR SECRETARY

The letter was posted Jan. 22 to the website of Financial Services Institute, a group that advocates on behalf of independent financial services firms and advisers.

A DOL spokesman told Bloomberg BNA Jan. 22 that the agency has not yet sent a formal response.

Latest Effort. The letter is the latest effort by Democrats in Congress to address concerns regarding the DOL’s proposal to change the definition of fiduciary under the Employee Retirement Income Security Act and how efforts by the Securities and Exchange Commission and the department would impact the financial services industry.

In August, 10 Senate Democrats sent a letter to Office of Management and Budget Director Sylvia M. Burwell, expressing their concerns that the re-proposed rule

would work at “cross-purposes with efforts by the Securities and Exchange Commission’s to create a uniform standard of care for broker-dealers and investment advisers (153 PBD, 8/8/13; 40 BPR 1938, 8/13/13).

The House on Oct. 29 passed a bill (H.R. 2374) that would prohibit the DOL from amending its rules defining the term “fiduciary” under ERISA until the SEC creates its rules. The bill passed by a margin of 254-166, with 30 Democrats crossing party lines to vote for the legislation, which was introduced by Rep. Ann Wagner (R-Mo.) (210 PBD, 10/30/13; 40 BPR 2553, 11/5/13). The measure hasn’t advanced in the Senate.

However, six House Democrats issued a letter prior to the vote in which they urged opposition to H.R. 2374.

An official from the Securities Industry and Financial Markets Association also recently said the DOL said wait to issue its proposed rule until the SEC issues its own proposal (see related article in this issue) (13 PBD, 1/21/14).

‘Coordinated Effort.’ The New Democrat Coalition describes itself as “the pro-growth, fiscally-responsible wing of the Democratic Party.” The coalition also played a major role in the Dodd-Frank Wall Street Reform and Consumer Protection Act, the letter to the labor secretary said.

“With respect to fiduciary standards, a key objective of the Dodd-Frank Act was to protect investors while reducing confusion. That should be an important consideration in the Department’s coordination with other regulators,” the letter said.

Sheila Grant, legislative and communications director for Rep. John Carney (D-Del.), one of those who signed the letter, told Bloomberg BNA Jan. 21 that the lawmaker “supports a coordinated effort by both the DOL and the SEC to examine the definition of fiduciary in order to ensure that investors are protected without putting undue burdens on small businesses, individuals and others who offer investment advice.”

Carney also thinks that a “new regulatory framework for brokers, dealers and investment advisers has to protect the interests of retail investors, retirement plan participants and sponsors from unfair and deceptive practices as they seek investment advice,” but that “any new framework should be crafted carefully to avoid unintended consequences like limiting access to investment education and information for working families,” Grant said.

Carney hasn’t met with Perez, and doesn’t have any meetings with him scheduled, Grant said.

Carney is a member of the Financial Services Committee and co-chair of the coalition’s Financial Services and Retirement Security Task Force.

Industry, Investor Reaction. “The financial industry is spending millions of dollars to spread misinformation on the Hill about a new fiduciary rule in order to stop the Department of Labor from modernizing its rules, which are terribly out of date,” Karen Friedman, executive vice president and policy director for the Pension Rights Center, told Bloomberg BNA Jan. 22. “This misinformation has been spread to all offices—regardless of party affiliation,” she said.

The center has been working closely with the AARP, AFL-CIO, the Consumer Federation of America and other groups to provide support to the DOL in pushing forward with its re-proposal. The groups have separately and together sent letters to lawmakers on the fiduciary issue, Friedman said.

Although some parties have said that broker-dealers’ concerns are based on opposition to being required to act in the best interest of their customers, that is not the actual basis of their concerns, Kent A. Mason, a partner in the Washington office of Davis & Harman LLP, told Bloomberg BNA Jan. 24.

“The broker/dealer industry generally supports application of the best interest standard. Broker/dealers are concerned about the DOL’s fiduciary project because if they are required to be fiduciaries, the DOL’s prohibited transaction rules would prohibit them from providing investment services with respect to individual retirement accounts and retirement plans, even if those services are in the best interest of the customer,” Mason said in an e-mail.

The prohibition would be based on the way that broker-dealers can be compensated, including through commissions and fully disclosed indirect compensation from mutual funds, Mason said.

The agency met with strong opposition after releasing its original proposed rules in October 2010, in part because it did not include prohibited transaction exemptions dealing with the broker-dealer industry (203 PBD, 10/22/10; 37 BPR 2305, 10/26/10). The DOL has since then informally indicated that it will update some existing PTEs and issue new ones in its re-proposed rules that will address broker-dealer arrangements.

However, Mason said, the exemptions “may not be enough to cover the standard broker/dealer arrange-

ment, putting broker/dealers in the situation of not being able to provide services with respect to IRAs and retirement plans.”

U.K. Example. After the U.K. finalized rules with an effect very similar to the originally proposed DOL rules, many leading advisers, including the four major British banks—HSBC, Lloyds, Royal Bank of Scotland and Barclays—that deal with smaller investment accounts, all changed their policies to directly or indirectly cease providing advice to those small accounts, Mason said. Parliament, regulators and business all took notice of the effect of the rules, and the government expressed concern about the resulting decline in services available to small accounts, Mason said.

However, the U.K. example may have little to do with the ERISA fiduciary rules, Michael Finke, a professor in the Department of Personal Financial Planning at Texas Tech University, told Bloomberg BNA Jan. 22. “My guess is that this has everything to do with compensation and little to do with being held to a fiduciary standard,” Finke said.

“I interviewed commission-compensated brokers in states that did and did not have a stricter legal fiduciary standard of care and found little difference in their ability to cater to lower wealth clients,” Finke said. Finke’s study on his findings, “The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice,” was published in 2012 in the *Journal of Financial Planning*.

Finke said that while he expects that some providers will leave the market if the re-proposed rules become effective, “others will likely take their place as balances in defined contribution plans grow for average investors.”

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The New Democrat Coalition letter is at <http://www.financialservices.org/uploadedFiles/Letter-to-Secretary-Perez-DOL-Fiduciary-Rule.pdf>.