PENSION RIGHTS CENTER

PROTECTING AND PROMOTING RETIREMENT SECURITY
1050 30th Street NW | Washington, DC 20007
P: 202-296-3776 | F: 202-833-2472 | www.pensionrights.org

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

Attention: Definition of Fiduciary—RIN 1210-AC02

Dear Assistant Secretary Gomez:

The Pension Rights Center (the Center) submits the following comments on the Department of Labor's proposed regulation revising the definition of investment advice fiduciary. The Center is a nonprofit consumer organization that has been working since 1976 to protect and promote the retirement security of American workers and their families.

The proposed regulation would modify current regulations, adopted one year after ERISA's enactment, which tightly circumscribed the circumstances under which a person or entity becomes a fiduciary when providing financial advice for a fee to either a plan or a participant about investment of plan assets. The regulations adopted what is now referred to as a five-part test, which characterizes one-time advice, no matter how significant, as something other than fiduciary advice, and allows most investment advisors to bypass fiduciary status by using boilerplate language indicating that the advisor's services "are not intended to be the primary basis for investment decisions regarding plan assets." The latter factor makes fiduciary status for an investment advisor voluntary; the former factor means that advice to remove assets from a plan to invest in another investment vehicle, such as an individual retirement account, will seldom, if ever, result in the advisor being considered a fiduciary.

Under the regulations, a significant portion of the investment advice industry can provide unsophisticated retirement savers with conflicted and suboptimal investment advice rather than advice in the best interests of the retirement saver.

The regulatory five-factor definition seems unmoored from the statutory language defining fiduciary, which makes a person who gives investment advice respecting plan assets for a fee, whether direct or indirect, a fiduciary. The preambles to the regulations, both proposed and final, provide no real explanation as to why investment advice had to be provided on a continuous basis nor why there had to be a mutual agreement that the advice will be the primary basis for investment decisions concerning a plan's assets.[1]

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[1] It is plausible that the Department in 1975, proposed less than a year after ERISA's enactment, wanted to reassure banks and other financial institutions that the new statute did not create legal and professional uncertainty with their continuing financial interaction with plans. Moreover, 1975 predated the line of Supreme Court cases that held that it was not possible to obtain legal relief against non-fiduciaries, so the question of fiduciary status would not have appeared as legally consequential as it does today.

But the shortcomings of the five-factor test were modest in the retirement plan landscape as it existed in 1975. Most employees fortunate enough to be covered by a retirement plan at the time participated in defined benefit plans, few of which offered a lump sum benefit option. The term “rollover” and “IRA” had only just been invented and IRAs comprised a miniscule portion of national retirement savings. Participants in defined contribution plans typically had a fractional interest in the plan’s investment portfolio, which was usually managed by sophisticated investment professionals who were fiduciaries because of their ability to exercise control over plan assets or by virtue of ERISA § 402(c)(3). The mass migration to self-directed individual investment accounts was still in the future. And 401(k) brokerage accounts—indeed 401(k) plans themselves—did not yet exist. Thus, in 1975, people and entities giving financial advice with respect to retirement plan assets gave that advice almost exclusively to sophisticated plan fiduciaries capable of evaluating investment opportunities and identifying an advisor’s possible conflicts of interest.

It would have required Cassandra-like clairvoyance for the Department of Labor in 1975 to predict that the intervening decades would elevate the individual participant to a central role in investment and retirement distribution strategies and thus to become of necessity a significant consumer of investment advice.[2] Such an individual retirement investor will generally

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[2] Two other points are relevant here: first the Department of Labor employees who crafted the regulations had little expertise in fiduciary regulation, having been transferred to the Pension Welfare Benefits Administration after the enactment of ERISA; and second, consumer-oriented groups and labor organizations apparently failed to comment on the proposed rule, so there was little counterpoint to industry

expect relationships with investment professionals to be infused with trust and confidence in circumstances where a sophisticated plan fiduciary would not. As a result, an ill-conceived rule that once caused only occasional harm today whittles away at the retirement security of millions of American workers and their families.

- First, the proposed rule's consistency with the Fifth Circuit panel decision in *Chamber of Commerce of the United States of America v. United States Department of Labor ("Chamber v. DOL)*[3], which vacated an earlier DOL rule replacing the 1975 regulation;

- Second, why a national fiduciary standard is central to ERISA's statutory structure and function;

- Third, why the proposed rule will not harm moderate and low-income retirement savers;

- Fourth, why the proposed rule should apply to institutional retirement investors;

- Fifth, why the proposed rule should not be revised to provide a safe-harbor carve-out for so-called sophisticated investors; and

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support of the rule. Indeed, the Pension Rights Center was founded in 1976 and the National Employment Lawyers Association, with whom we filed comments on an earlier proposed investment fiduciary rule, in 1985.

[3] 885 F.3d 360 (5^{th} Cir. 2018)

- Sixth, the effects of conflicts of interest in rollover transactions.

1. **The Proposed Rule Is Consistent with the Fifth Circuit Holding in *Chamber v. DOL.***

In 2015, DOL proposed a new to replace the 1975 investment-advice fiduciary regulation. In 2016, the Department issued a final rule that reflected many of the comments received by individuals, consumer advocacy groups, plan sponsors, and the retirement industry. That rule, which the Center strongly supported, was upheld by a Texas district court.[4] On appeal, in a 2-1 decision that the Department accepted without seeking reconsideration *en banc* from the Fifth Circuit or *certiorari* from the Supreme Court, reversed the district court and vacated the rule and related prohibited transaction exemptions *in toto*. The Department responded by restoring the 1975 rule.[5]

The Department's decision not to appeal was, in our view, unfortunate, because the ruling by two judges (out of the four who ruled on the case) decided an issue of great national significance, whose ultimate resolution should have been rendered by the nation's highest court.[6]

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[4] *Chamber of Commerce of the United States of America v. Hugler*, 231 F. Supp. 3d 152 (N.D. Tex. 2017).

[5] See 85 Fed. Reg. 40589 (July 7, 2020).

[6] We note that a district court in the District of Columbia also upheld the rule against a broad challenge. *See National Association for Fixed Annuities v. Perez,* 217 F. Supp. 3d 1 (2016). In all, then, 3 federal judges believed the regulation valid and 2 federal judges believed the regulation was invalid. At the very least, this suggests that under Chevron, the statute itself was ambiguous.

These comments, however, do not take direct issue with the Fifth Circuit decision, although we regard the decision as incorrectly decided. Rather, our view is that the proposed rule at issue now is consistent with the Fifth Circuit's holding and reasoning.

The Fifth Circuit decision was principally based on its view that the ERISA definition of investment fiduciary reflected the common law conception of a fiduciary relationship, which arises when a relationship involves trust and confidence.[7] The Fifth Circuit indicated its view that the 1975 regulation properly distinguished a broker or salesperson from a fiduciary by requiring that the person giving advice do so on a regular basis pursuant to a mutual agreement, arrangement or understanding that such services will serve as a primary basis for the plan's investment decisions and that the advice is based on the particular needs of the plan. These regulatory requirements indicated that the relationship between the plan and the adviser was one of trust and confidence.

The 2016 rule, in contrast, included several components. It first defined the types of advice that would be considered investment advice. It next indicated that a person who gave a "recommendation" that included investment advice would be a fiduciary if that person

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[7] The Fifth Circuit also ruled that the Department overreached its authority when one of the prohibited transaction exemptions required an IRA to enter a best interest contract with its customer, which created a private cause of action. The Fifth Circuit held that Congress did not give the Department regulatory authority over IRAs. Neither the proposed rule, nor the accompanying PTEs, require a similar best interest contract as a condition for an exemption.

> “(i) Represents or acknowledges that it is acting as a fiduciary within the meaning of the Act or the Code;
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> (ii) Renders the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is based on the particular investment needs of the advice recipient; or
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> (iii) Directs the advice to a specific advice recipient or recipients regarding the advisability of a particular investment or management decision with respect to securities or other investment property of the plan or IRA.

The regulation then went on to define “recommendation” as:

> a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action. The determination of whether a “recommendation” has been made is an objective rather than subjective inquiry. In addition, the more individually tailored the communication is to a specific advice recipient or recipients about, for example, a security, investment property, or investment strategy, the more likely the communication will be viewed as a recommendation. Providing a selective list of securities to a particular advice recipient as appropriate for that investor would be a recommendation as to the advisability of acquiring securities even if no recommendation is made with respect to any one security. Furthermore, a series of actions, directly or indirectly (*e.g.*, through or together with any

> affiliate), that may not constitute a recommendation when viewed individually may amount to a recommendation when considered in the aggregate. It also makes no difference whether the communication was initiated by a person or a computer software program.

The regulation also included numerous carve outs.

The majority opinion, although not engaging in a close analysis of the actual regulatory language, concluded that it was broader than the statute permitted, creating fiduciary status in some situations where the relationship was not centered on trust and confidence —for example, in the case of a broker whose primary function was executing a buy or sell transaction and whose advice was merely incidental to that primary function.

The 2023 proposed rule, by contrast, is narrower and more sharply focused. The rule's primary operative provision provides that a person is an investment-advice fiduciary if the person

> renders "investment advice" with respect to moneys or other property of a plan or IRA . . . and . . .
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> (ii) The person either directly or indirectly . . . makes investment recommendations to investors on a regular basis as part of their business and the recommendation is provided under circumstances indicating that the recommendation is based on the particular needs or individual circumstances of the retirement investor and may be relied upon by the retirement investor as a basis for

> investment decisions that are in the retirement investor's best interest . . .[8]

The proposed rule, then, makes a person or entity a fiduciary if the person makes investment recommendations on a regular basis as part of a business *and* provides a recommendation to a potential investor that it claims is based on the particular needs or circumstances of that investor. The regular provision of advice as part of a business suggests expertise and professionalism, and the advisor's claim that the advice is tailored to the investor receiving the advice create the trust and confidence that underlies the Fifth Circuit view of a common law fiduciary relationship.

2. ERISA and the Importance of Uniform Federal Regulation.

ERISA is built on federal regulation of employee benefit plans and except in carefully and explicitly defined exceptions, state law is broadly preempted. Congress was concerned that retirement plans, which are often sponsored by multistate businesses, not be subject to a multitude of laws. ERISA also reflected a Congressional imperative that participants required uniform federal protections in a variety of areas, including

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[8] A person who renders investment advice would also be a fiduciary under the proposed regulations if the person "either directly or indirectly . . . has discretionary authority or control, whether or not pursuant to an agreement, arrangement, or understanding, with respect to purchasing or selling securities or other investment property for the retirement investor . . . or [t]he person making the recommendation represents or acknowledges that they are acting as a fiduciary when making investment recommendations."

vesting, accrual, and fiduciary regulation. Notwithstanding this animating statutory principle, many segments of the investment industry argue that state law adequately regulates standards of conduct for those who provide investment advice services that are not treated as securities under Federal securities regulation, for example, investments in crypto currency, precious metals, and certain annuity contracts, including fixed indexed annuities. Yet states differ widely in the standards they apply to the conduct of people recommending and selling such investment products, differ in enforcement efforts when there are violations of the applicable standards, and differ in whether individuals have private causes of action in state courts.

ERISA seeks uniform standards, both for plans and their fiduciaries, as well as for participants. Forgoing federal regulation in favor of a multiplicity of inconsistent state laws is inconsistent with ERISA's purpose and structure.

We also note that in enacting ERISA, Congress focused on protecting the interests and expectations of participants in retirement plans. And the Federal government, through its large annual tax subsidization of qualified retirement plans and individual retirement accounts, has a strong interest in creating an environment in which participants are able to maximize their retirement savings, reducing old age poverty. Many retirement investors are financially unsophisticated and have little retirement wealth outside their retirement plan (and perhaps home ownership). Such individuals should not be subject to different protective fiduciary standards based on the products in which they may be advised to invest or the states in which they reside.

Retirement savers often have different needs than people investing to achieve other goals. For example, complicated annuity products such as deferred fixed indexed and variable annuity contracts, are often purchased by wealthy investors attracted to the tax benefits of such contracts. But a typical retirement saver already possesses the tax deferral benefits embedded in such contracts and has no need to purchase them. And fixed indexed annuity contracts have been widely criticized for including expensive features to limit risk, which for younger retirement savers may be undesirable and for those who are risk averse may be a more expensive risk-limiting tool than simply investing in less risky stocks and bonds. Too often a sales pitch for such products is disguised as disinterested advice.

3. Access of Low and Moderate Retirement Investors' Access to Investment Advice.

Some spokespeople for the investment industry have suggested that the proposed regulation will reduce access to retirement advice if such advice must be focused solely on the best interest of the retirement saver. This argument is at odds with the resilience and adaptability of the investment advice market and additionally assumes that conflicted advice is ever desirable.

But it may be true that under the proposed rule, some investment advisers will not be able to use certain business models in which their objectivity is compromised by serious conflicts of interest. Will these advisers abandon the retirement savings market? Perhaps some will, but we are confident, given the size and importance of the market, that most will adapt and that other advice firms will fill any void. And in our view, those who are unwilling to eschew serious conflicts have no business advising retirement-plan participants.

4. Investment Advice to Retirement Plans and Plan Fiduciaries Should be in the Best Interest of the Plan and Its Participants.

The SEC best-interest standard for investment advice from broker-dealers applies to retail but not institutional clients. But when those institutional clients are retirement plans or their fiduciaries, they are acting on behalf of the individual retirement savers who participate in those plans and should receive advice in the best interest of the plan (and its participants), undistorted by an advisor's own pecuniary interests. Without the proposed regulations, however, plans and institutional fiduciaries would not be entitled to advice designed solely for the best interests of the plan and its participants.

Some suggest that plans and their fiduciaries should be presumed to be sufficiently sophisticated that they should be able to identify a sales pitch disguised as advice. But particularly in the case of plan fiduciaries of small businesses, this will not always be the case. And the proposed regulations leave a sophisticated plan fiduciary and an investment salesperson or entity considerable latitude to shape their relationship to avoid fiduciary status for the salesperson.

5. Advice to Sophisticated Retirement Investors.

Similar to the argument that non-retail customers are sufficiently sophisticated that they are able to identify and evaluate conflicts of interest and the appropriateness of a recommended investment, some have argued that wealthy, educated people should be presumed to be able to protect themselves from a salesperson's conflicting financial interests. But having financial resources and being well educated are no proxy for the kind of sophistication that allows a retirement investor to identify and evaluate conflicts of interest or the value of complex investment account.

We incorporate in our testimony an article written by Ron Rhoades entitled *An X-Ray of one affluent, educated, and sophisticated investor's portfolio shows how it was chewed up by fees.* [9] The subject of the article provided testimony on behalf of the Center on December 3rd at the Department's hearing on the proposed rule.

6. Rollover Advice is Investment Advice.

A participant in either a defined contribution plan, or a defined benefit plan with an elective lump sum benefit option, faces a consequential choice at retirement or separation from service: leave the benefit in the plan or take a lump sum, which will generally be rolled over to an individual retirement plan (or annuity).

Often the better alternative is to leave the benefit in the plan. In the defined benefit plan, the participant will receive an annuity

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[9] The article is available at https://riabiz.com/a/2013/8/12/an-x-ray-of-one-affluent-educated-and-sophisticated-investors-portfolio-shows-how-it-was-chewed-up-by-fees.

and in some cases the participant will receive a subsidized annuity (either a joint and survivor annuity for the participant and spouse or an early retirement annuity), with the subsidy not reflected in the lump sum amount. And the participant will seldom be able to use the lump sum to purchase an equivalent annuity. And in defined contribution plans, management and investment fees are generally lower in the plan than in a rollover IRA. In addition, a plan's investment options are screened by a plan fiduciary.

An investment professional giving advice in these circumstances often faces a conflict of interest. If the advice is to forgo the lump sum, the investment adviser will likely receive no compensation. If the advice is to take the lump sum, however, the adviser will likely receive substantial fees, immediately and in the future.

An article I co-authored with two pension economists, John Turner, and Bruce Klein, shows how an investment professional's advice can be skewed by the advisor's financial interests. *See* Turner, Klein, and Stein, *Financial Illiteracy Meets Conflicted Investment Advice: The Case of Thrift Savings Plan Rollovers,* 3 Journal of Retirement 47 (2014).[10] In the paper, we reported on a secret shopper exercise, in which one of my co-authors asked 15 investment advisory firms whether they would advise a rollover from Federal Thrift Savings Plan (the plan) to an IRA. At the time, the fees for the plan's investment options were under 3 basis points and the options generally outperformed their benchmarks even before fees. Yet, ten of the

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[10] The article is available at https://gflec.org/wp-content/uploads/2015/04/Turner-0408Assessing-the-Standard-for-Financial-Advice.pdf.

representatives with whom we spoke affirmatively recommended a rollover, and four firms declined to provide advice but suggested that a rollover would be a good idea, because of expanded investment choice. In only one case did the representative suggest that it would probably be good to leave the money in the plan because of the low costs and strong performance of the investment options.

This exercise suggests that the advisers were either poorly trained to offer competent investment advice, which is unlikely, or that were primarily motivated by their own pecuniary interests. Although our survey was done a decade ago, we are far from confident that much has changed.

We also note that it is increasingly common for defined benefit pension plans that do not otherwise provide lump sum benefit options to be amended to provide a lump sum option during a specified time window, especially when a plan is engaged in a pension risk transfer. And we further note that the Center has received numerous calls from plan participants who had been solicited by investment professionals to take a lump sum in such circumstances and invest it with them.

Conclusion

The Department deserves praise for developing these proposed regulations. The economic impact on the nation’s retirement savings and in improving the security of older Americans is well documented in the rule’s preamble and greatly exceeds the costs of implementation and regulatory compliance with the rule. And we hope that the investment industry will work with the

Department to refine the regulations and exemptions so that they will reduce the impacts of conflicts of interest, while minimizing compliance costs and uncertainty. That would be good for participants, the industry, and the nation.

Respectfully submitted,

Norman P. Stein
Senior Policy Advisor
Pension Rights Center
1050 30th Street, NW
Washington, DC. 20007

205-410-0989