Congressional Research Service
Informing the legislative debate since 1914

Department of Labor's 2015 Proposed Fiduciary Rule: Background and Issues

John J. Topoleski
Analyst in Income Security

Gary Shorter
Specialist in Financial Economics

April 1, 2016

Congressional Research Service
7-5700
www.crs.gov
R44207

Summary

On April 20, 2015, the Department of Labor (DOL) proposed redefining the term *investment advice* within pension and retirement plans. Under the Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406), a person who provides investment advice has a fiduciary obligation, which means that the person must provide the advice in the sole interest of plan participants. Thus, redefining the term investment advice could affect who is subject to this fiduciary standard.

Regulations issued in 1975 define investment advice using a five-part test. To be held to ERISA's fiduciary standard with respect to his or her advice, an individual must (1) make recommendations on investing in, purchasing, or selling securities or other property, or give advice as to the value (2) on a regular basis (3) pursuant to a mutual understanding that the advice (4) will serve as a primary basis for investment decisions, and (5) will be individualized to the particular needs of the plan. DOL proposed broadening the term's definition to capture activities that currently occur within pension and retirement plans, but do not meet the existing definition of investment advice.

The proposed rule would replace the current five-part test with a more inclusive definition. **Table 1** in this report compares the current and proposed definitions. For example, under the current regulation, an individual must provide advice on a regular basis to be a fiduciary, which generally would not include recommendations on whether or not to roll over a 401(k) account balance to an Individual Retirement Account (IRA). The expanded definition would remove the requirement that advice be given on a regular basis.

Securities brokers and dealers who provide services to retirement plans and who are not fiduciaries under current regulations are not required to act in the sole interests of plan participants. Rather, their recommendations must meet a *suitability standard* which requires that recommendations be suitable for the plan participant, given factors such as an individual's income, risk tolerance, and investment objectives. The suitability standard is a lower standard than a fiduciary standard. Under DOL's proposed regulation, brokers and dealers could be considered fiduciaries when they provide recommendations to participants in retirement plans.

In addition to broadening the definition of investment advice, the rule would provide carve-outs for situations that would not be considered investment advice. For example, providing generalized investment or retirement education would not be considered investment advice under the proposed rule.

The proposed rule is accompanied by proposed prohibited transaction exemptions (PTEs) and proposed amendments to existing PTEs. These proposals would allow fiduciaries to continue to engage in certain practices that would otherwise be prohibited (such as charging commissions for products that they recommend or having revenue-sharing agreements with third parties).

DOL first proposed broadening the definition of investment advice in October 2010. The proposed regulation generated much controversy and was withdrawn in September 2011. The revised proposals issued in April 2015 also have generated considerable controversy. Following the release of the proposals, DOL received public comments and held three and a half days of public hearings on the proposals. DOL has not indicated when it expects to issue the final rule.

In the 114th Congress, bills have been introduced that would, among other provisions, delay or prohibit the implementation of a final rule or establish a best interest standard for advice in retirement plans.

H.R. 1090, the Retail Investor Protection Act, would prohibit DOL from issuing a final rule on the definition of investment advice until at least 30 days after the SEC were to issue a rule for the standards of conduct for brokers and dealers. On October 27, 2015, H.R. 1090 passed the House of Representatives.

H.R. 3020 and S. 1695, the Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 2016, would prohibit DOL from using any funds to finalize, implement, administer, or enforce the proposed fiduciary regulation.

H.R. 3922, the Retirement Choice Protection Act of 2015, would (1) transfer authority for issuing regulations on IRAs from DOL to the Department of the Treasury and (2) establish a best interest standard for fiduciaries who provide investment advice.

H.R. 4293, the Affordable Retirement Advice Protection Act, and H.R. 4294, the Strengthening Access to Valuable Education and Retirement Support Act of 2015 (or the SAVERS Act of 2015), would, among other provisions, add a statutory definition of investment advice and a best interest prohibited transaction exemption. In addition, the bills would require Congress to approve of investment advice regulations that have been issued after January 1, 2015. Companion legislation has been introduced in the U.S. Senate. S. 2502, the Affordable Retirement Advice Protection Act, was introduced by Senator Johnny Isakson on February 4, 2016, and S. 2505, the SAVERS Act of 2016, was introduced by Senator Mark Kirk on February 4, 2016.

Contents

Tables

Contacts

Overview

On April 20, 2015, the Department of Labor (DOL) issued a proposed rule that would expand the definition of *investment advice* within employer-sponsored private-sector pension plans and Individual Retirement Accounts (IRAs).[1] Individuals who provide recommendations that meet the definition of investment advice are held to a *fiduciary* standard, which is a higher standard of conduct than for individuals who provide recommendations that do not meet the definition. Individuals who are held to fiduciary standards are required to act solely in the interests of plan participants and beneficiaries. Therefore, expanding the definition of investment advice may increase the number of individuals held to this higher standard.

Background on Pensions, Individual Retirement Accounts, and Investments

Although most workers can expect to become eligible to receive Social Security benefits after the age of 62, a number of tax-advantaged methods of preparing for retirement might also be available to them.[2] For example, their employers might sponsor a pension plan or the workers might establish and contribute to IRAs to use as a source of income in retirement.

Pension Plans

A pension plan is established and operated by a plan sponsor. The plan sponsor is the employer (or, in the case of a multiemployer pension plan, the representatives appointed by the employers) that establishes or maintains an employee benefit plan, such as a pension plan.[3]

A pension plan may be either a single employer plan or a multiemployer pension plan, depending on the number of employers sponsoring it. A single employer pension is sponsored by one employer and provides pension benefits to that company's employees. Multiemployer plans are operated pursuant to a collective bargaining agreement.[4] In a multiemployer plan, two or more employers and one or more unions collectively sponsor a pension plan and workers earn pension benefits when they work for any employer that is a sponsor of the plan.

The two types of employer-sponsored pension plans are defined benefit (DB) and defined contribution (DC) pension plans.

Defined Benefit Pension Plans

Participants in DB pension plans receive monthly payments in retirement. The payment amount is calculated using a formula established by the plan. The formula used by single-employer plans is typically different from the formula used by multiemployer plans.

[1] See Department of Labor (DOL), Employee Benefits Security Administration (EBSA), "Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice; Proposed Rule," 80 *Federal Register*, April 20, 2015.

[2] For more information on the tax treatment of retirement savings, see U.S. Congress, Joint Committee on Taxation, *Present Law and Background Relating to the Tax Treatment of Retirement Savings*, prepared by Joint Committee on Taxation, 112th Cong., 2nd sess., JCX-32-12, April 13, 2012.

[3] See 29 U.S.C. §1002(16)(B).

[4] Some single employer plans are also operated as part of a collective bargaining agreement.

In most single employer plans, participants receive a monthly payment in retirement that is based on a formula that typically uses a combination of length of service, accrual rate, and average of final years' salary. In collectively bargained single-employer and multiemployer DB pension plans, the payment is typically calculated as the length of service with employers that contribute to the plan multiplied by a dollar amount.

The pension plan provides these payments for the lifetime of the worker after retirement. Plan participants who are married receive a joint-and-survivor annuity, which is an annuity payable for the lifetime of the participant or the participant's spouse, whichever is longer.[5] Many DB pension plan participants are offered the option to receive their benefit as a single, lump-sum benefit payment.

DB pension plans in the private sector are generally funded entirely by employer contributions. DOL data in 2011 indicated that among private-sector workers who participated in DB plans, 4% were required to make an employee contribution to the plans.[6]

The Federal Reserve reported that there were $3.1 trillion in assets in private-sector DB pension plans at the end of 2014.[7]

Defined Contribution Pension Plans

Workers in DC pension plans typically contribute a percentage of their wages to an individually established account. Employers may also contribute a match to the DC plan, which is an additional contribution equal to some or all of the worker's contribution. The account accrues investment returns and is then used as a basis for income in retirement. DC plans do not provide guarantees of lifetime income, unless participants purchase an annuity. Examples of DC plans are 401(k), 403(b), and 457(b) plans, and the Thrift Savings Plan (TSP).[8]

The Federal Reserve reported that there were $5.4 trillion in assets in private-sector DC pension plans at the end of 2014.[9]

IRAs

IRAs are tax-advantaged accounts that individuals (and their spouses) can establish to accumulate funds for retirement. Any individual under the age of 70½ who has earnings from work may establish and contribute to an IRA.[10] The two types of IRAs are differentiated primarily by the tax treatment of contributions and distributions. Contributions to traditional IRAs may be tax

[5] A married participant may choose to receive a single-life annuity (payments for the life of the participant only) with the consent of the spouse.

[6] See DOL, *National Compensation Survey: Employee Benefits in the United States*, March 2011, at http://www.bls.gov/ncs/ebs/benefits/2011/ebbl0048.pdf.

[7] See Board of Governors of the Federal Reserve System, *Financial Accounts of the United States*, p. Table L.118.b, http://www.federalreserve.gov/releases/z1/Current/z1.pdf.

[8] The plans, apart from the Thrift Savings Plan (TSP), are named for the section of the tax code that authorized them. Private-sector employers establish 401(k) plans, public school systems and nonprofits establish 403(b) plans, and state and local governments and nonprofits establish 457(b) plans. The TSP is a DC plan for federal government employees.

[9] See Board of Governors of the Federal Reserve System, *Financial Accounts of the United States*, p. Table L.118.c, http://www.federalreserve.gov/releases/z1/Current/z1.pdf.

[10] A spouse may make contributions to a non-working spouse's Individual Retirement Account (IRA).

deductible,[11] and distributions are included in taxable income.[12] Contributions to Roth IRAs are not tax deductible, but distributions are not included in taxable income.

Individuals may rollover their lump-sum payment from a DB plan or their DC plan assets to an IRA or another employer-sponsored DC plan.[13] A *rollover* is the transfer of assets from an IRA or employer-sponsored plan to an IRA or employer-sponsored plan upon separation from the original employer at job change or at retirement.[14]

The Federal Reserve reported that there were $7.4 trillion in assets in IRAs at the end of 2014.[15]

Investment Options in Defined Contribution Plans and IRAs

Participants in DC pension plans and IRAs typically have a number of investment options from which to choose. Common options include mutual funds, company stock, and variable annuities.

A *mutual fund* is a company that invests in stocks, bonds, and other financial securities and assets.[16] Mutual funds are regulated by the Securities and Exchange Commission (SEC) under the Investment Company Act of 1940 (P.L. 76-768).

IRA owners and sometimes DC pension plan participants may own the stock of individual companies. The stock of the employer that sponsors the plan is sometimes an investment option within DC plans.

An *annuity* is an insurance product in which an investor receives a regular (typically monthly) payment beginning at a specified date for the lifetime of the investor (and spouse or other designated person if the investor chooses). To acquire the annuity, the investor makes either a one-time purchase or a series of purchase payments. A fixed annuity pays a specified regular payment, whereas a variable annuity’s payments may change depending on the performance of the investment options the investor chooses. Generally, annuities are regulated by the state in which they are sold; variable annuities are also subject to SEC regulation.[17]

Investment products are typically bought and sold using securities brokers and dealers. A *broker* is an individual engaged in the business of buying and selling securities for the account of

[11] Contributions to traditional IRAs are tax deductible for individuals who (1) are not covered by a pension plan at work or (2) are covered by a pension plan at work but who have income under specified thresholds. The income thresholds are available in CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*.

[12] Distributions before the individual is aged 59½ are subject to an additional 10% tax penalty unless one of the exceptions found in 26 U.S.C. 72(t) applies. See CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*.

[13] Some rollovers, such as transfers from a Roth 401(k) plan to a traditional IRA are not allowed. See the Internal Revenue Service (IRS) Rollover Chart at http://www.irs.gov/pub/irs-tege/rollover_chart.pdf.

[14] More information on IRAs is available in CRS Report RL34397, *Traditional and Roth Individual Retirement Accounts (IRAs): A Primer*, by John J. Topoleski.

[15] See Board of Governors of the Federal Reserve System, *Financial Accounts of the United States*, p. Table L.117 line 27, http://www.federalreserve.gov/releases/z1/Current/z1.pdf.

[16] Mutual funds are an important part of Americans’ retirement savings: in 2014, about 55% of DC assets and 48% of IRA assets were invested in mutual funds. See Investment Company Institute, *2015 Investment Company Fact Book*, Figure 1.5, http://www.icifactbook.org/pdf/2015_factbook.pdf. Other DC and IRA investments include the stock and bonds of individual companies, and variable annuities.

[17] More information on the regulation of fixed and variable annuities is available from the Insured Retirement Institute at http://irionline.org/government-affairs/annuities-regulation-industry-information and from the Securities and Exchange Commission (SEC) at http://www.sec.gov/investor/pubs/varannty.htm.

others.[18] When an investor buys or sells a security using a broker, the broker acts as the agent for the investor. A *dealer* is an individual who is in the business of buying and selling securities for the individual's own account (often through a broker).[19] Dealers take ownership of securities and use their own inventory of securities for sales and purchases. The term *broker-dealer* is often used because of the overlap in brokers' and dealers' duties and because one financial firm often performs both duties.[20]

A *registered investment adviser* is an individual who advises clients about financial securities such as stocks, bonds, and mutual funds.[21] Investment advisers are regulated by the SEC under the Investment Advisers Act of 1940 (P.L. 76-768).

Regulations for Pension Plans and IRAs

To protect the interests of pension plan participants and beneficiaries, Congress enacted Employee Retirement Income Security Act of 1974 (ERISA; P.L. 93-406). ERISA is codified in the *United States Code* in Title 26 (Internal Revenue Code, or IRC) and Title 29 (Labor Code). ERISA sets standards that pension plans must follow with regard to plan participation (who must be covered); minimum vesting requirements (how long a person must work for an employer to acquire a non-forfeitable right to the benefit earned); plan funding (how much must be set aside to pay for future benefits); and fiduciary duties (standards of conduct for certain individuals who have discretion over plan operations or who provide investment advice to the plan or plan participants). The fiduciary duty requires that individuals such as plan sponsors, administrators, and others who oversee pension plans operate these plans prudently and in the sole interests of plan participants.

ERISA also established the Pension Benefit Guaranty Corporation (PBGC), which is an independent federal agency that insures DB pension plans covered by ERISA.[22] ERISA covers only private-sector pension plans and exempts pension plans established by federal, state, and local governments and by churches.

IRAs were first authorized by ERISA. Provisions that affect IRAs are found only in the IRC. The Labor Code does not have any IRA provisions. However, DOL does oversee employer-sponsored IRA plans such as SIMPLE- and SEP-IRAs.[23]

Role of the Department of Labor and the Department of Treasury

Both DOL and the U.S. Treasury oversee private-sector pension plans and IRAs.[24] Generally, DOL oversees issues concerning the protection of pension plan participants and the IRS, under the Treasury, oversees issues related to contributions to pension plans and taxes. Because IRA

---

[18] See 15 U.S.C §78c(a)(4).

[19] See 15 U.S.C §78c(a)(5).

[20] For more information, see CRS Report R41381, *The Dodd-Frank Wall Street Reform and Consumer Protection Act: Standards of Conduct of Brokers, Dealers, and Investment Advisers*.

[21] For more information, see http://www.sec.gov/investor/pubs/invadvisers.htm. Securities and Exchange Commission, *Investment Advisers: What You Need to Know Before Choosing One*, http://www.sec.gov/investor/pubs/invadvisers.htm.

[22] For more information on PBGC, see CRS Report 95-118, *Pension Benefit Guaranty Corporation (PBGC): A Primer*.

[23] More information on SIMPLE- and SEP-IRAs is available at http://www.dol.gov/ebsa/publications/choosing.html.

[24] The proposed regulation applies to private-sector pension plans. It would not apply to the pension plans of state and local governments, the federal government, and plans operated by churches.

provisions are found only in the IRC, the Treasury oversees most issues regarding IRAs. However, a 1978 executive order, among other things, transferred authority over certain issues regarding prohibited transactions from the Secretary of the Treasury to the Secretary of Labor.[25]

Prohibited Transaction Exemptions

ERISA prohibits certain transactions between a plan and individuals who are fiduciaries. Fiduciaries may not

- deal with the assets of the plan in their own interests or for their own accounts;
- act in any transaction involving the plan on behalf of a party (or represent a party) whose interests are adverse to the interests of the plan or the interests of its participants or beneficiaries; or
- receive any consideration for their own personal accounts from any party dealing with such plan in connection with a transaction involving the assets of the plan.

ERISA allows DOL to issue exemptions to prohibited transactions that allow an individual, a plan, or a group of individuals or plans (a class) to engage in transactions that otherwise would violate ERISA.[26] These exemptions are referred to as prohibited transaction exemptions (PTEs).

Securities and Exchange Commission[27]

The SEC is an independent government agency that regulates many aspects of investing in financial securities such as the offering of securities by companies, the buying and selling of securities by brokers and dealers, and the markets on which securities are bought and sold.

SEC Regulation of Broker-Dealers

Under the Investment Advisers Act of 1940, registered investment advisers are fiduciaries and must act in their clients' best interest. Securities brokers and dealers are not covered by the act if the advice they provide is incidental to the transaction and they do not receive a fee for the advice. Generally, brokers and dealers who receive commissions are not subject to the act.

The Financial Industry Regulatory Authority (FINRA), the self-regulatory organization of securities brokers, requires that recommendations by brokers and dealers be suitable for the customer, taking into account the customer's investment profile.[28]

Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank; P.L. 111-203) required the SEC to conduct a study of (1) the effectiveness of the existing regulatory environment for providing recommendations and investment advice about securities to retail customers; (2) whether statutes or recommendations should be changed to address any shortcomings that were identified; (3) whether the exemption from fiduciary duty for securities brokers and dealers should be eliminated; and (4) the potential costs of eliminating the exemption.

[25] See the Reorganization Plan No. 4 of 1978 at http://www.dol.gov/ebsa/regs/exec_order_no4.html.

[26] The procedures governing the filing and processing of Prohibited Transactions Exemptions are at 29 C.F.R. §2570.30 to 29 C.F.R. §2570.52.

[27] This section was written by Gary Shorter, specialist in Financial Economics.

[28] See Financial Industry Regulatory Authority "(FINRA) Rule 2111, Suitability," at http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=13390&element_id=9859&highlight=2111.

In 2011, the SEC released the mandated report, *Study on Investment Advisers and Broker-Dealers*,[29] which recommended that brokers and dealers be subject to a uniform fiduciary standard that is no less stringent than the standard to which investment advisers are subject.

Protections for Pension Plan Sponsors and Participants

Retirement plans are complex, and individuals often rely on financial services professionals to assist them with their decisionmaking. For example, an employer might seek out assistance in determining what investments to offer in a 401(k) plan they have established; participants in 401(k) plans might seek assistance in choosing their investments from among the options offered by the plan; or workers who participate in employer-sponsored 401(k) plans might seek assistance on whether to leave their 401(k) account balance in the plan or roll it over into an IRA or into another employer's DC plan either upon job change or at retirement.

Standards in Pension Plans

The way in which some financial services professionals are compensated may give rise to conflicts of interests, if these professionals' recommendations result in larger commissions or otherwise benefit them. These potential conflicts could lead to the professionals making recommendations that are not in the interests of their clients. By contrast, some financial services professionals have compensation structures that do not vary based on which products clients choose. This type of compensation structure could mitigate any conflicts of interest.

Individuals who transact with a pension plan may be required to meet certain standards. The standard that applies depends on the individuals' role and the actions they are taking. For example, an individual providing investment advice is subject to the high fiduciary standard, whereas an individual who is acting on the direction of the plan participant to buy or sell a particular security or mutual fund may have a lower standard of duty.

Fiduciary Duty

ERISA Section 3(21)(A) provides that a person is a "fiduciary" to the extent that the person

- exercises any discretionary authority or control with respect to the management of the plan or exercises any authority with respect to the management or disposition of plan assets;
- renders investment advice for a fee or other compensation with respect to any plan asset or has any authority or responsibility to do so; or
- has any discretionary responsibility in the administration of the plan.[30]

An individual who is a fiduciary is required, among other duties, to "discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries."[31] ERISA identifies four standards of conduct: (1) a duty of loyalty, (2) a duty of prudence, (3) a duty to diversify

[29] "Study on Investment Advisers and Broker-Dealers As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act," January 2011, http://www.sec.gov/news/studies/2011/913studyfinal.pdf.

[30] See ERISA §3(21)(A).

[31] ERISA §404(a).

investments, and (4) a duty to follow plan documents to the extent that they comply with ERISA.[32]

Suitability Standard

Other individuals who do not have a fiduciary duty under ERISA may be bound by other standards of conduct. For example, brokers and dealers (who might make recommendations regarding the purchase or sale of securities) may be held to a suitability standard. FINRA, the self-regulatory organization of securities brokers, provides that recommendations be suitable for the customer, taking into account the customer's investment profile.[33]

In some instances, individuals who provide routine services to a plan (such as record keeping) might not be under any standard. In addition, a class of activities relating to the formation of a plan is called settlor functions. These settlor functions include decisions to establish a plan or include certain features or benefits are considered business decisions and are not governed by ERISA.[34]

Investment Advice

As noted above, ERISA Section 3(21)(a) established three situations in which a person qualifies as a fiduciary. The second situation, in which an individual renders investment advice for a fee or other compensation, is the subject of the proposed rule that DOL issued on April 20, 2015. The current rule was promulgated in 1975.

1975 Rule

In 1975, DOL addressed the second of the three actions that render an individual a fiduciary. DOL issued regulations that created a five-part test to determine whether an individual provided investment advice and thus was subject to the fiduciary standard.

To be held to ERISA's fiduciary standard with respect to his or her advice, an individual must (1) make recommendations on investing in, purchasing, or selling securities or other property or give advice as to the value (2) on a regular basis, (3) pursuant to a mutual understanding that the advice (4) will serve as a primary basis for investment decisions and (5) will be individualized to the particular needs of the plan. An investment adviser is not treated as a fiduciary unless each of the five elements of this test is satisfied for each instance of advice.[35]

Proposed and Re-proposed Rule Process

On October 22, 2010, DOL proposed an update to the regulation that would have changed the definition of fiduciary. The proposed rule would have increased the types of activities subject to the fiduciary standard.

---

[32] ERISA §404(a)(1)(A) – 404(a)(1)(D).

[33] See FINRA Rule 2111: Suitability, at http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=13390&element_id=9859&highlight=2111.

[34] See Employee Benefits Security Administration, *Meeting Your Fiduciary Responsibilities*, http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html.

[35] See http://www.dol.gov/ebsa/newsroom/fsfiduciary.html.

The proposed rule generated considerable controversy. DOL received 202 public comments on the proposed rule between October 26, 2010, and February 11, 2011.[36] In addition, DOL held a public hearing in March 2011 in which the views of several stakeholders were heard.[37] Following this public hearing, DOL received 114 public comments, including 45 comments from Members of the House and Senate.[38] On September 19, 2011, DOL announced that it would repropose the rule with the intent of reissuing it in early 2012.[39]

On February 23, 2015, DOL indicated that it was forwarding the reproposed rule to the Office of Management and Budget (OMB) for review. On that same day, President Obama said that he was "calling on the Department of Labor to update the rules and requirements that retirement advisers put the best interest of their clients above their own financial interests."[40] On April 20, 2015, the Employee Benefits Security Administration (EBSA) published the reproposed rule in the *Federal Register*[41] along with two proposed class exemptions that would allow certain transactions to occur that could otherwise be prohibited under ERISA, as well as the proposed amendments to several other existing class exemptions.[42]

The comment period for the proposed rule ended July 21, 2015.[43] DOL held a public hearing during the week of August 10, 2015, with a comment period lasting through September 24, 2015.[44] DOL will then consider the comments and may publish a final rule. Although DOL has not indicated when it will publish the final rule, it proposed that the final rule would be effective 60 days after it is published in the *Federal Register* and that the requirements of the rule would generally become applicable 8 months after publication.

Details of the Proposed Rule

The proposed rule replaces the five-part test with language that describes the activities and communications that, if done for a fee or other compensation, would constitute fiduciary investment advice. The proposed rule also provides a list of activities and communications that would not be treated as investment advice.

The following are the types of activities that constitute investment advice under the proposed rule, if they are done for a fee or other compensation:

- investment recommendations;

---

[36] See http://www.dol.gov/ebsa/regs/cmt-1210-AB32.html#comments.

[37] See http://www.dol.gov/ebsa/pdf/1210-AB32hearingagenda.pdf.

[38] See http://www.dol.gov/ebsa/regs/cmt-1210-AB32.html#phcomments.

[39] Employee Benefits Security Administration, "US Labor Department's EBSA to Re-propose Rule on Definition of a Fiduciary," press release, September 19, 2011, http://www.dol.gov/opa/media/press/ebsa/EBSA20111382.htm.

[40] See The White House, "Remarks by the President at the AARP," press release, February 23, 2015, https://www.whitehouse.gov/the-press-office/2015/02/23/remarks-president-aarp.

[41] See Employee Benefits Security Administration, "Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice; Proposed Rule," 80 *Federal Register* 21928 - 21960, April 20, 2015.

[42] See Employee Benefits Security Administration, "Proposed Best Interest Contract Exemption," 80 *Federal Register* 21960 - 21989, April 20, 2015 and Employee Benefits Security Administration, "Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs," 80 *Federal Register* 21989 - 22004, April 20, 2015.

[43] The comments are available at http://www.dol.gov/ebsa/regs/cmt-1210-AB32-2.html.

[44] See Employee Benefits Security Administration, "Hearing on Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice and Related Proposed Prohibited Transaction Exemptions," 80 *Federal Register* 34869 - 34871, June 18, 2015.

- recommendations as to the advisability of taking a distribution from a plan or IRA;
- recommendations for the investment of securities or other property that are rolled over from a plan or an IRA;
- recommendations for the management of securities or other property, including rollovers from a plan or IRA;
- the appraisal or a fairness opinion of the value of securities or other property if connected with a specific transaction by a plan or IRA; or
- a recommendation of a person to provide investment advice for a fee or other compensation.

The following activities would *not* constitute investment advice under the proposal:

- recommendations made to a plan fiduciary of a plan that has 100 or more participants or has at least $100 million in plan assets;
- selection and monitoring assistance if an individual is identifying alternatives that meet objective criteria specified by the plan fiduciary or is providing objective financial data and benchmarks;
- marketing by platform providers who market to a plan without regard to the individual needs of the plan or the plan's participants;[45]
- appraisals for Employee Stock Ownership Plans (ESOPs), though ESOPs might see their own regulations; and
- provision of investment education, such as information about the plan, general financial, investment, and retirement information.

The proposal provides that the following individuals would not be subject to the fiduciary standard:

- swaps dealers;[46]
- employees of the plan sponsor or employee organization provided they do not receive compensation for the advice beyond their normal compensation;
- individuals who engage in executing securities transactions.

Prohibited Transaction Class Exemptions

In addition to requiring plan fiduciaries to adhere to certain standards of conduct, ERISA prohibits fiduciaries from engaging in specified transactions deemed likely to injure a pension plan. Section 406(b) of ERISA bars certain transactions between a plan and a party of interest[47] with respect to a plan. A number of exemptions from the prohibited transactions exist, both in statute and via DOL-issued exemptions to individuals or classes of individuals.

---

[45] A platform provider is a service provider who provides a pension plan sponsor investment options from which the sponsor can choose to include in the plan.

[46] A swap is a type of financial contract in which two parties agree to exchange (or "swap") payments with each other as a result of changes in things such as a stock price or interest rate. For more information, see http://www.sec.gov/News/Article/Detail/Article/1365171492905.

[47] ERISA §(3)(14) lists, among others, the following as parties of interest: plan fiduciaries, a person providing services to the plan, an employer that has employees covered by the plan.

Accompanying the 2015 proposed rule that would update the definition of investment advice, DOL has proposed a best interest contract (BIC) exemption so that certain broker-dealers and others who act as plan fiduciaries would be able to continue to receive compensation that would otherwise be prohibited. For example, absent the exemption, fiduciaries would not be able to receive commissions, load fees, or 12b-1 fees as a result of their advice.[48]

The proposed BIC exemption would require compliance with certain conditions, including the following:

- The financial institution must acknowledge fiduciary status in a contract with the retirement investor.
- The financial institution must adhere to impartial conduct standards, which include acting in the best interest of the retirement investor[49] and not accepting more than reasonable compensation.[50]
- The financial institution must warrant that it has adopted written policies to mitigate the impact of conflicts of interest and must disclose whether the financial institution offers proprietary products or receives third-party payments for the purchase, sale, or holding of any asset that it offers.
- Prior to the execution of a transaction, the financial institution must provide an individual disclosure the to the retirement investor of the acquisition, ongoing, and disposition costs (if any) of the investment.
- Retirement investors must receive annual disclosures from the financial institution.
- Each financial institution relying on the exemption must maintain a web page that describes the types of compensation payable to the adviser and to the financial institution in connection with each asset that could be purchased. The web page must be updated at least four times per year.
- The financial institution must notify DOL that it intends to rely on the exemption and it must maintain records of its compliance with the exemption. DOL may request the records.

[48] Brokers and dealers often receive commissions (also known as loads) as a result of a sale of a security. Rule 12b-1 fees are annual fees that may be charged by mutual funds from fund assets to pay for promotional costs and commissions to brokers and other salespeople. More information on mutual fund fees is available at http://www.sec.gov/answers/mffees.htm.

[49] The proposed regulation defines *best interest* as "advice that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party."

[50] The regulation does not define *reasonable compensation* but notes that it depends on the particular facts and circumstances of the transaction.

Comparison of Current and Proposed Rule

Table 1 compares the definition of investment advice under DOL's current regulation and under the proposed regulation.

Table 1. Investment Advice in Private-Sector Employer-Sponsored Retirement Plans and Individual Retirement Accounts (IRAs)

(Department of Labor's current and 2015 proposed rule)

Current Rule	2015 Proposed Rule
An investment adviser is a fiduciary if all of the following apply: (1) the adviser makes recommendations on investing in, purchasing, or selling securities or other property, or gives advice as to their value; (2) the adviser provides the advice on a regular basis; (3) the advice is provided pursuant to a mutual understanding; (4) the advice will serve as a primary basis for investment decisions; and (5) the advice will be individualized to the particular needs of the plan. Investment advisers who are fiduciaries can only receive compensation if it is for a level fee unless they are covered by an appropriate Prohibited Transaction Exemption (PTE). Brokers and dealers who are not fiduciaries are subject to the Security and Exchange Commission's suitability standard which says that recommendations must be "suitable" for the investor. Brokers and dealers, when not acting as fiduciaries, may receive compensation in the form of commissions and other fees that vary depending on the financial product purchased. The current rule does not apply to IRAs. However, IRAs are subject to prohibited transaction provisions in the Internal Revenue Code.	A person would be considered a fiduciary if he or she receives a direct or indirect fee and provides a recommendation regarding: • the purchase or sale of securities or other property; • the advisability of taking a distribution from a plan or IRA; • the investment of securities or other property that are rolled over from a plan or an IRA; • the management of securities or other property including rollovers from a plan or IRA; • the appraisal or a fairness opinion of the value of securities or other property if connected with a specific transaction by a plan or IRA; or • a recommendation of a person who is going to provide investment advice for a fee or other compensation. Brokers and dealers who are not fiduciaries would continue to be subject to the Security and Exchange Commission's suitability standard. Commissions and third-party fees would be prohibited unless a broker or dealer abides by the best interest contract (BIC) or another exemption. The BIC would allow current compensation practices to continue provided the individual or financial institution agrees to provide advice in the best interest of the retirement investor and to adhere to other provisions that would ensure that the best-interests standard is met. The proposed rule would apply to IRAs.

Source: Congressional Research Service analysis of Department of Labor's regulation that defines investment advice (29 C.F.R. §2510.3-21) and the April 20, 2015, proposed regulation.

Issues

The proposed fiduciary rule has generated much controversy. Controversial issues include questions about the Obama Administration's rationale for the rule; concerns about the rule's effect on small businesses and small investors; and suggestions that DOL should wait for the SEC to issue a rule requiring a fiduciary standard for securities brokers and dealers.

Administration's Perspective

The Obama Administration has put forward several reasons explaining the need to update the definition of investment advice. These reasons include changes in how Americans prepare for retirement, quantitative estimates of the cost of conflicted financial advice, and concerns regarding rollovers from DC plans to IRAs when workers change jobs or retire.

Changes in How Americans Prepare for Retirement

DOL argues that the definition of investment advice needs to be updated because the nature of how Americans prepare for retirement has changed since 1975.[51] In the mid-1970s, Americans who participated in an employer-sponsored pension plan most likely participated in a DB pension. Since then, the number of participants in DB plans has decreased and the number of participants in DC plans has increased. According to DOL data on participation counts,[52] in 1975, 74% of participation in private-sector plans was in DB pension plans and 26% was in DC plans; by 2012, 31% of participation in private-sector plans was in DB pension plans and 69% was in DC plans.[53] Participants in DC plans have more decisions to make than participants in DB plans (such as decisions on contribution amounts, investment allocations, rollovers, and withdrawals). Because financial decisions can be complicated, DC plan sponsors sometimes provide investment advice or investment education to plan participants. In addition, retirement investors may receive outside help with these decisions.

Evidence in Support of Rule

The Obama Administration's rationale for the need to update the investment advice rule is laid out in two documents: (1) a February 2015 report from the Council of Economic Advisers (CEA) on conflicted investment advice[54] and (2) the Regulatory Impact Analysis (RIA) by DOL that was released with the proposed rule.[55]

The CEA estimates that conflicted advice costs IRA investors about $17 billion per year. This cost is a result of both (1) lower investment returns of funds purchased and (2) higher fees associated with investments recommended as result of conflicted advice.

Some have said that the CEA analysis is flawed. For example, one report critical of the CEA analysis said that the conclusions in the academic literature that CEA cites are more nuanced than in the CEA analysis. This report also said that the CEA analysis does not attempt to quantify the benefits that brokers provide under current regulations.[56]

---

[51] See, for example, Department of Labor, Employee Benefits Security Administration, "Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice; Proposed Rule," 80 *Federal Register* 21934, April 20, 2015.

[52] Pension plans report to DOL the number of participants in their plans. Because individuals can be in more than one plan, the number of participants reported by DOL overstates the total number of participants.

[53] See U.S. Department of Labor, Employee Benefits Security Administrations, *Private Pension Plan Bulletin Historical Tables and Graphs*, December 2014, Table E-5, http://www.dol.gov/ebsa/pdf/historicaltables.pdf.

[54] See Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings*, February 2015, https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

[55] See Employee Benefits Security Administration, *Fiduciary Investment Advice: Regulatory Impact Analysis*, April 14, 2015, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

[56] See Jeremy Berkowitz, Renzo Comolli, and Patrick Conroy, *Review of the White House Report Titled, "The Effects of Conflicted Investment Advice on Retirement Savings,"* NERA Economic Consulting, March 15, 2015, http://www.nera.com/content/dam/nera/publications/2015/PUB_WH_Report_Conflicted_Advice_Retirement_Savings_0315.pdf.

Among the points the RIA made in support of the proposal are the following:

- The structure of the market in which retirement plans operate creates conflicts of interest that are not adequately addressed by current regulations. For example, a GAO report indicated that plan sponsors may be confused as to whether their advisers are subject to a fiduciary standard.[57]
- Advisers that offer advice to plans regarding which investment options to include in their plans (platform providers) might have fee arrangements that create conflicts of interest. For example, a platform provider might have a revenue sharing arrangement in which the provider receives a commission when particular investment options are included in a plan.[58]
- DOL has found enforcement challenges because it must demonstrate that an individual meets each element of the five-part test. For example, when a DB plan terminates, in order to guarantee participants' future benefits, the plan must purchase annuity contracts for each of the plan participants. However, the purchase of these annuity contracts would be a one-time event that does not meet the requirement for advice to be provided on a regular basis. An adviser providing recommendations on the purchase of the contracts thus might not be considered a fiduciary.[59]
- IRA investors might be particularly vulnerable to advisers' conflicts of interest, even in the existing regulatory framework. The RIA indicated that IRA investors would see gains from the proposal of between $40 billion and $44 billion over 10 years and compliance costs would be between $2.7 billion and $5.7 billion over 10 years.[60]
- The RIA also looked at changes to the investment advice regulation in Great Britain (which implemented new regulations on financial advisers in January 2013). Some have expressed concerns about the impact of the proposal on investors with smaller account balances.[61] The RIA concluded that there had been little impact on the ability of small investors to receive advice.[62]

Some stakeholders have questioned the validity of the evidence in the RIA and claim that the RIA does not justify the adoption of the proposed rule. For example, in a comment letter to DOL, the Investment Company Institute (ICI) challenged the RIA's conclusion that mutual funds that are sold by securities brokers underperform relative to other mutual funds. ICI also argued that the

[57] See U.S. Government Accountability Office, *Improved Regulation Could Better Protect Participants from Conflicts of Interest*, GAO-11-119, January 28, 2011, http://www.gao.gov/assets/320/315363.pdf.

[58] See Employee Benefits Security Administration, *Fiduciary Investment Advice: Regulatory Impact Analysis*, Section 4.2.1.3, Platform Providers, page 141, April 14, 2015, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

[59] See Employee Benefits Security Administration, *Fiduciary Investment Advice: Regulatory Impact Analysis*, Section 4.2.3, Department Enforcement Challenges, p. 149, April 14, 2015, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

[60] See Employee Benefits Security Administration, Fiduciary Investment Advice: Regulatory Impact Analysis, Section 3.3.1, Quantified Gains to Investors, p. 101, April 14, 2015, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

[61] See, for example, PFS Investments, Inc. of Primerica Inc., *Comment Letter of DOL's Proposed Conflict of Interest Rule*, July 21, 2015, http://www.dol.gov/ebsa/pdf/1210-AB32-2-00615.pdf.

[62] See Employee Benefits Security Administration, *Fiduciary Investment Advice: Regulatory Impact Analysis*, pp. 42-47, April 14, 2015, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

RIA failed to account for the societal harms as a result of the rule (for example, some investors might lose access to investment advice).[63]

Concerns Regarding Rollovers from DC Plans to IRAs

The Obama Administration and other policymakers have expressed concerns regarding rollovers from DC plans (such as 401(k) accounts) to IRAs.[64] In addition, the SEC included as one of its 2014 examination priorities the sales practices of investment advisers who target retirement-aged workers to roll over their account balances to higher-cost investments.[65] One reason for the concern is the large amount of funds that are rolled over from employer-sponsored plans to IRAs. According to ICI, in 2012, 87% of traditional IRAs were opened by individuals making rollovers from employer-sponsored plans.[66] ICI indicated that in 2010, $288 billion was transferred from employer-sponsored pension plans to IRAs.[67]

A Government Accountability Office (GAO) report issued in March 2013 found that, upon separation from their employer, due to job change or retirement, individuals do not always receive recommendations that are in their best interest. The report also identified several factors encouraged them to roll over their 401(k) account balances to IRAs.[68] For example, plan participants often find the process confusing; there is a lack of assistance from their employers; and the marketing of IRAs by financial institutions is pervasive and may be misleading, particularly with regard to fees.[69]

Pension plan participants have a variety of factors to consider when making the decision to roll over an account balance from a 401(k) plan to an IRA. For example, the fees in a 401(k) plan are typically lower than in an IRA (because of economies of scale); IRAs often offer a greater number and variety of investment options; individuals sometimes prefer to consolidate 401(k) plans from multiple jobs into a single IRA; and ERISA's fiduciary protections generally do not apply to IRAs.

[63] See Investment Company Institute, *Public Comment to Conflict of Interest Proposed Rule (Regulatory Impact Analysis)*, July 21, 2015, http://www.dol.gov/ebsa/pdf/1210-AB32-2-00749.pdf.

[64] See, for example, See Employee Benefits Security Administration, *Fiduciary Investment Advice: Regulatory Impact Analysis*, April 14, 2015, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf and U.S. Senate Committee on Health, Education, Labor, and Pensions, "GAO Uncovers Troubling Practices Carried Out by Financial Firms That Drain Americans' 401(k) Retirement Savings in Report Requested by Sen. Harkin, Rep. Miller, and Sen. Nelson," press release, April 2013, http://www.help.senate.gov/ranking/newsroom/press/gao-uncovers-troubling-practices-carried-out-by-financial-firms-that-drain-americans-401k-retirement-savings-in-report-requested-by-sen-harkin-rep-miller-and-sen-nelson.

[65] The SEC examination priorities target areas that the SEC believes to have heightened risk. See Securities and Exchange Commission, *Examination Priorities for 2014*, January 9, 2014, http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf.

[66] See Investment Company Institute, *2015 Investment Company Factbook*, Figure 7.19, https://www.ici.org/pdf/2015_factbook.pdf.

[67] See Investment Company Institute, *The Role of IRAs in U.S. Households' Saving for Retirement, 2014*, ICI Research Perspective, vol. 21, no. 1, January 2015, p. 14, https://www.ici.org/pdf/per21-01.pdf.

[68] See U.S. Government Accountability Office, *401(k) Plans: Labor and IRS Could Improve the Rollover Process for Participants*, GAO-13-30, March 7, 2013, http://www.gao.gov/products/GAO-13-30.

[69] Upon separation from employment, DC plan participants might have the option to maintain their accounts with the plan, although there are some circumstances in which an employer can force a rollover.

Recognizing concerns over the IRA rollover market, in December 2013, FINRA (the securities industry self-regulating association) issued guidance reminding broker-dealers that their recommendations regarding rollovers into IRAs needed to adhere to the suitability standard.[70]

In 2005, DOL issued an advisory opinion that a recommendation regarding a rollover decision is *not* investment under current regulations and *not* subject to a fiduciary standard under ERISA.[71] The proposed rule would supersede the 2005 advisory opinion on recommendations regarding rollovers from 401(k) accounts to IRAs and would consider recommendations regarding rollovers to be investment advice subject to the proposed rule.

Perspectives from Stakeholders

As evidenced by the comments DOL has received, stakeholders (such as Members of Congress, financial services professionals and firms, and advocacy groups) have a variety of views on the proposed rule. Some support the rule, some broadly support the goals of the proposed rule but disagree on the specifics of the rule, and others oppose the rule.[72]

Support for Best Interest Standard

Professionals in the financial services industry have indicated that they support a best interest standard; that is, they feel that they should be required to operate in the best interest of their clients. Many have indicated that they already do so. For example, at a congressional hearing, one witness indicated that "the vast majority of the financial services industry is completely fine with being required to act in the best interest of their customers."[73] Another witness said that his financial services company "acts in the best interest of its clients and … support[s] a best interest fiduciary standard."[74] Although many financial services professionals support the best interest standard, they also feel that the proposed rule may not be the way to achieve it because certain aspects may be too challenging to implement. For example, a large financial services firm indicated that the rule would be "unworkable" and would prevent the firm from "providing investment assistance that plans, participants and IRA owners need to invest successfully for retirement."[75]

[70] See Financial Industry Regulatory Authority (FINRA), *FINRA Reminds Firms of Their Responsibilities Concerning IRA Rollovers*, Regulatory Notice 13-45, December 2013, https://www.finra.org/sites/default/files/NoticeDocument/p418695.pdf.

[71] The Advisory Opinion applies only with respect to ERISA. See Employee Benefits Security Administration, *Deseret Mutual Benefit Administrators*, Advisory Option 2005-23A, December 7, 2005, http://www.dol.gov/ebsa/regs/aos/ao2005-23a.html.

[72] The public comments to the proposed rule and the webcast of DOL's public hearing are available at http://www.dol.gov/ebsa/regs/cmt-1210-AB32-2.html.

[73] See Testimony of Kent A. Mason of Davis & Harman LLP before the Subcommittee on Health, Employment, Labor, and Pensions of the House Education and Workforce Committee for the hearing entitled Restricting Access to Financial Advice: Evaluatin[g] the Costs and Consequences for Working Families and Retirees, June 17, 2015, http://democrats.edworkforce.house.gov/sites/democrats.edworkforce.house.gov/files/Mason%20Testimony.pdf.

[74] See Testimony of John F. "Jack" Haley, Jr. Executive Vice President, Fidelity Investments Before a hearing of the House Committee on Education and the Workforce Subcommittee on Health, Education, Labor, and Pensions, June 15, 2015, http://edworkforce.house.gov/uploadedfiles/testimony_haley.pdf.

[75] See Fidelity Investments, *Comment Letter to the Department of Labor on the Definition of the Term Fiduciary*, http://www.dol.gov/ebsa/pdf/1210-AB32-2-00658.pdf.

Rule Could Restrict Firms from Offering Own Products

Marketing materials from financial institutions might currently contain information about products that a particular financial institution offers. Such communications could be prohibited under the proposed rule. For example, a financial adviser could recommend having a particular class of mutual fund as an investment option but might not be allowed to indicate that his or her financial institution offers a particular fund. The chief executive officer of a large financial services firm said that "the proposed rule effectively makes it a conflict of interest to sell your own products."[76]

Disclosures and Compliance Under the Proposed Rule

One of the concerns expressed by some industry professionals about the BIC exemption is that the many disclosures required from service providers make it unworkable. Fiduciary advisers that make use of the BIC exemption would be required to enter into a written contract with the plan or IRA investors; provide information about the costs of the investments prior to the purchase (including acquisition and ongoing costs); disclose via a public web page the compensation arrangements with third parties; and maintain records about the investments and returns for six years for analysis by DOL.

One financial services professional testified that

> [t]hese disclosure requirements, some of which conflict with existing FINRA requirements, are completely unworkable, would confuse workers, and do nothing to help them better understand potential conflicts. We believe a single disclosure of material conflicts of the adviser, including compensation payable to the adviser in connection with the recommended transactions, will best support the purpose of a best interest standard."[77]

Potential Harm to Small Businesses

Small businesses do not fall under the seller's carve-out. The carve-out provides that advisers to certain plans are not fiduciaries if the plan has (1) 100 or more participants or (2) $100 million or more in plan assets. Because small plans, by definition, are not covered by these thresholds, advisers to small plans would be fiduciaries.[78]

Under the proposal, advisers to small plans would not be able take advantage of the BIC exemption and would be fiduciaries. They would generally be required to provide their services for a level fee. Advisers who are fiduciaries can receive commissions from mutual funds provided they offset the fees paid by the plan by the amount of the commissions received.[79] Because of the

---

[76] See Katherine Chiglinsky and Selina Wang, "MetLife Says Fiduciary Rule Threatens Ability to Advise," *Bloomberg BNA Benefits Practice Resource Center*, July 30, 2015.

[77] See Testimony of John F. "Jack" Haley, Jr. Executive Vice President, Fidelity Investments Before a hearing of the House Committee on Education and the Workforce Subcommittee on Health, Education, Labor, and Pensions, June 15, 2015, http://edworkforce.house.gov/uploadedfiles/testimony_haley.pdf.

[78] Advisers to plans in which the participant does not make investment choices would be able use the BIC exemption. In 2012, among DC plans with less than 100 participants, 6% of participants are in plans in which the participant did not direct any investments. See U.S. Department of Labor, *Private Pension Plan Bulletin: Abstract of 2012 Form 5500 Annual Reports*, January, p. Table D6.

[79] See Pension and Welfare Benefits Administration (PWBA) (note: since 2003 PBWA is the Employee Benefits Security Administration (EBSA)), *PWBA Office of Regulations and Interpretations*, Advisory Opinion 97-15A, http://www.dol.gov/ebsa/programs/ori/advisory97/97-15a.htm.

disruption to the business model, some have suggested that some advisers may exit the market rather than try to comply with the new regulations.[80] As a result, the sponsors of small pension plans that do not fall under the seller's carve-out might find that financial institutions are unwilling to provide advice to them. In congressional testimony, one service provider said that the DOL's proposed regulation would "severely restrict our ability to continue providing this assistance to small businesses.... "[81]

View of Some Consumer Advocacy Groups

Some consumer advocacy groups are supportive of the DOL proposal although a comprehensive survey of their views is beyond the scope of this report. For example, the Consumer Federation of America indicated their "strong support"[82] for the proposal. AARP is also supportive of the proposal.[83] Finally, the AFL-CIO urged DOL "to act quickly to finalize its proposal."[84]

Coordination with SEC[85]

Some Members of Congress and some financial services companies have suggested that the SEC and DOL should better coordinate their efforts to create a uniform fiduciary standard for all advisers, including registered investment advisers and broker-dealers.[86] Because DOL is further along in the process than the SEC, some have viewed this suggestion as a delaying tactic.[87]

DOL addressed the suggestion that DOL wait for the SEC to complete its rulemaking. DOL noted that under current law, fiduciary standards are different under ERISA and the IRC compared with the standards under the Investment Advisors Act. It also noted that in ERISA, Congress provided higher standards of conduct because of the importance of retirement plans and IRAs to retirement income security and because of the tax advantages they receive.[88]

Although the SEC chair has indicated her desire to move forward with the fiduciary rule for securities brokers and dealers, she has not indicated when it will do so. In March 2015, SEC Chair Mary Jo White observed "that broker-dealers and investment advisers should be subject to a uniform fiduciary standard of conduct when providing personalized securities advice to retail

---

[80] See, for example, U.S. Chamber of Commerce, *Locked Out of Retirement: The Threat to Small Business Retirement Savings*, June 9, 2005, https://www.uschamber.com/report/locked-out-retirement-threat-small-business-retirement-savings.

[81] See Testimony of John F. "Jack" Haley, Jr. Executive Vice President, Fidelity Investments Before a hearing of the House Committee on Education and the Workforce Subcommittee on Health, Education, Labor, and Pensions, June 15, 2015, http://edworkforce.house.gov/uploadedfiles/testimony_haley.pdf.

[82] See Consumer Federation of America, *Comment Letter on DOL's Proposed Conflict of Interest Rule*, July 21, 2015, http://www.dol.gov/ebsa/pdf/1210-AB32-2-00660.pdf.

[83] See AARP, *Comment Letter of DOL's Proposed Conflict of Interest Rule*, July 21, 2015, http://www.dol.gov/ebsa/pdf/1210-AB32-2-00695.pdf.

[84] See American Federal of Labor and Congress of Industrial Organizations (AFL-CIO), Comment Letter of DOL's Proposed Conflict of Interest Rule, July 21, 2015, http://www.dol.gov/ebsa/pdf/1210-AB32-2-00697.pdf.

[85] This section was written by Gary Shorter, Specialist in Financial Economics, gshorter@crs.loc.gov, 7-7772.

[86] See, for example, Comment Letter from Members of the Majority of the House Committee on Education and the Workforce to Thomas E. Perez, Secretary of Labor, July 21, 2015, http://www.dol.gov/ebsa/pdf/1210-AB32-2-00772.pdf.

[87] See *Written Testimony from Save Our Retirement*, Setting the Record Straight on the Industry's Unworkable Claims, August 12, 2015, http://www.dol.gov/ebsa/pdf/1210-AB32-2-WrittenTestimony16.pdf.

[88] See Employee Benefits Security Administration, *Fiduciary Investment Advice: Regulatory Impact Analysis*, pages 191 – 193, April 14, 2015, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

investors."[89] This idea provoked some criticism from some of her fellow SEC commissioners.[90] Chair White also announced that she had asked the staff to "develop rulemaking recommendations" for implementing the uniform fiduciary goal.[91]

Chair White, a Democratic appointee, identified several basic hurdles to accomplishing such rulemaking, which has no timetable. Among them are

- defining the nature of the fiduciary standard;
- providing clear guidance on what that standard would entail; and
- providing for the "meaningful application, examination, and consistent enforcement of a uniform fiduciary standard."[92]

In addition, by early September 2015, the two Republican SEC Commissioners, Daniel M. Gallagher Jr. and Michael S. Piwowar, had publicly criticized the goal of a uniform fiduciary standard.[93] Adoption of policy proposals and policy rules requires a majority vote of the five SEC commissioners. No more than three of the five commissioners may belong to the same political party.[94]

Reportedly citing an inadequate agency budget, Chair White also observed that the SEC has not been able to adequately supervise all the investment advisers under its regulatory ambit. As a component of its future fiduciary rule-making, she reportedly also recommended that the agency considering adopting a system under which third parties would augment the agency's examination of the advisers.[95]

Another aspect of the fiduciary policy discourse is the question of whether the DOL or the SEC should be first to complete their fiduciary standard rulemaking. For example, a number of securities industry officials have argued the SEC should take the lead over the DOL in promulgating new duty of care for broker-dealers.

Proponents of the SEC taking the lead include Kenneth Bentsen, president and chief executive of the Securities Industry and Financial Markets Association (SIFMA, a large trade group of

[89] See Testimony of SEC Chair Mary Jo White, chair of U.S. Securities and Exchange Commission, U.S. Congress, House Committee on Financial Services, *Examining the SEC's Agenda, Operations and FY 2016 Budget Request*, hearing, 114th Cong., 1st sess., March 24, 2015.

[90] For example, see Remarks at the National Association of Plan Advisors D.C. Fly-In Forum by Commissioner Michael S. Piwowar, September 30, 2014, http://www.sec.gov/News/Speech/Detail/Speech/137054307713; and Remarks at The SEC Speaks in 2015 by Commissioner Daniel M. Gallagher, February 20, 2015, http://www.sec.gov/news/speech/022015-spchcdmg.html.

[91] Testimony of Mary Jo White, chair of U.S. Securities and Exchange Commission, U.S. Congress, House Committee on Financial Services, Examining the SEC's Agenda, Operations and FY 2016 Budget Request, 114th Cong., 1st Session.

[92] Ibid.

[93] For example, see Commissioner Michael S. Piwowar, Remarks at the National Association of Plan Advisors D.C. Fly-In Forum, September 30, 2014, at http://www.sec.gov/News/Speech/Detail/Speech/1370543077131, and Commissioner Daniel M. Gallagher, Remarks at The SEC Speaks in 2015, February 20, 2015, at http://www.sec.gov/news/speech/022015-spchcdmg.html.

[94] Republican Commissioner Daniel Gallagher announced that he was leaving the SEC on October 2, 2015. "Statement of Commissioner Daniel M. Gallagher," *SEC*, September 4, 2015, http://www.sec.gov/News/Speech/Detail/Speech/1370543077131. Democratic commissioner Luis Aguilar has been a commissioner at the SEC since 2008, and his term expired in June 2015, however commissioners are allowed to stay on until a presidentially-appointed replacement.

[95] For example, see SEC Chief White Backs Fiduciary Rule for Brokers, *Think Advisor*, March 17, 2015, at http://www.thinkadvisor.com/2015/03/17/sec-chief-white-backs-fiduciary-rule-for-brokers.

securities firms, banks, and asset managers), who reportedly made the argument that the agency has the advantage of "technical expertise."[96] Similarly, an official of another industry stakeholder, Richard Ketchum, chairman and chief executive officer of the Financial Industry Regulatory Authority (FINRA, the self-regulatory organization of securities brokers), has said that the SEC is in the best position to implement a new industry-wide standard of fiduciary care.[97]

By contrast, arguing that the SEC is likely to be "locked in a conflict on this [fiduciary rulemaking] issue for a long, long time" and that the agency has become "divided philosophically" on whether to pursue the fiduciary rulemaking, former SEC Chairman Arthur Levitt reportedly claimed that the DOL fiduciary rule should be allowed to be the standard, albeit how imperfect it might be.[98]

An official from another stakeholder group, Dennis Kelleher, president and chief executive officer of the investor advocacy group Better Markets, appeared to argue for the SEC and DOL being allowed to promulgate fiduciary rules at their unique individual paces. Mr. Kelleher reportedly observed that the SEC and DOL "have different statutes, missions and jurisdictions, and that it is important for both agencies to act on their separate mandates" and that neither "should be subordinated to the other."

Further elaborating, Mr. Kelleher noted that "after many years of broad and deep consultation and deliberation [DOL], is very far along in [the process of] satisfying its independent duty to protect Americans' tax-advantaged retirement savings by closing loopholes." And of the SEC's efforts, the Better Markets head reportedly said that the agency "is many years behind the DOL" in deliberating on a fiduciary standard, talking to the various stakeholders, and "getting to the point where it might be appropriate to even propose a rule."[99]

In responses to questions directed at her during a hearing before the House Subcommittee on Financial Services and General Government Committee on Appropriations on March 22, 2016, SEC Chair Mary Jo White observed that while the agency was developing its own uniform fiduciary rule for brokers and advisors, the prospective rule would probably not be identical to the DOL's forthcoming fiduciary rule.

Elaborating, Chair White said that if there was "a DOL rule that preceded ours [the SEC's] and overlapped, we would continue to talk about coordination and making our rules and the regime as compatible as possible. [Such rules] don't always land identically; you try to make them land identically if you can, but [the SEC and DOL] are separate agencies, [with] separate statutory mandates."[100]

---

[96] David Picon, "FINRA Chairman: SEC Should Lead on Uniform Fiduciary Standard," *Monday Business Briefing*, May 9, 2015, https://global.factiva.com/ha/default.aspx#./!?&_suid=144182834416306855690777468446.

[97] See Financial Industry Regulatory Authority, *Richard G. Ketchum, Chairman and Chief Executive Officer, Remarks From the 2015 FINRA Annual Conference*, May 25, 2015, https://www.finra.org/newsroom/speeches/052715-remarks-2015-finra-annual-conference.

[98] Arthur Levitt, "SEC Deadlocked on Fiduciary, Advisors Need DOL Rule," *Think Advisor*, August 21, 2015, http://www.thinkadvisor.com/2015/08/21/arthur-levitt-sec-deadlocked-on-fiduciary-advisors.

[99] Melanie Waddell, "SEC's White Supports Fiduciary Rule for Brokers, Third-Party Audits," *Investment Advisor*, April 2, 2015, http://www.thinkadvisor.com/2015/04/02/secs-white-supports-fiduciary-rule-for-brokers-thi.

[100] House Appropriations Subcommittee on Financial Services and General Government Holds Hearing on President Obama's Fiscal 2017 Budget Request for the Securities and Exchange Commission. *CQ Financial Transcripts*, March 22, 2016, http://www.cq.com/doc/financialtranscripts-4857644?4&search=PW8PmtEA.

On the question of a timetable for issuing the SEC rule, Chair White reemphasized that crafting such a rule was "complicated, not fast [and that the] SEC staff's parameters of recommendations" regarding a uniform fiduciary rule "are being discussed with my fellow commissioners."[101]

Timeline for the Proposed Rule

DOL published the proposed rule on April 20, 2015. The comment period for the proposed rule was extended by 15 days from to July 6, 2015, to July 21, 2015.[102] DOL held a public hearing on the proposed rule from August 10 to August 13, 2015, and had an additional comment period after the public hearing lasting until September 24. 2015. DOL may develop and release the final rule but has not indicated a timetable for doing so.

Legislation in the 114th Congress

The following legislation has been introduced in the 114th Congress that would prevent or delay implementation of the fiduciary rule.

Passed the House of Representatives

H.R. 1090, the Retail Investor Protection Act, introduced on February 25, 2015, by Representative Ann Wagner, would (1) prohibit DOL from issuing a fiduciary rule until 30 days after the SEC issues a rule for the standards of conduct for brokers and dealers and (2) require the SEC to report to the House Committee on Financial and the Senate Committee on Banking, Housing, and Urban Affairs on, among other items, whether retail investors would be harmed by the rule and whether there are alternatives to the rule that the SEC could pursue.

Explaining the rationale behind the bill, Representative Ann Wagner said,

> [The] proposed rule from the Department of Labor potentially harms the very people that it claims to protect: low- and moderate-income Americans seeking advice for investing for their retirement. It would greatly expand the definition of a fiduciary under ERISA and fails to take into account the vast regulatory structure already in place…. While OMB typically reviews Labor rules for an average of 117 days, this was pushed through without a full review process in just 50 days. We believe that the SEC should go first in regulating this space, and we hope that Democrats who have supported that position previously continue to do so.[103]

Although the bill appears to have the support of a number of stakeholders, including several insurance industry-related groups,[104] it has also attracted critics who characterized it as an attempt to delay or prohibit the DOL from completing its fiduciary rulemaking.[105]

---

[101] SEC, DOL Fiduciary Rules Will Likely Be Different, White Says, *Think Advisor*, March 22, 2016, http://www.thinkadvisor.com/2016/03/22/sec-dol-fiduciary-rules-will-likely-be-different-w.

[102] See Employee Benefits Security Administration, "Hearing on Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice and Related Proposed Prohibited Transaction Exemptions," 80 *Federal Register* 34869 -34871, June 18, 2015.

[103] "Rep. Wagner Statement on Labor Fiduciary Rule," *Press Release from the Office of Cong. Ann Wagner*, April 14, 2015, http://wagner.house.gov/media-center/press-releases/rep-wagner-statement-on-labor-fiduciary-rule.

[104] For example, see "Rep. Ann Wagner Tells NAIFA: Congress Needs to Hear From You on DOL Proposal," *NAIFA*, http://www.naifa.org/news-publications/naifa-blog/may-2015/rep-ann-wagner-tells-naifa-congress-needs-to-hea; and Daniel Williams, "NAFA: Congresswoman Ann Wagner will 'Punch a Bear' to halt DOL," *NAFA*, June 18, 2015, (continued...)

On October 27, 2015, H.R. 1090 passed the House of Representatives.

Reported Out Of Committee

Two bills were introduced in the U.S. House and reported out of committee that would define investment advice and add a best interest PTE. Companion legislation has been introduced in the U.S. Senate.

H.R. 4293, the Affordable Retirement Advice Protection Act, introduced by Representative Phil Roe on December 18, 2015, and H.R. 4294, the Strengthening Access to Valuable Education and Retirement Support Act of 2015 (or the SAVERS Act of 2015), introduced by Representative Peter Roskam on December 18, 2015, are nearly identical bills which would define investment advice in U.S. Code and also provide for a best interest PTE. H.R. 4293 was reported out of the House Education and Workforce Committee on February 2, 2016, and H.R. 4294 was reported out of the House Ways and Means Committee on February 3, 2016.

Companion legislation has been introduced in the U.S. Senate. S. 2502, the Affordable Retirement Advice Protection Act, was introduced by Senator Johnny Isakson on February 4, 2016, and S. 2505, the SAVERS Act of 2016, was introduced by Senator Mark Kirk on February 4, 2016.

H.R. 4293 amends the labor code (29 U.S.C.) and H.R. 4294 amends the tax code (26 U.S.C.). Many of the provisions in the bills are nearly identical, though H.R. 4294 contains provisions that are not in H.R. 4293.

Summary of Provisions Common to H.R. 4293 and H.R. 4294

This section summarizes the provisions common to H.R. 4293 and H.R. 4294.

The bills would define investment advice and also provide an exemption for recommendations that are in the best interest of the investor, provided specified conditions are adhered to.

Definition of Investment Advice

Investment advice would be a recommendation

- to buy, hold, or sell a plan investment, including distributions from a plan or a rollover;
- on the management of plan assets; or
- of a person to manage plan assets.

The advice must be provided through either

(...continued)

http://www.lifehealthpro.com/2015/06/18/nafa-congresswoman-ann-wagner-will-punch-a-bear-to.

[105] For example, see "[Financial Planning] Coalition Statement on Wagner Fiduciary Bill," http://financialplanningcoalition.com/coalition-statement-on-wagner-fiduciary-bill/. The Financial Planning Coalition describes itself as a "a collaboration of Certified Financial Planner Board of Standards (CFP Board), the Financial Planning Association® (FPA®) and the National Association of Personal Financial Advisors (NAPFA) – the leading national organizations representing the development and advancement of the financial planning profession." Also, see "Open Letter from Barbara Roper and Micah Hauptman of the Consumer Federation of America to Representatives in Opposition to H.R. 1090," March 2, 2015, http://m.wealthmanagement.com/site-files/wealthmanagement.com/files/uploads/2015/02/CFA%20letter.pdf.

- a written acknowledgement that the person providing the advice is a fiduciary; or
- a mutual agreement, arrangement, or understanding that the advice is individualized to the plan or to the plan participant and that the individual who receives the advice intends to materially rely on the advice.

Disclaimers and Carve-Outs

The person providing a recommendation could provide a written disclaimer that the recommendation is not individualized for the recipient and should not be materially relied upon for making investment decisions. The disclaimer would state: "This information is not individualized to you, and there is no intent for you to materially rely on this information in making investment or management decisions." The disclaimer must be in writing and presented in a clear and prominent manner. Such a recommendation would not be considered investment advice and would not be held to a fiduciary standard.

The bills provide for several "carve-outs" in which information or recommendations would not be considered investment advice. These carve-outs include

- individuals who provides a disclosure that they are providing recommendations in a sales or marketing capacity;
- counter-parties in swaps transactions;
- employees of the plan sponsor, provided they are not receiving any additional compensation;
- platform providers who make available investment alternatives without regard to the needs of a plan or plan participants;
- valuation information; and
- financial education.

In the bills, financial education would be defined as either (1) information described in DOL's Interpretative Bulletin 96-1[106] or (2) information that describes the factors to consider in deciding whether to receive a distribution from a plan and whether to roll over such a distribution, provided that examples are accompanied by all of the material facts and assumptions upon which the examples are based.

Definition of Best Interest Recommendation

The bills contain provisions in which an individual may provide investment advice under a best interest recommendation. Individuals who adhere to the best interest recommendation would not be subject to the fiduciary standard.

The best interest standard would require that the individual who provides the recommendation would

- receive no more than reasonable compensation;
- provide recommendations that a prudent person would provide, based on the recipient's age, other factors as disclosed by the recipient, and other unspecified factors; and

[106] DOL Interpretive Bulletin 96-1 is available at http://www.dol.gov/ebsa/regs/fedreg/final/96_14093.htm.

- place the interests of the recipient of the advice above his or her own interests.

A best interest recommendation may include a recommendation that would contain

- only a limited number of investment options, provided there is a disclosure that "The same or similar investments may be available at a different cost (greater or lesser) from other sources"; or
- variable compensation (such as commissions) provided there is a clear disclosure of the variable compensation. The requirements of this disclosure include (1) a notice that the same or similar investments may be available at a greater or lesser cost from other sources; and (2) a description of the fees or compensation received (i) directly from the advice recipient and (ii) from a third party in connection with the transactions (what are sometimes called "indirect fees.") The advice recipient would be able to request the specific amounts of indirect compensation received in connection with the transaction. Individuals would be able to correct errors or omissions in disclosing information about variable compensation provided the individual was acting in good faith and the error is corrected as soon as possible but not later than 30 days from when the person learns of the error.

Effective Date and Effect on Promulgated Regulations

The provisions of the bill would take effect on the 61st day after date of enactment and would apply to information or recommendations made on or after two years after the date of enactment.

The bills would prohibit DOL from amending any investment advice rules or administrative procedures promulgated under ERISA 3(21) or 26 U.S.C. 4975(e)(3).

The bills would require that any regulations or administrative procedures that became effective after January 1, 2015, would not be effective unless a bill or joint resolution that specifically approves the rule is enacted within 60 days of the enactment of either H.R. 4293 or H.R. 4294. The bills contain provisions that would grandfather existing transactions: the provisions of the bills would not apply to transactions for which compensation has been received prior to the date on which the provisions of the bill become effective.

Provisions in H.R. 4294

In the tax code, the penalty for engaging in a prohibited transaction is an excise tax. Under current law, a person who engages in a prohibited transaction may be subject to excise taxes. The tax is 15% of the amount involved and can be 100% if the transaction is not corrected. Because H.R. 4294 amends the tax code, several provisions are in H.R. 4294 but are not in H.R. 4293.

H.R. 4294 would add special rules for prohibited transactions with respect to investment advice that is not a best interest recommendation. The bill defines "correction" and "correct" to be the payment to, or reimbursement of, actual damages as a result of relying on the investment advice.

H.R. 4294 also provides a prohibited transaction exemption related to certain fee arrangements. An individual who provides investment advice would not be engaging in a prohibited transaction if the investment advisor

- receives no more than reasonable compensation defined in 4975(d)(2);[107]

[107] 26 U.S.C. § 4975(d)(2) states "any contract, or reasonable arrangement, made with a disqualified person for office (continued...)

- discloses that the same or similar investments may be available at a greater or lesser cost;
- discloses any variable compensation the investment adviser receives; and
- corrects any omissions of disclosure, provided the adviser was acting in good faith.

Introduced

H.R. 3020, the Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 2016, introduced by Representative Tom Cole on July 10, 2015, and S. 1695, the Departments of Labor, Health and Human Services, and Education, and Related Agencies Appropriations Act, 2016, introduced by Senator Roy Blunt on June 25, 2015, contain provisions that would prohibit DOL from using any funds to "finalize, implement, administer, or enforce the proposed" fiduciary regulation. H.R. 3020 was reported out of the House Committee on Appropriations on July 10, 2015. S. 1695 was reported out of the Senate Appropriations Committee on June 25, 2015. P.L. 114-113, the Consolidated Appropriations Act, 2016, did not contain any provisions related to proposed fiduciary regulation.

H.R. 3922, the Retirement Choice Protection Act of 2015, introduced by Representative Mike Kelly on November 4, 2015, would (1) transfer authority for issuing regulations on IRAs from DOL to the Department of the Treasury and (2) establish a best interest standard for fiduciaries who provide investment advice.

Author Contact Information

John J. Topoleski
Analyst in Income Security
jtopoleski@crs.loc.gov, 7-2290

Gary Shorter
Specialist in Financial Economics
gshorter@crs.loc.gov, 7-7772

(...continued)

space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor."