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HAWAII ATTORNEY GENERAL SUPPORTS FEDERAL RULE REQUIRING RETIREMENT ADVISORS TO PUT CLIENTS AHEAD OF THEIR OWN PROFITS

HONOLULU – Attorney General Doug Chin joined with a group of eight state attorneys general on Monday urging the U.S. Department of Labor to lift its delay in implementing a rule that would require financial advisors to put clients' best interests ahead of their own.

The investment advice fiduciary rule was set to take effect April 10, but the Department of Labor delayed it by 60 days to June 9. On February 3, President Donald Trump ordered the agency to review the fiduciary rule "to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice."

"To the contrary, postponement of its application is costing investors tens of millions of dollars each day as advisors continue to give conflicted advice and the rule should be implemented without further delay," the attorneys general wrote in a letter to Acting Secretary of Labor Edward Hugley. "This rule is long overdue and would provide substantial protections to consumers seeking retirement investment advice and create only necessary changes to the retirement investment market."

The rule would expand the definition of fiduciary and hold all retirement investment advisors to the standard of a fiduciary. In addition to putting client interests before advisors' profits, the rule also would require advisors to disclose conflicts of interest, and would remove advisors' limited liability for harms resulting from their advice.

The Labor Department issued the fiduciary rule on April 6 of last year, to protect investors and address problems in the retirement investment advice market. Previously, an agency analysis found that conflicting advice issues were widespread and cause serious harm to investment plan and IRA investors. Additionally, the analysis found that investment agencies often arrange compensation ahead of clients' interests.

"The rule addresses conflicts that lead to widespread abuse of vulnerable investors and in turn dramatically improves the quality of financial investment advice provided," the attorneys general wrote. "Rather than self-regulating in anticipation of change, the

industry has taken full advantage of their non-fiduciary status to the detriment of consumer investors."

The letter is signed by attorneys general in the states of Hawaii, Illinois, Iowa, North Carolina, Oregon, Pennsylvania, and Washington, plus the District of Columbia. A copy of the letter is attached.

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IOWA DEPARTMENT OF JUSTICE
OFFICE OF THE ATTORNEY GENERAL

April 17, 2017

Acting Secretary of Labor Edward Hugley
Office of the Department of Labor
200 Constitution Ave. NW
Washington D.C. 20210

Re: Presidential Memorandum on Fiduciary Duty Rule, Request for Comments

We write to address concerns raised by President Trump in his February 3rd Memorandum to the Secretary of Labor, to express our strong support for the Department of Labor's (the "Department") Fiduciary Duty Rule ("rule"), and to express our strong opposition to the delay of its application date. The rule would expand the definition of fiduciary and hold all retirement investment advisers to the standard of fiduciary, meaning that such advisers must put the interest of the client before their own, disclose conflicts of interest, and establishes advisor liability when investors are harmed by their advice. This rule is long overdue and would provide substantial protections to consumers seeking retirement investment advice and create only necessary changes to the retirement investment market. We urge the rule's adoption and lifting of the delay period currently in place.

I. Introduction

The Employee Retirement Income Security Act (ERISA) was enacted in 1974 and is the comprehensive Act "improving the equitable character and the soundness of [benefit and retirement] plans."[1] As narrowly written, however, it provides exemptions and loopholes that allow retirement investment advisers—notably Individual Retirement Account (IRA) advisers, among others—to avoid fiduciary standards that other retail investment advisors are held to. This means that non-fiduciary advisers are free to give retirement investment advice with conflicts of interest, provide imprudent and disloyal advice for the benefit of the advisor and their agency, and do so while maintaining limited liability for resulting harm to the investor without any obligation to disclose this information.

Consumer protection is one of the key responsibilities of state Attorneys General. Each of us works individually and with our colleagues around the country on numerous federal consumer protection legislative and regulatory initiatives. In our view, one cannot understate the importance of strong, consistent enforcement of national, state, and local consumer protection

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[1] 29 U.S.C. § 1001 (2017).

laws and regulations. Together, they establish an umbrella of protection that ensures fair competition and deters exploitive practices.

For fair competition and the deterrence of exploitative practices to take hold consumers must be well-informed. Given the complex nature of the finance market and the sophistication required to navigate it at almost all levels sets the cost for information in the finance market very high for consumers. This leads to less than optimal knowledge by consumers creating a high demand for investment service advisers which creates an imbalance of information held between adviser and consumer. What is more, without being held to a fiduciary standard advisers can legally take advantage of this fact and advantage of the consumer. As first-line defenders of consumers we are deeply troubled by this fact and find that the Department's rule will restore balance to the retirement investment market.

II. Concerns About Harm to Consumers and Access to Retirement Savings

The Department's rule was established to protect investors and to address problems in the retirement investment advice market. Findings by the Department in its Regulatory Impact Analysis (RIA) show that conflicting advice issues are widespread and take on different forms and they cause serious harm to plan and IRA investors.[2] The RIA also found that investment agencies often arrange compensation to be based on advisers' ability to promote the agency's interests—placing it ahead of the clients'.[3] These conflicts arise not only with IRA investments, but plan investments and 401(k) plans as well, which studies show have resulted in decreased earnings per year compared to other plans and high-cost portfolio holdings that make no significant contributions to the investor.[4] Additionally, ERISA is outdated and has become obsolete in today's market, which has changed dramatically over the last four decades making this rule's application necessary.

The rule addresses conflicts that lead to widespread abuse of vulnerable investors and in turn dramatically improves the quality of financial investment advice provided. By making IRA advisors fiduciaries, the rule prohibits transactions that produce conflicts of interest and requires them to put the investors' interest ahead of their own. Prohibiting such transactions is necessary because most retirement investors are not financially sophisticated and are not likely to inquire into whether a conflict exists. Advisors often portray themselves as being trusted fiduciaries and

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[2] DEP'T OF LABOR, REGULATING ADVICE MARKETS (Apr. 2016), https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf.

[3] *Id*.

[4] Ian Ayres & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(K) Plans*, 124 YALE L.J. 1476 (2015); Veronika K. Pool el al., *Are 401(k) Investment Menus Set Solely for Plan Participants?*, CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE (2015).

consumers treat them as such. By eliminating conflict advice investors will receive individualized investment recommendations untainted by agency goals, meeting the expectations that consumers already hold.

The Department states in its RIA that the rule will "have little effect on access to investment advice."[5] Of specific concern is access to investment advice for small investors, and some commentators argue that the proposal will increase costs for small IRA and plan investors, thereby reducing their access. However, the RIA disagrees and there is clear evidence that the rule will have the opposite effect.[6] The purpose of the rule is to reduce advisory conflicts, which small investors are more vulnerable to, and the RIA concludes that quality advice will be available at affordable costs for small investors under the new rule. Furthermore, changes in the market combined with application of the rule will open up new lines of products for investors. One such product proposal is a new class of mutual fund that complies with the rule but also provides for commission-based advice that allows brokers to determine the cost of their services.[7] Another product, called T shares, will carry lower maximum sales loads but with reduced compensation costs, benefiting small investors.[8] These changes allow for greater competition in the market amongst brokers and will result in access for investors at all levels.

III. Concerns About Disruptions to the Retirement Services Industry

Disruptions to the industry will primarily come in the form of compliance costs, which will be significantly outweighed by the gains that application of this rule will provide. Over the next ten years IRA investors will have the potential to gain $33 billion to $36 billion, while that same timeframe poses a predicted $16 billion compliance costs to the industry, $5 billion of which will be up-front expenses in the first year.[9] Without application of the rule investors will lose $95 billion to $189 billion within the next 10 years caused by conflict advice. Furthermore, IRAs are now the largest form of retirement saving and are only expected to grow. Between 2016 and

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[5] REGULATING ADVICE MARKETS, *supra* note 3, at 244.

[6] *The Department of Labor Conflict of Interest Rule is Already Delivering Benefits to Workers and Retirees: Delay Puts Those Benefits at Risk*, CONSUMER FEDERATION OF AMERICA (Jan. 31, 2017), http://consumerfed.org/wp-content/uploads/2017/01/1-31-17-DOL-Rule-Delivering-Benefits_Fact-Sheet.pdf.

[7] John Waggoner, *American Funds gets SEC Approval for Clean Shares*, INVESTMENTNEWS (Jan. 13, 2017, 12:12PM), http://www.investmentnews.com/article/20170113/FREE/170119955/american-funds-gets-sec-approval-for-clean-shares.

[8] John Rekenthaler, *Lower-Cost T Shares Coming to a Fund Near You*, MORNINGSTAR (Jan. 6, 2017), http://beta.morningstar.com/articles/787395/lower-cost-t-shares-coming-to-a-fund-near-you.html.

[9] https://www.federalregister.gov/documents/2017/03/02/2017-04096/definition-of-the-term-fiduciary-conflict-of-interest-rule-retirement-investment-advice-best.

2020, almost $2.4 trillion is expected to move from Defined Benefit and Defined Contribution plans to RIA investments.[10]

In fact, the costs associated with compliance of the rule for retirement investment advisers is an indication of how pervasive conflicts of interest are in the industry and provides support for immediate application of the rule. The retirement services industry has been on notice of proposed changes for over six years and yet conflicts remain widespread and costly to investors. Rather than self-regulating in anticipation of change, the industry has taken full advantage of their non-fiduciary status to the detriment of consumer investors. Industry practices financially incentivize giving conflicted advice and the cost to the industry in changing these practices should not delay the rule's application because it is the only way such changes will take effect.

IV. Concerns for Increased Litigation

Litigation was not a large focus in the RIA, but it provides some considerations for mitigating costs and potential for litigation. The Department estimates that insurance premiums will increase approximately $99.7 million per-year for the roughly 332,340 broker-dealers covering errors and omissions liability and potential litigation.[11] Another component of the rule is to require advisers to put in writing that they will be advising as a fiduciary, thereby mitigating potential litigation over fiduciary status. Providing prohibited transaction exemptions (PTEs) is another factor that could mitigate litigation because it puts in place other consumer protections for the benefit of allowing some conflicted transactions to move forward. Finally, potential for litigation should not be considered a downside to the rule because it provides a remedy to investors that have been wronged by advisors acting under the heightened standards as fiduciaries.

V. Conclusion

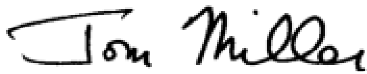
It is our determination, after consideration of the concerns raised by President Trump on the impact of the Fiduciary Duty Rule, that the application of the rule will not adversely affect Americans ability to gain access to retirement information and financial advice. To the contrary,

[10] REGULATING ADVICE MARKETS, *supra* note 3, at 107 (citing a study by Cerulli Associates).

[11] The potential insurance increases do not cover penalties paid by advisors that lose in litigation.

postponement of its application is costing investors tens of millions of dollars each day as advisors continue to give conflicted advice[12] and the rule should be implemented without further delay.

Sincerely,



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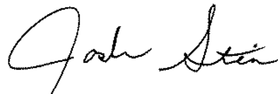

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[12] *Retirement Ripoff Counter Shows Losses of $532 Each Second Without Fully Enforced Fiduciary Rule*, AMERICANS FOR FINANCIAL REFORM (Apr. 5, 2017, 4:38PM), http://ourfinancialsecurity.org/2017/04/afr-event/.

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