July 17, 2015

VIA ELECTRONIC SUBMISSION

The Honorable Phyllis C. Borzi
Assistant Secretary of Labor
Employee Benefits Security Administration
Department of Labor
200 Constitution Ave., NW
Washington, DC 20210
www.regulations.gov

Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule--Retirement Investment Advice (RIN 1210-AB32)

Dear Assistant Secretary Borzi:

The Office of Advocacy (Advocacy) offers the following comment to the Employee Benefits Security Administration (EBSA) in response to the above-referenced rulemaking issued on April 14, 2015.[1] The proposed rule would expand the definition of "fiduciary" of an employee benefits plan. Advocacy thanks EBSA staff for participating in our small business employee benefits roundtable to discuss this rulemaking with small business stakeholders. At the roundtable, small business owners and representatives expressed concern that the proposed rule would be burdensome for small businesses that offer retirement services. Based on input from small business stakeholders, Advocacy is concerned that the Initial Regulatory Flexibility Analysis (IRFA) contained in the proposed rule lacks essential information required under the Regulatory Flexibility Act (RFA)[2]. Specifically, the IRFA does not adequately estimate the costs of the proposal or the number of small entities that would be impacted by it. For example, small business stakeholders advise Advocacy that the proposed rule would likely increase the costs associated with servicing smaller plans sponsored by small business employers. They observe that the proposed rule could even limit their ability to offer savings and investment advice to clients. Based on this feedback, Advocacy encourages EBSA to consider ways to decrease the potential small business burdens of the proposed rule, including expanding the scope of exemptions contained in the proposal. For these reasons, Advocacy recommends that EBSA republish for public comment a Supplemental IRFA before proceeding with this rulemaking.

[1] 80 Fed. Reg. 21927.
[2] 5 U.S.C. § 601 et seq.

Office of Advocacy

Advocacy was established pursuant to Pub. L. 94-305 to represent the views of small entities before federal agencies and Congress. Advocacy is an independent office within SBA, so the views expressed by Advocacy do not necessarily reflect the views of the SBA or the Administration. The Regulatory Flexibility Act (RFA),[3] as amended by the Small Business Regulatory Enforcement Fairness Act (SBREFA),[4] gives small entities a voice in the rulemaking process. For all rules that are expected to have a significant economic impact on a substantial number of small entities, federal agencies are required by the RFA to assess the impact of the proposed rule on small business and to consider less burdensome alternatives.

The Small Business Jobs Act of 2010 requires agencies to give every appropriate consideration to comments provided by Advocacy.[5] The agency must include, in any explanation or discussion accompanying the final rule's publication in the Federal Register, the agency's response to these written comments submitted by Advocacy on the proposed rule, unless the agency certifies that the public interest is not served by doing so.[6]

Advocacy performs outreach through roundtables, conference calls and other means to develop its position on important issues such as this one. Advocacy held roundtables with small entities on this issue on August 31, 2011 and June 10, 2015. Advocacy has also spoken with other small business stakeholders about this rulemaking.

Background

On October 22, 2010, EBSA published a proposed rule that would have amended a 1975 regulation that defines when a person providing investment advice becomes a "fiduciary" under ERISA.[7] The proposed rule would have expanded the scope of that definition to subject investment advisers to fiduciary requirements such as required disclosures and to prohibit advisers from engaging in certain transactions.[8]

In response to the 2010 proposal, EBSA received numerous public comment letters stating that the proposal would have made it impermissible for investment advisers to engage in certain transactions that were common practices under the commission-based model. In 2011, EBSA announced that it planned to withdraw the proposed rule, and that the agency would start over to draft a new proposal to update the definition of fiduciary.[9]

On April 14, 2015, EBSA re-issued the proposed rule that would expand the definition of fiduciary of an employee benefit plan under ERISA.[10] The 2015 proposal would extend the fiduciary standard of care to all advisers of workplace retirement plans and IRAs. The proposed rule would require these

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[3] 5 U.S.C. § 601 et seq.
[4] Pub. L. 104-121, Title II, 110 Stat. 857 (1996) (codified in various sections of 5 U.S.C. § 601 et seq.).
[5] Small Business Jobs Act of 2010 (PL 111-240) § 1601.
[6] Id.
[7] 75 Fed. Reg. 65263-02, Oct. 22, 2010.
[8] Id.
[9] http://www.dol.gov/opa/media/press/ebsa/EBSA20111382.htm. .
[10] 80 Fed. Reg. 21927.

advisers to disclose any potential conflicts of interests and the proposal would again prohibit advisers from engaging in certain transactions.

The 2015 proposed rulemaking also includes a package of proposed exemptions that would allow advisers to continue to receive payments that could create conflicts of interest if certain conditions are met.[11] Two exemptions have received particular attention from the public: (1) the "best interest contract exemption," and (2) the "seller's carve-out."

The best interest contract exemption would be available to advisers who make investment recommendations to individual plan participants, IRA investors, and small, non-participant-directed plans with fewer than 100 participants.[12] The exemption would require retirement investment advisers to formally acknowledge fiduciary status and enter into a contract with their customers in which they commit to fundamental standards of impartial conduct.[13]

The seller's carve-out would exempt fiduciary advice made to a plan in an "arm's length transaction."[14] The seller's carve-out would only be available for employee benefit plans that have 100 or more participants.[15]

In the RFA analysis of the proposal, EBSA defines a small business based on the SBA size standard for businesses in the Financial Investments and Related Activities Sector: a business with up to $38.5 million in annual receipts.[16] Because EBSA lacks data on revenue to precisely measure the number of firms which meet this size standard by type of firm (such as broker dealer or registered investment advisor), the agency does not integrate this definition into any of its analyses. Instead, EBSA consulted with staff and reviewed analyses from the Securities and Exchange Commission (SEC) as well as public comments to a SEC request for information to calculate the number of small entities that would be impacted by the proposal.[17] EBSA conservatively and generally estimates that up to 2,440 small broker dealers (BDs), 15,100 small registered investment advisers (RIAs), and 2,300 other small service providers to ERISA plans would experience additional costs imposed by the proposed rule.[18]

In the proposal's Regulatory Impact Analysis (RIA), EBSA describes two different cost scenarios to estimate the potential costs of the proposal on small entities. EBSA concludes that small BDs on average could spend approximately $53,000 (Scenario B) or $242,000 (Scenario A) in the first year and approximately $21,000 (B) or $97,000 (A) in subsequent years; small RIAs will spend approximately $5,300 in the first year and $500 in subsequent years; and small service providers will spend approximately $5,300 in the first year and $500 in subsequent years.[19]

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[11] Id.
[12] Id.at 21929.
[13] Id.
[14] Id. at 21941.
[15] Id.
[16] Regulatory Impact Analysis for Fiduciary Investment Advice proposal , p. 181, available at http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.
[17] Id. at 2.
[18] Id. at 182.
[19] Id.

EBSA bases these cost estimates on SEC information received in response to a 2013 Request for Data and Other Information (RFI) relating to the benefits and costs that could result from various alternative approaches regarding the standards of conduct and other obligations of BDs and RIAs.[20] EBSA focused on two comment letters in response to the SEC RFI. The first from the Securities Industry and Financial Markets Association (SIFMA) provided estimated costs that would be incurred by BDs if the SEC promulgated a regulation establishing a uniform fiduciary standard.[21] The second comment letter from the Investment Adviser Association (IAA) approximated costs that are incurred by its RIA members to comply with SEC rules based on a recent survey of investment advisers.[22]

The Proposed Rule's IRFA is Deficient

Under the RFA, an IRFA must contain: (1) a description of the reasons why the regulatory action is being taken; (2) the objectives and legal basis for the proposed regulation; (3) a description and estimated number of regulated small entities (based on the North American Industry Classification System (NAICS)); (4) a description and estimate of compliance requirements, including any differential for different categories of small entities; (5) identification of duplication, overlap, and conflict with other rules and regulations; and (6) a description of significant alternatives to the rule.[23] Advocacy is concerned that because the proposed rule's IRFA is deficient, the public has not been adequately informed about the possible impact of the proposal on small entities, and EBSA has not effectively weighed less burdensome significant alternatives to the proposed rule that would meet the EBSA's objectives.

Primarily, EBSA does not clearly state what constitutes a small business in the analysis for this rulemaking. Although EBSA uses a NAICS Code to define a small business, this definition does not figure into EBSA's estimate for affected entities because the agency states that it lacks data on revenue.[24] Instead, EBSA relies on a combination of SEC and EBSA data to estimate the total number of BDs, RIAs, and ERISA plan service providers in the market. The agency then proceeds to divide firms into small, medium, and large size categories based on an allocation methodology that is not fully explained, as it draws on a combination of data sources and unstated assumptions.[25] The agency's methodology for eliminating non-ERISA/IRA firms from the affected firm count suffers from a similar lack of transparency and clarity. For these reasons, it is uncertain whether the IRFA contained in the proposed rule accurately takes into account all of the potential small business impacts of the proposal.

Additionally, EBSA based its cost estimates for the proposal on information provided by SIFMA and IAA. However, while these comment letters provide citations to broader summaries of surveys conducted by the commenter, there is little to no information about these surveys. EBSA should provide more information on these surveys as they play a critical role in its IRFA. Key

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[20] Id.at 157.
[21] Id.
[22] Id.
[23] 5 USC § 603.
[24] It is worth noting that Advocacy's firm-size data has revenue data on the NAICS code that EBSA employs in its definition.
[25] See Regulatory Impact Analysis for Fiduciary Investment Advice proposal, p. 159, available at http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

information omitted includes the demographic makeup of the surveys' samples, response rates, sampling procedures, and surveying procedures to name a few.

Without more information on the data sources and methodologies on which it relies in its IRFA, EBSA runs the risk of misapplying data from the comment letters. This is particularly problematic in the use of the "IAA ratio" to determine the number of small businesses potentially affected by this proposed rule because it is not clear whether the IAA's data is representative of all small firms which would be necessary to allow for such a broad extrapolation.

Given all of these questions regarding the underlying data used in its estimates, EBSA rightfully acknowledges the shortcomings in some of its data sources, estimates, and methodologies in its IRFA. However, EBSA does not actually do anything in its analysis that would take this uncertainty into account. For example, EBSA should consider both obtaining additional information on small entities as well as providing cost estimates in ranges and running multiple sensitivity analyses to see how the costs of the rule might change if some of the factors considered by EBSA are different than its assumptions.

As the proposal contains an IRFA with inadequate cost and small business estimates, the public will not be fully informed as to the possible impact of the proposed rule on small entities. Moreover, because the estimates provided by the IRFA appear to be flawed, it is uncertain how EBSA could accurately evaluate alternatives to the proposed rule which would reduce the burdens on small businesses. As an example, a number of small business owners and representatives have been in contact with Advocacy to express concern that the proposed rule underestimates the burdens it would impose and that the proposal could even limit their ability to offer savings and investment advice to client. Without a more accurate understanding of the regulatory burden on small businesses, EBSA will not be able to understand both the extent of the costs of the rule as well as the efficiency and effectiveness of potential alternatives to help small entities. As described in more detail below, small business stakeholders report to Advocacy that EBSA does not fully consider and evaluate certain alternatives in the proposal that could help reduce these costs and burdens on small entities.

Small Business Feedback

Advocacy has performed outreach and heard from a number of small business owners and representatives about this proposal. On August 31, 2011, Advocacy hosted a small business roundtable to provide an opportunity for small business owners and representatives to discuss the 2010 proposal with EBSA staff. On June 10, 2015, Advocacy hosted a small business roundtable on the EBSA re-proposed rule at which time EBSA staff made a presentation to small business representatives about the rulemaking. EBSA staff also received feedback from small business stakeholders at the roundtable. Since the roundtable, Advocacy has continued to receive feedback from small business owners and representatives.

Much of the input that Advocacy has received comes from small business owners who provide administrative services to small pension plans of less than 100 participants that are sponsored by small business employers. These small business stakeholders report that the proposed rule would likely increase the costs and burdens associated with servicing smaller plans sponsored by small

business employers. Small business owners expressed concern that the proposal could limit financial advisers' ability to offer savings and investment advice to clients, such as suggesting options for an IRA rollover. These small business stakeholders report that the proposal could ultimately lead advisers to stop providing retirement services to small businesses.

To help reduce the burdens associated with the proposed rule, small business owners and representatives suggest expanding the scope of two exemptions contained in the proposal: (1) the best interest contract exemption, and (2) the seller's carve-out. Small business stakeholders suggest that the best interest contract exemption should be extended to participant-directed plans. Small business owners reported to Advocacy that most small plans are participant-directed. Therefore, under the current proposal, small business advisers to small plans would not be able to take advantage of this exemption.

Small business representatives also observe that EBSA should consider extending the "seller's carve-out" to interactions with smaller plans of less than 100 participants. Small business stakeholders indicated that smaller plans with less than 100 participants usually operate similarly and have a level of sophistication similar to larger plans. Not being able to take advantage of the seller's carve-out would discourage small business advisers from working with smaller plans.

Recommendation

Advocacy recommends that EBSA republish a Supplemental IRFA for additional public comment before proceeding with this rulemaking. The Supplemental IRFA should provide a more accurate estimate of the small entities impacted by proposal. Specifically, EBSA should be more transparent about its process for allocating firms into various size categories based on distribution percentages derived from previous reports. EBSA should also better explain, and provide evidence to justify, its approach for dividing ERISA plan service providers into small, medium, and large size categories.

Advocacy also suggests that EBSA provide in its Supplemental IRFA a more accurate estimate of the costs of the proposal. Because of the lack of clarity and small entity data, Advocacy recommends that EBSA conduct multiple sensitivity analyses on its assumptions and use ranges as opposed to point estimates wherever possible.

Advocacy also recommends that the Supplemental IRFA also take into account the suggestions of small business owners and representatives to expand the scope of the best interest contract exemption and the seller's carve-out. Advocacy encourages EBSA to continue to conduct outreach with small business stakeholders to help develop additional alternatives and exemptions in the proposed rule that would make it less burdensome and costly for small businesses. By republishing a Supplemental IRFA and giving full consideration to additional regulatory alternatives, EBSA will gain further valuable insight into the effects of the proposed rule on small business and be more transparent in explaining and justifying the choices that it made in the proposal. Advocacy stands ready to assist EBSA in these efforts.

Advocacy again thanks EBSA for participating in its small business roundtable and encourages the agency to adopt these recommendations. If you have any questions or require additional information please contact me or Assistant Chief Counsel Dillon Taylor at (202) 401-9787 or by email at Dillon.Taylor@sba.gov.

Sincerely,

Claudia Rodgers
Acting Chief Counsel for Advocacy

Dillon Taylor
Assistant Chief Counsel for Advocacy

Copy to: The Honorable Howard Shelanski, Administrator
Office of Information and Regulatory Affairs
Office of Management and Budget