June 3, 2015

Mr. Richard Ketchum
Chairman and Chief Executive Officer
Financial Industry Regulatory Authority
1735 K Street N.W.
Washington, D.C. 20006

Re: The Department of Labor's Fiduciary Duty Rule

Dear Mr. Ketchum:

We write in response to your recent testimony before the House Financial Services Subcommittee on Capital Markets and Government Sponsored Enterprises hearing, entitled "Oversight of the Financial Industry Regulatory Authority (FINRA)," as well as your remarks from the 2015 FINRA Annual Conference.

We are troubled by your ill-informed opposition to the important and urgent regulatory effort led by the Department of Labor (DOL) to require brokers and others to **put their clients' interests first** and **end conflicts of interest** that harm millions of hardworking Americans just trying to save for a secure and dignified retirement. Frankly, as the head of an organization that claims to be "dedicated to investor protection and market integrity," we would have expected you to applaud the DOL's efforts and to call on the SEC to act quickly to do the same: require that clients' best interests are put first and end any circumstance where brokers or others could put their personal economic interests above the interests of their clients.

The DOL—not the SEC—has longstanding, Congressionally-mandated authority to set standards for those providing investment advice about retirement assets.

In the hearing, you stated that you "regret the possibility of having different standards with regard to the Labor Department proposal and what exists in the securities market." However, these different standards are not simply a "possibility"—they are intentional mandates established by Congress which have existed for decades already.

In 1974, Congress deliberately tasked the DOL, not the SEC, with administering the Employee Retirement Income Security Act (ERISA), which means it is responsible for protecting retirement assets and establishing rules for those who give retirement investment advice. Most important, it created higher standards for retirement accounts than

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those that exist under the securities laws administered by the SEC. Congress made this distinction—fully aware of the SEC's mandate—because it recognized the unique importance of retirement assets for American workers and retirees. Reflecting these public policy choices, most retirement savings also receive preferential tax treatment.

These are well known and widely accepted facts. For example, SEC Chair Mary Jo White has repeatedly recognized these facts, most recently during her testimony before the Senate Financial Services and General Government Appropriations Subcommittee. Chair White explained that the DOL and SEC "are separate agencies with separate statutory mandates," and the DOL rule proposal relates to the DOL's "important" mandate under ERISA.

After 40 years, the 1975 ERISA rulemaking on fiduciary duty is in urgent need of updating to close loopholes and adjust to today's radically different system for retirement savings. Traditional employer defined benefit plans, common then, have mostly been replaced by defined contribution plans and individual retirement accounts, which now total more than $14 trillion in retirement assets.

As a result, most Americans no longer have professionally managed pensions and now have to rely on advisers, including your members, to help them navigate the complex world of investment choices and to maximize their savings in hopes of a secure and dignified retirement. Only the DOL can update its fiduciary rule under ERISA so that Americans have access to the unbiased advice they need now more than ever before.

The DOL is the *only* authority that can set the fiduciary standard to protect all assets held in retirement accounts.

You also stated that "the right way to move forward is for the [SEC] to look at the possibility of a balanced fiduciary standard across all products." But the SEC does not have the legal authority to create an advisory standard for "all products."

As you know, the SEC only regulates transactions in securities. However, retirement accounts often include a variety of other, non-securities investments, including insurance products. The SEC could not write a rule that protects retirement account owners from conflicted advice as to those types of assets.

Further, you said, "the SEC should lead the best interest standard." We question this assertion for two reasons. First, there's no legal or policy reason why the SEC should take the lead in protecting retirement assets. On the contrary, as pointed out above, this important public policy was specifically and explicitly given to the DOL. Second, waiting for the SEC to "lead" would prove disastrous for workers and retirees who need better protection from conflicted investment advice as soon as possible. Every passing day means millions of dollars in retirement funds siphoned off by advisers who are not subject to the fiduciary duty.

For years, brokers (your members) under the SEC's jurisdiction have been subject to a much weaker suitability standard, not a fiduciary duty, even when they provide securities investment advice. The SEC has been considering regulatory action for nearly a decade in this space, but thus far has failed to take action to require brokers to meet the fiduciary standards that obviously should apply. We hope the SEC can finally take this step—especially because many brokers advertise themselves as trusted advisers—but recent statements by SEC Chair White make very clear that the SEC is just beginning to consider whether and how to proceed with a new fiduciary duty rule for brokers. The DOL, on the other hand, has worked long and hard to produce a strong rule proposal that is now in the comment phase – years ahead of the SEC. And it must be noted again that no SEC fiduciary rule could ever protect all of the assets held in retirement accounts.

The DOL consulted extensively with the SEC to ensure that advisers would not face *conflicting* standards.

Criticisms about the DOL's approach also ignore the DOL's frequent and apparently very successful efforts to consult with the SEC and to avoid *conflicting* standards of conduct for advisers. In her testimony this month, Chair White said the SEC has worked "closely in providing extensive technical assistance" to the DOL since the beginning of the process, especially about the "broker-dealer" model.

Based on these consultations as well as extensive input from industry and other stakeholders, the DOL proposal took strides to accommodate the broker-dealer business model, including allowing for commission compensation. Given this, it was surprising to hear you say the DOL proposal uses a "description of broker-dealer business we don't believe is accurate."

At least on the issue of compensation, which has been the primary focus of concern among brokers, the DOL has taken great pains to understand and accommodate the broker-dealer business model. Furthermore, it has done what the SEC and FINRA have failed to do, which is to require firms to take meaningful steps to rein in compensation practices that encourage their advisers to behave in ways that are harmful to investors.

Conflicts of interest are draining retirement savings from workers and retirees alike, and an updated ERISA "best interest" rule is desperately needed to appropriately protect Americans' retirement savings.

During your testimony, you said "our system works because our investors have a range of choice with respect to products built around a lot of requirements to ensure what's provided to them is suitable." Well, not quite. As you well know, what is "suitable" may not be in the clients' best interests. In fact, "suitability" allows brokers and others to put their own economic interest above the best interests of their clients. That isn't a system that works. That's a system that's broken. Put differently, that "system works" for brokers, but not for those who struggle to save and invest for retirement.

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While there are many good brokers and other professionals working in the best interests of their clients, there are still far too many who do not. DOL estimates losses from conflicts of interest - enabled under the suitability standard - will amount to between $210 billion and $430 billion over the next decade. That's hard-earned money that should be in American's retirement accounts, not brokers' pockets. Making matters worse, these conflicts often impact low- and middle-income workers and retirees most and they can least afford to see their meager retirement savings siphoned off.

These are very real problems. For example, as hopefully FINRA knows (and is investigating), just last month, according to news reports, a compliance officer at Wells Fargo described the very conflicts that the DOL proposal seeks to address, writing:

> **"when brokers answered me honestly as to why they picked annuities over mutual funds or even plain vanilla stocks??? Payout baby!!!"**

These are the conflicts that happen every day on FINRA's watch. A DOL best interest fiduciary duty rule is targeted at stopping these very abuses. Maybe you should be overseeing FINRA's efforts to stop these abuses rather than railing against a much-needed new rule.

<u>The DOL's fiduciary standard would emphasize mitigation of conflicts of interest, rather than mere disclosure of those conflicts.</u>

While your remarks at the 2015 FINRA Annual Conference express support for a fiduciary standard to ensure "customer interests come first," the five "markers" you provide to guide a FINRA-crafted best interest standard would rely heavily on a disclosure-based regime instead of one where conflicts of interest are directly, substantively mitigated. The standard you propose would rely on "more effective disclosure provided to investors;" that "firms' representatives should provide...point of sale disclosures regarding relevant conflict, risk and fee issues relating to a recommendation;" and that conflicts remaining after management "be knowingly consented to by the customer."

The DOL's regulatory impact analysis notes (and years of independent studies support and prove) that "disclosures often fail to make investors aware of their advisers' conflicts, let alone understand their nature and potential implications." Indeed, one study reviewed notes that "for many investors, the fact that they were given disclosures was seen as meaningless." Even worse, studies have found that "disclosure of adviser conflicts can 'backfire,'" as investors may "interpret disclosure as a sign of honesty and/or believe that payment that cause conflicts signal high professional standing."

For this reason, the DOL's proposed "Best Interest Contract Exemption" would require financial institutions to, among other things, adopt measures that would explicitly "prevent...material conflicts of interest." This provision would require institutions to take meaningful steps to rein in conflicted practices and compensation structures first and foremost. In short, real investor protection means actually limiting the impact of conflicts of

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interest and requiring advisers always to put the best interests of their clients ahead of their own.

Contrary to your statements, there are some in the industry who have positively regarded the higher standards that the DOL rulemaking would achieve. John Thiel, head of Merrill Lynch Wealth Management, recently said the company has "supported the notion of a consistent and higher standard for every professional that deals...with retirement plans." Walt Bettinger, president and CEO of Charles Schwab Corporation, also noted that he thinks "there are several points in which we have philosophical alignment with what the Department of Labor has shared." Burton Malkiel and Adam Nash, CIO and CEO of Wealthfront, respectively, recently wrote, "The guiding principle of the Labor Department's proposal is absolutely correct and long overdue."

We hope that you will reconsider your ill-advised position on the DOL best interest rule in light of the facts discussed above. Rather than working against the rule, you can work with it, recognizing DOL's unique and important authority under ERISA and committing to give all retirement savers a better chance to live a more dignified retirement. As the CEO of an organization claiming to be "dedicated to investor protection and market integrity," you should be a leader in the fight for the strongest "best interest" fiduciary duty rule possible.

Sincerely,

Dennis M. Kelleher
President & CEO

CC: The Honorable Thomas E. Perez, Secretary of Labor
Phyllis Borzi, Assistant Secretary for Employee Benefits Security, Department of Labor
The Honorable Mary Jo White, Chair, Securities and Exchange Commission