Comments of the Competitive Enterprise Institute and FreedomWorks Foundation

on the

Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice

of the

U.S. Department of Labor, Employee Benefits Security Administration

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Dear Sir or Madam,

On behalf of the Competitive Enterprise Institute and FreedomWorks Foundation, we are pleased to provide these comments on the proposed rulemaking regarding "Definition of the Term 'Fiduciary'; Conflict of Interest Rule Retirement Investment Advice" (RIN 1210-AB32) and associated notices of proposed Prohibited Transactions Exemptions published on April 20, 2015.

Founded in 1984, the Competitive Enterprise Institute (CEI) is a non-profit research and advocacy organization that focuses on regulatory policy from a pro-market perspective. A strong focus of CEI is regulatory barriers affecting access to capital and investor choice. Many of the policy solutions CEI has put forward over the years were incorporated into the Jumpstart Our Business Startups (JOBS) Act, signed by President Barack Obama in 2012.

Over the past four years, Mr. Berlau has testified before the House Energy and Commerce Committee and the House Financial Services Committee on access to credit and capital for consumers and small business. In addition, before he came to CEI, Mr. Berlau had written about both capital formation and investor protection as a journalist for publications such as Investor's Business Daily and the Washington Times. Mr. Kuiper is a CFA® charterholder and former research analyst with Calamos Investments.

FreedomWorks Foundation is a 501(c)(3) educational institution that promotes the adoption of, free market policies that inure to the benefit of consumers and citizens generally. Accordingly, FreedomWorks Foundation has taken an active part in the public debate on issues of economic and regulatory importance in many sectors of the economy, including financial services, energy, and technology, among others. Mr. Brough has testified before Congress, federal agencies, and state legislatures on various regulatory topics. Formerly, he worked at the Office of Information and Regulatory Affairs within the Office of Management and Budget where he was responsible for reviewing transportation regulations.

Introduction: *The rule's underlying premise is wrong – with disclosure and transparency, individuals can "prudently manage" retirement accounts.*

Early on in the proposed regulation, the DOL makes clear that its primary rationale is not preventing fraud or even improving disclosure, but rather restricting choices of individual savers that the DOL deems imprudent. The DOL expresses the view that "seldom" can Americans "prudently manage retirement assets on their own," and that they "generally cannot distinguish … good investment results from bad." Therefore, the rule's restrictions of choices in 401(k)s and individual retirement accounts (IRAs) are supposedly needed because "disclosure alone has proven ineffective."

This rationale is dubious because it goes against core beliefs about individual liberties that not only motivated this country's founding documents, but are expressed by policymakers of many persuasions. This core belief posits that adult individuals – guided by rules for transparency and disclosure – should be able to make informed choices about matters that impact their lives.

In signing the JOBS Act in 2012, President Obama opined that "ordinary Americans" should "be able to go online and invest in entrepreneurs that they believe in."[1] Yet by writing a proposed rule that goes beyond its mandate from the Employee Retirement Income Security Act of 1974 (ERISA) and that end-runs the Securities and Exchange Commission (SEC) in regulation of the securities market, the DOL eviscerates bipartisan goals of investment liberalization from the JOBS Act and other public policies. If the proposed rule goes into effect, not only will today's retirement savers lose choices, they will have to pay dramatically more for basic services to maintain their IRAs and 401(k)s. Thus, the new rule also goes against the intentions of the drafters of ERISA, as saving for retirement will become much less secure.

Savers would become less informed and lose access to brokerage services under the rule.

In this rule, the DOL claims authority under ERISA to reclassify a broad swath of investment professionals as "fiduciaries" with a government-imposed "best interest" standard, which subjects them to heavy penalties and lawsuits if the DOL or a court determines that they deviated from this standard. This is true even for financial professionals, such as appraisers, whose clients manage their own 401(k) portfolios or hold self-directed IRAs. Individual savers could also be hit with excise taxes up to 100 percent if an investment choice they make under current rules is suddenly deemed a "prohibited transaction" under the new rule.

Such restrictions and prohibitions would have devastating impacts on savers' ability to educate themselves through investment guidance and make what they believe are the best choices for their retirement. First, by creating a presumption against broker compensation from mutual funds or annuities – even if there is heightened disclosure to the investor – the rule will force brokers to charge more for services to lower or middle income investors and will likely result in many of these savers losing services entirely. Similar rules implemented by the United Kingdom

[1] "Remarks by the President at JOBS Act Bill Signing," The White House, Apr. 5, 2012, http://www.whitehouse.gov/the-press-office/2012/04/05/remarks-president-jobs-act-bill-signing

in 2013 that banned outside compensation caused banks to stop servicing accounts below $80,000 in U.S. dollars[2]

A study by the consulting firm Oliver Wyman and the Securities Industry and Financial Markets Association concluded that 12 million to 17 million investors could lose access to their current service providers under a less stringent fiduciary mandate considered by the SEC—so losses under the proposed DOL rule likely would be even worse.[3] And because the proposed rule does not even contain a simple exemption for call centers, investors may lose crucial outside guidance to simple queries.

Clearly, investors should be able to choose which model of investment professionals they want servicing their retirement accounts. And clearly, in the case of IRAs, they should be allowed a broad choice of assets to have in their accounts.

Many self-directed IRAs contain, by the individual investor's design, everything from precious metals such as gold and silver to peer-to-peer loans from platforms such as Prosper and Lending Club. Venture capitalists and angel investors have also given crucial seed funding to startup businesses through their IRAs, and some of these firms went on to create thousands of jobs and changed the way we live. According to Forbes, venture capitalist Peter Thiel invested in Facebook in its early stages partially through his IRA.[4] Whether inclusion of these alternative assets is a good investment strategy is a matter of opinion, but it should be a choice for the investor to make. But this is a choice they may lose if mere appraisers of assets in IRAs -- who don't in any way purport to provide investment advice -- are suddenly deemed "fiduciaries" under this rule.

There is no such thing as a one-size fits all 'best interest'

Some commenters critical of the proposed rule have professed support for some type of "best interest" mandate. We decline to do so, as we believe that discerning investors in choosing their service providers are best suited to determine their own best interests. Any government edict for "best interest" runs the dangers of biasing investors and financial professionals toward investments they believe the government favors.

This is illustrated in the proposed rule's seeming favoritism toward passively managed index funds, as opposed to actively managed funds. The rule states, "Facilitating investments in such

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[2] Testimony of Kent A. Mason before the Education and the Workforce Committee, U.S. House of Representatives, June 17, 2015, http://edworkforce.house.gov/uploadedfiles/testimony_mason.pdf

[3] "Study - Standard of Care Harmonization, Impact Assessment for SEC," Oliver Wyman and the Securities Industry and Financial Markets Association, Nov. 1, 2010, http://www.sifma.org/issues/item.aspx?id=21999

[4] Deborah L. Jacobs, "How A Serial Entrepreneur Built A $95 Million Tax Free Roth IRA," *Forbes,* Mar. 20, 2012, http://www.forbes.com/sites/deborahljacobs/2012/03/20/how-facebook-billionaires-dodge-mega-millions-in-taxes/

high-quality, low-fee products would be consistent with the prevailing (though by no means universal) view in the academic literature that posits that the optimal investment strategy is often to buy and hold a diversified portfolio of assets calibrated to track the overall performance of financial markets."

This greatly oversimplifies the current debate among financial experts. Index funds may in aggregate be cheaper, but their low expense ratios do not reflect the total cost. Active managers, for instance, can protect investors on the downside, pure passive and index investing cannot. Studies have confirmed active funds' underperformance on the way up during booms but outperformance on the way down during busts.[5] This is an incredibly important and overlooked fact, especially for those savers nearing retirement who don't have another 20 years or more left in their investing lifetime. For them, capital *preservation* is much more important than capital *appreciation*. Yet this fact gets lost in the proposed rule, as DOL cites studies that only look at total and aggregate outperformance vs. underperformance with a perpetual time frame.

Also important is that not *all* active managers consistently underperform and investors should have the freedom to try to invest in those that do outperform. Research on how active funds, *in aggregate*, do not outperform passive funds after fees does not mean there are not specific managers or funds that consistently outperform. Such managers have been documented,[6] and investors should be allowed to use their own money to try to choose outperforming funds. Restricting investment choices to what the government deems as superior would be akin to restricting consumer choice to certain car models or manufacturers that bureaucrats deem are better.

Conclusion

In the past two weeks, there has been a surge of new comments. Feedback for the rule has climbed to around 2000 comments. Many of the commenters express the view that they simply want to be left alone. "Stay out of my retirement investing,"[7] and "please stay out of my 401(k)"[8] are the typical sentiments of these concise comments.

The DOL should heed these voices, review the complete set of data and withdraw the proposed rule. Then, it should offer a new proposal that allows for improved disclosure and broadened investment options.

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[5] Robert Isbitts, "Index funds beat active 90% of the time. Really?," *Advisor Perspectives*, Aug. 2, 2014, http://www.advisorperspectives.com/commentaries/sungarden_080214.php

[6] Among the outperforming funds available to retail investors listed by Morningstar.com are the Artisan Global Value Investor, the Artisan International Value Investor, and the Oakmark I

[7] Comments of Stan Nackdymon to the Employee Benefits Security Administration of the U.S. Department of Labor, July 9, 2015, http://www.regulations.gov/#!documentDetail;D=EBSA-2010-0050-0474

[8] Comments of John O'Neill to the Employee Benefits Security Administration of the U.S. Department of Labor, July 7, 2015, http://www.regulations.gov/#!documentDetail;D=EBSA-2010-0050-0431

Sincerely,

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