TREASURY DEPARTMENT
COMMONWEALTH OF PENNSYLVANIA
HARRISBURG, PA 17120

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Via Electronic Submission

Chairman Jay Clayton
U.S. Securities and Exchange Commission
100 First Street NE
Washington, D.C. 20210

RE: Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers

Dear Chairman Clayton:

Thank you for your request for public input regarding the Securities and Exchange Commission's (SEC) reassessment of the current regulatory framework governing retail investments.[1] As a bipartisan coalition of State Treasurers from across the country, we recognize the many financial perils facing individual investors, and endorsed the Department of Labor's Fiduciary Rule as a critical protection. We urge the SEC to develop a regulatory framework that will ensure that all financial professionals who offer advice on investments must hold their clients' interests first.

We come from a diverse coalition of states and perspectives, yet we share a common underlying belief: individual investors must be protected. As the chief financial officers and the voice of financial leadership in our states, treasurers want people to save in the manner most appropriate for them, and we want those professionals that facilitate saving and investing to be fairly compensated for their sound advice. As this letter will present, the Fiduciary Rule has already improved the retirement savings market, but these improvements are threatened by the DOL's partial delay of the Fiduciary Rule and could be undermined or undone by a weakened securities regulation by the SEC.

Interest of State Treasurers

As State Treasurers, we are on the front lines of the retirement crisis, and many of us are exploring policies and programs to encourage early retirement savings in an effort to help individuals achieve basic retirement security. As Americans rely less on defined benefit plans and increasingly on individual savings to carry them through their retirement years, the role of private financial advisors has become ever more critical to the large and growing number of individual investors that must be encouraged and safeguarded in their efforts to save for their futures. It is estimated that as many as 45 percent of working age households have no retirement savings, and those that do have median balances of only $3,000.[2] Those with inadequate retirement savings will inevitably rely disproportionately on public assistance in their retirement years. The SEC must step in to protect investors where the DOL has only partially succeeded.

State Treasurers regard the duty of loyalty as an essential public investor protection.

As State Treasurers, we serve as custodians of each state's treasury and ensure the prudent oversight of entrusted public funds. As our states' chief financial officers, we administer a variety of financial programs, including higher education savings accounts, investment accounts for disabled individuals, financial literacy programs, and unclaimed property programs.

A significant responsibility of ours is the prudent management and, in many states, the investment of public funds, often under contract with private investment managers. A central provision within each contract involving the investment of public funds is a statement detailing the applicable standard of care. Consistent with our responsibility to prudently manage public funds, and recognizing the absolute necessity to ensure that investment managers entrusted with public funds make investment decisions in the best interest of taxpayers, State Treasurers routinely demand the inclusion of a written fiduciary standard that requires managers to act in the sole beneficial interest of the public funds they manage.

The DOL's Fiduciary Rule requires such a standard of all financial professionals who offer retirement investment advice by asserting that they must adhere to standards of "impartial conduct," "give prudent advice that is in the customer's best interest, avoid misleading statements, and receive no more than reasonable compensation."[3] Any standard less robust than this does not provide adequate protection for investors. The DOL's adoption of the Fiduciary Rule is premised upon an explicit recognition that the investment advice provided to individual investors is often conflicted, and that such conflicts are "widespread," and cause "serious harm" to plan and IRA investors.[4] The underlying record supports the DOL's finding that the "impact of these conflicts of interest on retirement investment outcomes is large and widespread."[5]

In fact, even partially implemented, the Fiduciary Rule is already delivering tangible benefits to retirement investors. These benefits – which include innovations and adaptations by financial firms such as the shift of retirement accounts to asset-based fee structures, the reduction of conflicts of interest (including in commission accounts), and the introduction of innovative new investment products such as mutual fund clean shares, which the Commission approved last year – will result in lower costs to investors.[6] The DOL originally estimated that full implementation of the Fiduciary Rule will return between $33 and $36 billion in potential gains to individual retirement account (IRA) investors over the first 10 years, for just one segment of the market.[7] Even greater gains could be realized under an SEC regulation that protects both qualified and non-qualified accounts.

There has been no legal or factual development since the DOL's adoption of the Rule that would support a reevaluation or revision of the underlying need and purpose of the Rule. Legal efforts to challenge implementation of the Fiduciary Rule have been unsuccessful, with the federal court concluding on each occasion that the Department was well within its authority to adopt and immediately implement the protections contained within the Rule.[8]

Delay of the Fiduciary Rule imperils consumers.

Unfortunately, although the core principal of the Fiduciary Rule is now in place, it has been undermined by the delay until July 2019 of all regulatory enforcement mechanisms to ensure compliance with the Rule, including, *inter alia*, the requirements to enter into a written contract (which gives rise to breach of contract claims as an enforcement mechanism for IRA investors) and to adopt policies and procedures to minimize conflicts. During the delay, the DOL is under executive order to review the exemptions, consider "possible changes and alternatives," and may ultimately "decide to revise or repeal" them.[9]

This implementation delay, and the accompanying non-enforcement agreement, represent a step back in terms of protecting the interests of retirement savers and investors. While firms are operating under a period of "temporary enforcement" of the Fiduciary Rule from DOL, they are perpetuating variable compensation, revenue sharing, and other conflicts of interest targeted by the Rule as long as they make a "good faith" effort to adhere to impartial conduct standards.[10] As the Consumer Federation of America recently noted, market research conducted by the broker-dealer industry indicates that a majority (64 percent) of firms have changed neither their product mix, nor their internal compensation arrangements in order to comply with the Fiduciary Rule, despite progress made by their industry peers since 2016.[11]

The DOL has admitted that the cost of this delay will be borne by retirement savers in the form of a "deferral of some of the estimated investor gains" that would otherwise be realized under full implementation.[12] These gains might never be realized if firms can use the SEC's current disclosure-based standard to satisfy the DOL Fiduciary Rule requirements. As noted by the AARP, "A best interest standard that does not require firms to reduce incentives that reward and encourage advice that is not in investors' best interests is likely to be a best interest standard in name only."[13] The SEC is uniquely situated to close the door on harmful pricing and practices through its imposition of a robust best-interest standard of care for all financial professionals who offer investment advice about securities.

As State Treasurers, we share the SEC's interest in being responsive not only to investors but to the financial industry as well. A balanced regulatory framework will also take both of these perspectives into account. In considering a universal standard, we urge the SEC to incorporate the DOL Fiduciary Rule's Best Interest Contract Exemption (BICE) into any proposed regulatory framework. The BICE allows for commissions, and thus certain basic conflicts, while ensuring that investment advice remains in the best interests of the customer. In short, BICE expands the range of investor options while preserving reasonable financial services practices and protecting industry from an overly burdensome regulatory structure.

Weak regulations by the SEC will undermine investor protections.

We are encouraged by the SEC's intention to work closely with the DOL to develop a fiduciary standard that would be applicable to advisers as well as broker-dealers, across all securities investment accounts, not just retirement accounts.[14] While the idea of a universal standard for all financial advisers has merit, it would not be worth the compromise of a weakened fiduciary rule – in particular, one that does not hold advisers to a standard of impartial, conflict-free conduct, but rather allows them to act in their own self-interest, instead of their clients' best interests, as long as they disclose it.

Disclosure is not enough. The SEC's own review of research demonstrates that the average retail investor lacks basic financial literacy, with a "weak grasp of elementary financial principals" and lacking "critical knowledge of ways to avoid investment fraud."[15] We encourage your staff to review the DOL's Regulatory Impact Analysis, which finds that "most individuals cannot distinguish between the different types of advisers or the different standards of conduct to which different advisers must adhere, and this confusion is exacerbated by industry marketing and other practices" among broker-dealers and investment advisers.[16]

Accordingly, we strongly urge the SEC to consider the overwhelming record of evidence that disclosures alone are insufficient to reduce investor confusion or to protect investors from the harm of conflicted advice. A strong and effective rule must instead "combine a best interest standard with restrictions on practices that encourage recommendations that are not in customers' best interests," just as the Department of Labor Fiduciary Rule – in its entirety – does.[17] The development of such a rule from the SEC would ensure that when retail investors receive investment advice about their taxable securities accounts, they receive the same critical protections as they do for their retirement accounts. It would effectively close the door on broker-dealers' attempts to use a weak, disclosure-based SEC rule to circumvent the stronger protections DOL has adopted for retirement accounts.

Conclusion

As State Treasurers, we are committed to protecting the financial interests of our constituents – in particular, ensuring that retirement planning and investment advice is not conflicted, and is provided in the sole interest of savers. With the partial implementation of the DOL's Fiduciary Rule, the investment market is arguably more treacherous now than before for retail investors. While such investors have been led to expect conflict-free advice from a broker-dealer regarding retirement assets, the implementation delay and non-enforcement policy call that into question. Meanwhile, they have no such assurance regarding other investments. The SEC must take action to correct this market inequity and confusion. We are encouraged that the SEC is committed to developing standards which are, in your own words, "clear and comprehensible to the average investor, consistent across retirement and non-retirement assets and coordinated with other regulatory entities, including the DOL and state insurance regulators."[18]

Thank you for your commitment to an SEC that will serve not just financial professionals, but the long-term interests of "Mr. and Mrs. 401(k)."[19] We share this dual priority, and we look forward to the SEC's efforts to ensure that their future financial security is protected.

Sincerely,

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Pennsylvania State Treasurer

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[1] Public Statement, Chairman Jay Clayton, Securities and Exchange Commission, June 1, 2017. Available at: https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31

[2] National Institute on Retirement Security, *The Retirement Savings Crisis: Is it worse than we think?* (June 2013). Available at: https://www.nirsonline.org/wp-content/uploads/2017/06/retirementsavingscrisis_final.pdf

[3] Federal Register, Vol. 81, No. 68 at 20947 (April 8, 2016).

[4] Federal Register, Vol. 81, No. 68 at 20950 (April 8, 2016).

[5] *Id.*

[6] Letter from Barbara Roper and Micah Hauptman, Consumer Federation of America, to the Department of Labor, August 7, 2017, at 3-20.

[7] Regulating Advice Markets, Regulatory Impact Analysis for Final Rule and Exemptions, Department of Labor, April 2016, at 170.

[8] *United States Chamber of Commerce v. Hugler,* 2017 U.S. Dist. LEXIS 17619 (N.D. Tex., Feb 8, 2017) (The Court upheld the Fiduciary Rule by granting the Department of Labor's motion for summary judgment and determined that the rule is a "reasonable interpretation under ERISA and is entitled to Chevron deference."); *MKT Synergy Grp., Inc., v. United States Dep't of Labor, et. Al.,* 2017 U.S. Dist. LEXIS 23155 (D. Kan., Feb 17, 2017) (The Court determined that the Plaintiff failed to establish the requirements necessary for preliminary relief because "the Plaintiff could not establish irreparable harm, that the balance of equities tips in its favor, or that an injunction is in the public interest."); *Nat'l Ass'n for Fixed Annuities v. Perez,* 2016 U.S. Dist. LEXIS 162428 (D.D.C., Nov. 4, 2016) (The Court upheld the Fiduciary Rule and stated "the new rules were adopted to protect retirement investors from conflicted advice and potential losses to their retirement savings. Enjoining the rule would delay this protection.").

[9] Federal Register, Vol. 82, No. 168 at 41365 (August 31, 2017).

[10] Department of Labor Field Assistance Bulletin 2017-02 (May 22, 2017).

[11] Letter from Micah Hauptman and Barbara Roper, Consumer Federation of America, to the Department of Labor, October 10, 2017. Available at: https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA27/00141.pdf

[12] Federal Register, Vol. 41, No. 365, at 41372 (August 31, 2017).

[13] Letter from the AARP to the SEC Re: Request for Comment on Standards of Conduct for Investment Advisers and Broker-Dealers, September 6, 2017. Available at: https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2278279-160981.pdf

[14] Testimony on Examining the SEC's Agenda, Operation, and Budget, from Chairman Jay Clayton, Securities and Exchange Commission, before the U.S. House Financial Services Committee, October 4, 2017.

[15] August 2012 SEC Study Regarding Financial Literacy Among Investors. Available at: https://www.sec.gov/news/studies/2012/917-financial-literacy-study-part1.pdf

[16] April 2016 DOL Regulatory Impact Analysis for Final Rule and Exemptions, page 108. Available at: https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/completed-rulemaking/1210-AB32-2/conflict-of-interest-ria.pdf

[17] Letter from Barbara Roper and Micah Hauptman, Consumer federation of America, to Chairman Jay Clayton, Securities and Exchange Commission, September 14, 2017. See pages 37 – 43. Available at: https://www.sec.gov/comments/ia-bd-conduct-standards/cll4-2447346-161075.pdf

[18] Testimony on Examining the SEC's Agenda, Operation, and Budget, from Chairman Jay Clayton, Securities and Exchange Commission, before the U.S. House Financial Services Committee, October 4, 2017.

[19] Id.