IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF TEXAS

CHAMBER OF COMMERCE OF THE UNITED STATES OF AMERICA, et al.,

Plaintiffs,

v.

THOMAS E. PEREZ, SECRETARY OF LABOR, and UNITED STATES DEPARTMENT OF LABOR,

Defendants.

Civil Action No. 3:16-cv-1476-M
Consolidated with:
3:16-cv-1530-C
3:16-cv-1537-N
Hon. Barbara M. G. Lynn

BRIEF OF PUBLIC INVESTORS ARBITRATION BAR ASSOCIATION
AS *AMICUS CURIAE* IN SUPPORT OF DEFENDANTS

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TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Regulations

Rules

Other Authorities

INTRODUCTION AND INTEREST OF *AMICUS CURIAE*

The Public Investors Arbitration Bar Association ("PIABA") is an international bar association whose members represent investors in disputes with the securities industry. Currently, there are over 400 members from 44 states, Puerto Rico, and Japan. PIABA was established in 1990 as an educational and networking organization for securities arbitration attorneys who represent the public investor in securities disputes. Many PIABA members are involved in promoting the interests of the public investor in securities and commodities arbitration through service on committees of PIABA, as well as national, state and local bar associations.

The mission of PIABA is to promote the interests of the public investor in securities and commodities arbitration by protecting public investors from abuses in the arbitration process; making securities and commodities arbitration as just and fair as systematically possible; and creating a level playing field for the public investor in securities and commodities arbitration.

PIABA accomplishes its mission partly through active involvement in the administrative rule-making process. PIABA members have a strong interest in the standards of conduct that govern those who advise investors. PIABA members represent investors who have received conflicted advice from investment advisers, securities brokers, and insurance brokers, often for their retirement accounts. PIABA members have seen firsthand the harm that has resulted from the regulatory system that falls short of protecting the public. PIABA gave a voice in the rule-making process to those investors and advocates for their protection.

This case involves a rule which has been adopted by the Department of Labor (the "Department") governing retirement investment advice, as well as related exemptions (collectively, the "rulemaking"). The three sets of Plaintiffs in this case (hereinafter the "Consolidated Plaintiffs") contest the Department's rulemaking on a number of grounds. Because PIABA is a bar association consisting of attorneys who primarily represent investors, PIABA can speak to the impact on investors of the current system if the Department's Conflict of Interest Rule is not fully enacted and the status quo is maintained. In furtherance of this, PIABA can also provide some background as to the current statutory and regulatory structure, and how the Department's rulemaking fits within that structure. PIABA will focus primarily on the rule and two of the related exemptions. Definition of the Term "Fiduciary"; Conflict of Interest Rule – Ret. Inv. Advice, 81 Fed. Reg. 20946, 20997 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2510.3-21) (the "Department's Conflict of Interest Rule"), Best Interest Contract Exemption, 81 Fed. Reg. 21002, 21076 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2550) (the "BIC Exemption"), and Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 84–24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, and Investment Company Principal Underwriters, 81 Fed. Reg. 21147, 21174 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2550) ("PTE 84-24"). For the reasons set forth below, the Consolidated Plaintiffs' request for summary judgment should be denied, and full implementation of the rule should proceed.

ARGUMENT

The federal laws governing investment advice have been enacted in a piecemeal fashion over the past eight decades. Throughout this time period, a number of different agencies have been granted authority to regulate the financial services industry. Each statute passed by Congress has served a particular purpose, and the various agencies have been entrusted with authority for carrying out the stated purposes of each statute. The result of this piecemeal legislation has led to overlapping jurisdiction over the financial services industry; however, the purposes behind the various statutes remain distinct.

The Department is responsible for administering ERISA, while the Securities and Exchange Commission is responsible for administering a good portion of the securities statutes. Those who provide investment advice fall under the jurisdiction of both, as well as other regulatory bodies.

There is nothing in any of the relevant statutory text, legislative history, or regulations which prevents this multi-layered regulation of investment advice. Multi-layered regulation is a standard part of the industry, and as will be demonstrated, multi-layered regulation is necessary for the protection of investors.

The Consolidated Plaintiffs have filed motions for summary judgment, seeking to vacate the Department's rulemaking. "An agency determination or action is reviewed, not tried, by the district court; "[f]actual issues have been presented, disputed, and resolved."" *Garcia for Cong. v. Fed. Election Comm'n*, 22 F. Supp. 3d 655, 658 (N.D. Tex. 2014). Therefore, unlike a Federal Rules of Civil Procedure 56 motion for summary judgment, "the court determines not whether the material facts are disputed, but whether the agency properly dealt with the facts." *Id.* (Internal quotations omitted.) Here, the Department properly dealt with the facts before it, and issued appropriate and necessary rulemaking to protect retirement investors. Accordingly, the Department's rulemaking should be permitted to proceed.

I. Laws Governing the Securities Industry and Investment Advice

A. Federal and State Regulation of Investment Advice

The foundation for the legislative and regulatory framework governing the securities industry was constructed following the stock market crash in 1929. Congress adopted the first of the federal statutes governing the securities industry, the Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified at 15 U.S.C. § 77a, *et seq.* (2012)), in the midst of the Great Depression. This statute "require[s] that investors receive financial and other significant information concerning securities being offered for public sale." *The Laws That Govern the Sec. Indus.*, Sec. & Exch. Comm'n., https://www.sec.gov/about/laws.shtml.

A year later, Congress adopted the Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified at 15 U.S.C. § 78a, *et seq.* (2012)) (the "1934 Act"). Congress created the

Securities and Exchange Commission (the "SEC") with the 1934 Act, and empowered it "to register, regulate, and oversee brokerage firms, transfer agents, and clearing agencies as well as the nation's securities self-regulatory organizations (SROs)." *The Laws That Govern the Sec. Indus.*, Sec. & Exch. Comm'n.

Congress continued to consider additional regulation of the securities industry. In 1939, the SEC submitted a report to Congress on Investment Trusts and Investment Companies.[1] The report examined investment counselor firms and investment counselors, who were not regulated broadly at that time. Representatives of investment counselors recognized that their function was the "furnishing to clients on a personal basis competent, unbiased, and continuous advice regarding the sound management of their investments" and they could not do this "unless all conflicts of interest between the investment counsel and the client were removed." *Id.* at 28. Following the issuance of this report, Congress adopted the Investment Advisers Act of 1940, ch. 686, 54 Stat. 847 (1940) (codified at 15 U.S.C. § 80b-1, *et seq.* (2012)) (the "Advisers Act").

In 1974, Congress adopted the Employee Retirement Income Security Act, Pub L. 93-406, 88 Stat 832 (1974) (codified at 29 U.S.C. § 1001, *et seq.* (2012)) ("ERISA"). Although not exclusively regulating the securities industry, it does regulate investment advice when rendered in connection with retirement accounts. Congress determined that it would protect participants in employee benefit plans and their beneficiaries "by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans, and by providing for appropriate remedies, sanctions, and ready access to the Federal courts." *Id.* at § 1001(b). Congress adopted a definition of "fiduciary" which covered those who rendered investment advice. *See Id.* at § 1002(21)(A). A parallel definition was adopted under the Internal Revenue Code (the "Code"), as applicable to IRAs. *See*

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[1] *See Inv. Trusts and Inv. Cos.: Report of the Sec. and Exch. Comm'n Pursuant to Section 30 of the Public Utility Holding Co. Act of 1935*, Sec. & Exch. Comm'n (1939).

Tax on Prohibited Transactions, Pub. L. 93-406, 88 Stat. 829, 971 (1974) (codified at 26 U.S.C. § 4975(e)(3) (2012)).

By 1978, the Department was given certain responsibilities under both ERISA and the Code for employee benefit plans and IRAs, as explained by President Carter: "Labor will have statutory authority for fiduciary obligations. ERISA prohibits transactions in which self-interest or conflict of interest could occur, but allows certain exemptions from these prohibitions. Labor will be responsible for overseeing fiduciary conduct under these provisions." Reorganization Plan No. 4 of 1978, § 102, 43 FR 47713 (1978).

Insurance has been regulated primarily at the state level. In 1871, nineteen of thirty six state insurance regulators sent representatives to the inaugural meeting of the organization now known as the National Association of Insurance Commissioners ("NAIC") to discuss the importance of uniform regulation. *See* Fed. Ins. Office, How to Modernize and Improve the System of Insurance Regulation in the United States 11 (2013). Today, the NAIC coordinates state insurance regulation by developing model legislation, rules, and regulations. *Id.* at 12. The NAIC has developed numerous model laws and regulations on a comprehensive list of topics, including the Suitability in Annuity Transactions Model Regulation. Suitability in Annuity Transactions Model Regulation, MDL-275 (2015), http://www.naic.org/store/free/MDL-275.pdf.

B. Exemptions to the Regulation of Investment Advice

Within the statutes governing the regulation of investment advice, there exist certain exemptions, which carve out categories of individuals exempted from the coverage of the statute.

For example, under the Advisers Act, investment advisers are defined to exclude "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." Definitions, 15 U.S.C. § 80b-2(11)(C) (2012). At the time Congress adopted this definition, it had considered the statutes then in effect at the state levels. Brokers were sometimes exempted from the state statutes covering investment counselors because any investment advice furnished by them was incidental to other functions they performed. *See Memorandum submitted by the Securities and Exchange Commission entitled "Statutory Regulation of Investment Counselors, by research department, Illinois Legislative Council,"* Investment Company Act of 1940 and Investment Act of 1940, P.L. No. 768, 1005, 1007 (1940). Thus, in the Advisers Act, Congress adopted similar language, conditioning the exemption on the provision of advice being incidental to the conduct of the broker's business, and the broker not receiving any special compensation for the advice. It was clear, however, that a broker may be subject to the Advisers Act if both of these conditions were not met. At the time, the SEC's General Counsel offered his opinion on the topic:

> Clause (C) of Section 202(a)(11) amounts to a recognition that brokers and dealers commonly give a certain amount of advice to their customers in the course of their regular business, and that it would be inappropriate to bring them within the scope of the Investment Advisers Act merely because of this aspect of their business. On the other hand, that portion of clause (C) which refers to 'special compensation' amounts to an equally clear recognition that a broker or dealer who is specially compensated for the rendition of advice should be considered an investment adviser and not be excluded from the purview of the Act merely because he is also engaged in effecting market transactions in securities.

Opinion of General Counsel Relating to Section 202(a)(11)(c), Investment Advisers Act Release No. 2, 1940 WL 975 (Oct. 28, 1940).

Over time, brokers expanded the services and fee structures they offered their clients to include fee-based programs. Through the fee-based programs, brokers offered investors "a package of brokerage services—including execution, investment advice, custodial and recordkeeping services—for a fixed fee or a fee based on the amount of assets on account with the broker-dealer." Certain Broker-Dealers Deemed Not To Be Investment Advisers, Release No. 34-42099, Investment Advisers Act Release No. 1845, 64 Fed. Reg. 61226-01, 61228 (Nov. 10, 1999). The SEC recognized that fees earned in fee-based accounts might constitute "special compensation" for advice under the Advisers Act. *Id.* at 61227. However, the SEC did not believe that these compensation arrangements should subject brokers to the Advisers Act. "While in 1940 the form of compensation a broker-dealer received may have been a reliable distinction between brokerage and advisory services, development of the new brokerage programs suggest strongly that it is no longer." *Id.* Accordingly, in 2005, the SEC adopted Rule 202(a)(11)-1(a), which stated that brokers would not be required to treat clients as advisory customers so long as the advice remained solely incidental to the brokerage services provided to the customer. Certain Broker-Dealers Deemed Not To Be Investment Advisers, Release No. 34-51523, Investment Advisers Act Release No. 2376, 70 Fed. Reg. 20424-01, 20434 (Apr. 19, 2005).

Not long after this rule was adopted, it was challenged, and the Court of Appeals for the D.C. Circuit rejected the SEC's power to adopt such a rule. *Fin. Planning Ass'n v. SEC*, 482 F.3d 481 (D.C. Cir. 2007). The court found that the adoption of Rule 202(a)(11)-1 was the SEC's attempt to expand the exemption for brokers by utilizing its broad power to exempt "other persons." *Id.* at 487-90. However, because Congress had already provided for an express exemption for brokers, the SEC could create a separate exemption for them. *Id.* Following the ruling, brokers who offered fee-based accounts were required to register as investment advisers and comply with the Advisers Act.

C. Overlap in Regulation

The Department's jurisdiction over the financial services industry has, at times, overlapped with the jurisdiction of other regulators. An example where financial services firms are subject to different laws relates to a practice known as "agency cross trading." Agency cross trading is a practice in which an investment adviser or an affiliated broker dealer sells portfolio securities from one client account to another client account without going through a public market. The theory behind these types of trades is reduction of transaction costs. Mutual funds are permitted to cross trade pursuant to Rule 17a-7 under the Investment Company Act of 1940 subject to review by the fund's Board of Directors. Exemption of certain purchase or sale transactions between an investment company and certain affiliated persons thereof, 17 C.F.R. § 270.17a–7 (2016). Rule 206(3)-2 under the Investment Advisers Act of 1940 permits the practice for separately managed accounts provided certain disclosure and other transaction-related requirements are met. Agency cross transactions for advisory clients, 17 C.F.R. § 275.206(3)–2 (2016). Section 406(b)(2) under ERISA, on the other hand, prohibits the practice of cross trading except for plans with assets of at least $100 million. Exemptions from prohibited transactions, 29 U.S.C. § 1108 (19) (2012). Compliance with the statute exempts investment managers from the prohibited transactions restrictions under ERISA. The Department set forth certain content standards for the investment manager's cross trading policies and procedures, if the investment manager wished to rely on the exemption. *See* Statutory exemption for cross-trading of securities, 29 C.F.R. 2550.408b-19 (Oct. 7, 2008). The requirements set forth by the Department were stricter than those required under either the Investment Company Act or the Advisers Act. Accordingly, a transaction that may otherwise be in compliance with the Investment Company Act and the Investment Advisers Act may conversely subject an investment manager to an enforcement action by the Department and a private cause of action for civil liabilities under ERISA by the plans involved in the non-compliant transaction.

Over the years, the Department has continued to exercise its oversight with respect to financial services firms, sometimes working with the SEC. For example:

- In January 2014, the DOL and the SEC combined forces to reach a settlement with Western Asset Management Company to restore $17.4 million to various pension plans that were victimized by Western's prohibited transactions. https://www.dol.gov/newsroom/releases/ebsa/ebsa20140113

- In April 2014, an investment adviser, Donald Gene DeWaay, Jr. agreed to pay $341,487 to 68 ERISA plans for failing to act solely in the best interest of plan participants. https://www.dol.gov/newsroom/releases/ebsa/ebsa20140628
- In December 2011, Merrill Lynch settled allegations it gave imprudent investment advice to two pension plans. In the settlement, Merrill Lynch agreed to restore the losses to the plans and place the employee involved under a heightened supervision plan for two years. https://www.dol.gov/ebsa/newsroom/2011/11-1673-ATL.html

II. Standards of Conduct Applicable to the Provision of Investment Advice

There are a number of statutes and regulations that govern the provision of investment advice; accordingly, there are a number of different standards of conduct applicable to the giving of advice depending on who is giving the advice and what type of advice is being given.

Both the 1934 Act and the Advisers Act contain antifraud provisions, which are the primary source for the standards of conduct applicable to securities brokers and investment advisers. The Supreme Court has examined both the 1934 Act and the Advisers Act to determine the standard of care associated with each Act. In doing so, the Court has focused on the level of intent necessary to find a violation of each Act's antifraud provision. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

In examining the Advisers Act, the Court concluded the relationship was fiduciary in nature. *Capital Gains Research Bureau*, 375 U.S. at 191. Justice Goldberg, writing for the majority, stated,

> And the Committee Reports indicate a desire to preserve 'the personalized character of the services of investment advisers,' and to eliminate conflicts of interest between the investment adviser and the clients as safeguards both to 'unsophisticated investors' and to 'bona fide investment counsel.' The Investment Advisers Act of 1940 thus reflects a congressional recognition 'of the delicate fiduciary nature of an investment advisory relationship,' as well as a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline as investment adviser—consciously or unconsciously—to render advice which was not disinterested. It would defeat the manifest purpose of the Investment Advisers Act of 1940 for us to

> hold, therefore, that Congress, in empowering the courts to enjoin any practice which operates 'as a fraud or deceit,' intended to require proof of intent to injure and actual injury to clients.

Id. at 191–92.

With respect to the 1934 Act, the Supreme Court has determined that the antifraud section was intended to cover behavior that involved some element of scienter. *See Ernst & Ernst*, 425 U.S. at 201. As explained by the Court, "Section 10(b) makes unlawful the use or employment of 'any manipulative or deceptive device or contrivance' in contravention of Commission rules. The words 'manipulative or deceptive' used in conjunction with 'device or contrivance' strongly suggest that [section] 10(b) was intended to proscribe knowing or intentional conduct." *Id.* at 197. The Court was "unwilling to extend the scope of the statute to negligent conduct." *Id.* at 214. Accordingly, the antifraud section of the 1934 Act has not been viewed as creating a fiduciary standard.

Although the term fiduciary is not found within the Advisors Act, the Supreme Court has held that an investment adviser is held to a fiduciary standard which includes "an affirmative duty of 'utmost good faith, and full and fair disclosure of all material facts,' as well as an affirmative obligation 'to employ reasonable care to avoid misleading' . . . clients." *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). This fiduciary duty imposes continuing duties of loyalty and care. *See* SEC Staff, *Study on Inv. Advisers and Broker-Dealers*, p. 22 (2011), https://www.sec.gov/news/studies/2011/913studyfinal.pdf. The duty of loyalty requires investment advisers to act in their clients' best interests and disclose all conflicts of interest. *Id.* The duty of care requires investment advisers to provide suitable investment advice after investigating a customer's financial situation and investment objectives. *Id.* at 27-28.

A securities broker has other obligations to investors which are defined by FINRA rules.[2] FINRA Rule 2111 (the "Suitability Rule") governs the recommendations a securities broker or brokerage firm makes to an investor. The Suitability Rule provides in relevant part:

> A member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile.

FINRA Manual, Fin. Indus. Regulatory Auth., Rule 2111(b).[3]

Layered upon the federal regulatory scheme is state regulation and state common law, which also governs the conduct of securities brokers. A number of states impose a fiduciary duty upon brokers as a matter of common law. In some states, the broker is a fiduciary simply by virtue of being a broker; in other states, a broker may be deemed a fiduciary depending upon the relationship between the broker and the customer.[4] Thus, securities brokers are subject to the FINRA Suitability Rule and may also be subject to a fiduciary standard depending on the state in which they are doing business and/or the nature of their relationship with their customer. However, the duties vary widely across the country.

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[2] FINRA is a self-regulatory organization, and is responsible for regulating brokerage firms and securities brokers. *See What We Do*, Fin. Indus. Regulatory Auth., http://www.finra.org/about/what-we-do.

[3] A "member" is a brokerage firm and an "associated person" is a securities broker.

[4] *See, e.g., Glisson v. Freeman*, 532 S.E.2d 442, 449 (Ga. Ct. App. 2000) (A "stockbroker's duty to account to its customer is fiduciary in nature, so that the broker is obligated to exercise the utmost good faith."); *Thropp v. Bache Halsey Stuart Shields, Inc.*, 650 F.2d 817, 819 (6th Cir. 1981) ("As a fiduciary, a broker stands in a special relationship to a client and owes him a duty to use reasonable care and to act in good faith."); *Dinsmore v. Piper Jaffray, Inc.*, 593 N.W.2d 41, 46 (S.D. 1999) ("Investors, as a rule, employ securities brokers to perform specialized financial services and entrust the brokers with the authority to act for them. This repose of trust in the broker, that the broker will act in the client's best interest, is a mark of a fiduciary relationship."); *Leib v. Merrill, Lynch, Pierce, Fenner & Smith*, 461 F.Supp. 951, 952 (E.D. Mich. 1978) ("Unlike the broker who handles a nondiscretionary account, the broker handling a discretionary account becomes the fiduciary of his customer in a broad sense.").

Unlike the 1934 Act and the Advisers Act, ERISA created an affirmative fiduciary standard within the Act itself, and defined those who would be subject to the standard. ERISA included as a fiduciary any person:

> to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

Definitions, 29 U.S.C. § 1002(21)(A) (2012). This definition was broad, covering a variety of relationships between the "fiduciary" and the plan. Unlike the definition of "investment adviser" under the Advisers Act, ERISA's definition of fiduciary did not contain any exemptions, conditional or otherwise.

Following the enactment of ERISA, the Department promulgated a five-part test which determined when someone would be deemed to be rendering investment advice, and as a result, deemed a "fiduciary" under the second prong of the above definition. *See* Definition of Fiduciary, 29 C.F.R. § 2510.3-21(j)(1) (2016).[5] A person would only be a fiduciary if such person (i) rendered advice to a plan as to the value of securities or other property, or made recommendations as to the advisability of investing in, purchasing, or selling securities or other property; (ii) on a regular basis; (iii) pursuant to a mutual agreement, arrangement or understanding, written or otherwise; (iv) that such advice would serve as a primary basis for investment decisions with respect to plan assets; and (v) the advice would be individualized based on the particular needs of the plan. *See Id.*, *see also* Definition of Fiduciary, 26 C.F.R. § 54.4975-9(c) (2016). Many securities brokers could avoid meeting this definition by simply entering into agreements whereby they would disclaim the investor's reliance on their advice. As a result, the fourth prong of the test would not be met,

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[5] The Department of Treasury enacted a parallel definition of "investment advice" in the Code. *See* Definition of Fiduciary, 26 C.F.R. § 54.4975-9(c) (2016).

because, according to such agreements, the advice given to the customers would not serve as the primary basis for the customer's investment decisions – regardless of whether this was true or not. This created a loophole – individuals who would otherwise be covered by the fiduciary definition were able to avoid coverage of the statute through the use of account agreements. This part of the fiduciary definition was the subject of the Department's Conflict of Interest Rule Proposal, and was amended with the final rule.

In addition to the standards set forth pursuant to the Advisers Act, the 1934 Act, FINRA rules, state regulatory and common law, and ERISA, there are also other standards that may be applicable to individuals who sell certain types of investment products. For example, those who sell annuities, which are insurance products, may be subject to the Suitability in Annuity Transactions Model Regulation. The model regulation requires that insurance producers have "reasonable grounds for believing that the recommendation is suitable for the consumer on the basis of the facts disclosed by the consumer as to his or her investments and other insurance products and as to his or her financial situation and needs, including the consumer's suitability information . . . ." Suitability in Annuity Transactions Model Regulation, MDL-275, § 6.A. In addition, the insurance producer must ensure that the consumer has been informed of the features of the annuity, MDL-275, § 6.A.(1), and that the consumer would benefit from the features of the annuity, MDL-275, § 6.A.(2). The insurer may not issue an annuity unless it determines that the annuity is suitable for the consumer. MDL-275, § 6.C. The insurer is further obligated to establish a supervision system "that is reasonably designed to achieve the insurer's and its insurance producers' compliance with this regulation . . . ." MDL-275, § 6.F.

It is important to realize that individuals who sell annuities will only be subject to the model regulation if the state has adopted the regulation. Implementation of the model regulation varies state to state. Only a few states have adopted the most current version of the model regulation in its entirety. *See* Suitability in Annuity Transactions Model Regulation, Chart at ST-275-3 – ST-275-9. Most states have adopted prior versions of the model regulation in whole or in part. *See Id.* As a result, individuals selling annuities may be subject to some version of the model regulation, or may not be subject to the model regulation at all. The standard of conduct with respect to the recommendation of annuity contracts is not consistent across the country. Customers purchasing annuity contracts will receive differing levels of protection depending on where they are located.

III. Investors Do Not Understand the Difference Between Brokers and Investment Advisers

The duty a financial professional owes to an investor is not always readily apparent to the investor. Although the individuals who provide advice to investors have specific titles under the respective regulatory regimes – broker or investment adviser – they rarely use those titles when dealing with the investing public. Financial professionals often use the title "financial advisor," "financial consultant," "wealth manager," or any of a number of other titles. According to FINRA, these "are generic terms or job titles, and may be used by investment professionals who may not hold any specific credential." *Prof'l Designations Database – Rules and Resources*, Fin. Indus. Regulatory Auth., http://www.finra.org/investors/rules-and-resources. FINRA has created a database for investors "to decode the letters that sometimes follow a financial professional's name" and to understand the various professional designations used by financial professionals. *Prof'l Designations Database*, Fin. Indus. Regulatory Auth., http://www.finra.org/investors/professional-designations. The North American Securities Administrators Association ("NASAA") has recognized the confusion and trouble that may be caused by the use of professional designations and has adopted a model rule prohibiting the misleading use of senior and retiree designations to address concerns over particularly troubling designations. *See* Press Release, NASAA, State Sec. Regulators Announce New Model Rule on the Use of Senior Certifications and Prof'l Designations, NASAA (Apr. 1, 2008), http://www.nasaa.org/5685/.

The industry's advertising, which creates the perception that the industry is acting in the best interests of its customers is as troubling as the use of confusing titles. PIABA examined several firms' websites and marketing materials and found that the firms used phrases such as "You're in good hands;" "get a more personalized plan for achieving success;" "Our advisors are ethically obligated to act with your best interests at heart;" and "your Financial Advisor should make you feel that your best interests are the top priority, no matter what is happening in the market and no matter the size of your portfolio." Peiffer & Lazaro, *Major Investor Losses Due to Conflicted Advice: Brokerage Indus. Adver. Creates the Illusion of A Fiduciary Duty Misleading Ads Fuel Confusion, Underscore Need for Fiduciary Standard*, 22 PIABA B.J. 1, 10-19 (2015). Notwithstanding the firms' presentment that they were looking out for their customers and acting in their best interests, when faced with claims for wrongdoing in arbitration, the firms denounced any fiduciary duties to their customers, often claiming they were nothing more than mere order takers. *See Id.*

It is not surprising that investors are confused by ambiguous titles and advertising that imply that investment firms are looking out for their customers. Most investors think stockbrokers, insurance brokers, financial advisors and investment advisers are all held to a fiduciary standard, even though investment advisers are the only ones consistently held to such a duty. *See* Infogroup/ORC, *U.S. Investors & The Fiduciary Standard: A Nat'l Opinion Survey* (Sept. 15, 2010), https://www.cfp.net/docs/public-policy/us_investors_opinion_survey_2010-09-16.pdf. More recently, a 2015 study confirmed that most retail customers think their financial advisor – regardless of which type of advisor it is – is a fiduciary. *See* Spectrem Group, *Fiduciary – Do Investors Know What It Means* (2015), http://349ab54c3b58919c6638-ff70f51d4942f2bbd11ba0e41cfec577.r51.cf2.rackcdn.com/Fiduciary%20Whitepaper.pdf. The industry is well-aware of the confusion. In a survey open to all brokers, investment advisers, and insurance consultants and producers, 97 percent of them said "investors don't understand the differences between brokers and investment advisers." *See* fi360, *Seeking Trustworthy Advice for Individual Investors – Fin. Intermediaries Indicate Strong Support for Fiduciary Standard*, 3 (Feb. 2015), http://www.fi360.com/uploads/media/2015fiduciarysurvey.pdf.

IV. Investor Confusion as to the Differing Roles Between Brokers and Investment Advisers Has Lead to Significant Harm

Conflicted advice harms investors every day. PIABA members have witnessed firsthand the devastating effects of such advice, seeing retirees forced to return to work making little more than minimum wage, and even dealing with clients attempting suicide after having lost their life savings to conflicted investment advice. *See* Joseph Peiffer, *Statement for the Record Submitted to the U.S. Dept. of Labor Employee Benefits Sec. Admin. On the Conflict of Interest Proposed Rule* (Aug. 11, 2015).

PIABA commented on the Department's Conflict of Interest Rule Proposal, and provided a number of examples of investors who had been represented by PIABA members and who had been harmed by conflicted investment advice with respect to their retirement funds. *See generally*, Letter from PIABA *to the U.S. Dept. of Labor Employee Benefits Sec. Admin.* (July 21, 2015), https://www.dol.gov/ebsa/pdf/1210-AB32-2-00654.pdf, and Letter from PIABA *to the U.S. Dept. of Labor Employee Benefits Sec. Admin.* (Sept. 24, 2015), https://www.dol.gov/ebsa/pdf/1210-AB32-2-03038.pdf (collectively "PIABA Comment Letters"). The cases discussed in the PIABA Comment Letters involved mutual funds, annuities (both variable and fixed), private placements, promissory notes, real estate investment trusts, as well as other investment products. *See Id.* Investors trusted their retirement funds to "financial advisors" – securities brokers, investment advisers and insurance brokers – and lost substantial portions of their retirement savings as a result of the conflicted investment advice they received. In many cases, the financial advisors were subject to the FINRA Suitability Rule; however, that rule was not sufficient to protect the investors or their retirement savings. *See Id.*

The products identified in the PIABA Comment Letters are similar to products which have concerned regulators in the past. For example, the SEC, NASAA and FINRA jointly determined that "[e]xaminers found that the most commonly discussed products at the sales seminars were variable annuities, real estate investment trusts, equity indexed annuities, mutual funds, private placements of speculative securities (such as oil and gas interests) and reverse mortgages." SEC, NASAA and FINRA, *Protecting Senior Investors: Report of Examinations of Sec. Firms Providing "Free Lunch" Sales Seminars*, p. 4 (Sept. 2007). The report went on to state that:

> Individuals who attend the seminars or who are considering attending are not always provided with the name of the firm sponsoring the seminar, and may not be aware that product sponsors (e.g., mutual fund companies and insurance companies) may provide funding for the seminars with the expectation that investment professionals will sell their products. In these situations, seminar attendees may not have known that the financial adviser speaking at the seminar was not unbiased in making product recommendations.

Id. at 5.

Conflicts of interest were a concern in 2007 when these entities examined "free lunch" seminars and looked at ways senior investors may be protected. Several of the investors discussed in the PIABA Comment Letters attended "free lunch" or sales seminars prior to being sold the products at issue. They did not understand the conflicts of interest which were present and which may have impacted the recommendations made by the various financial advisors.

CONCLUSION

The Department's Conflict of Interest Rule will require a heightened standard of care, one which will benefit investors such as those highlighted in PIABA's Comment Letters. It is important that the Rule be permitted to be fully enacted. It closes loopholes which were left open when the Department adopted the five-part test in 1975, and protects investors who receive retirement investment advice. Importantly, the Department's rulemaking will ensure that those who provide advice to retirement investors, and receive a fee, direct or indirect, are deemed fiduciaries. The rulemaking will remove the significant variations in the standards of conduct governing investment professionals providing advice with respect to retirement accounts which would otherwise exist were the status quo to be maintained.

The Conflict of Interest Rule properly defines investment advice under ERISA and the Code, and the rule should be upheld. Accordingly, the Consolidated Plaintiffs' request for summary judgment should be denied.

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Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify on that August 26, 2016, I electronically filed the foregoing document with the Clerk of the Court for the United States District Court for the Northern District of Texas using the CM/ECF system.

I certify that all participants in the case are registered CM/ECF users and that service will be accomplished by the CM/ECF system.

/s/ Richard A. Lewins
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