**IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF KANSAS**

Market Synergy Group, Inc., Plaintiff, v. United States Department of Labor, Thomas E. Perez, in his official capacity as Secretary of the United States Department of Labor, and Phyllis C Borzi, in her official capacity as Assistant Secretary of the United States Department of Labor, Defendants.	Civil Action No. 5:16-cv-04083 Hon. Daniel D. Crabtree

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

Diane A. Nygaard
Kenner Nygaard DeMarea Kendall LLC
117 W. 20th St., Suite 201
Kansas City, MO 64108
Tel: 816-531-3100
Fax: 816-531-3600
diane@kndklaw.com

*Counsel for Amicus Curiae
Public Investors Arbitration Bar Association*

August 24, 2016

TABLE OF CONTENTS

INTRODUCTION AND INTEREST OF *AMICUS CURIAE* 1

BACKGROUND 2

I. Laws Governing the Securities Industry and Investment Advice 2

II. Standards of Conduct Applicable to the Provision of Investment Advice 4

III. Investors Do Not Understand the Difference Between Brokers and Investment Advisers 7

IV. Investor Confusion as to the Differing Roles Between Brokers and Investment Advisers Has Lead to Significant Harm 9

ARGUMENT 11

I. The Department of Labor Has the Authority to Issue the Conflict of Interest Rule and Accompanying Exemptions 12

II. The Department of Labor has the Authority to Adopt and Amend Prohibited Transaction Exemption 84-24 and the Best Interest Contract Exemption 14

CONCLUSION 17

TABLE OF AUTHORITIES

Cases

Baizer v. Comm'r of Internal Revenue, 204 F.3d 1231 (9th Cir. 2000) 14

Chevron, U.S.A., Inc. v. NRDC, Inc., 467 U.S. 837, 866 (1984) 14

Comm'r of the Internal Revenue Serv. v. Keystone Consol. Indus., Inc. 508 U.S. 152 (1993) 14

Dinsmore v. Piper Jaffray, Inc., 593 N.W.2d 41, 46 (S.D. 1999) 6

Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 (1976) 5

Glisson v. Freeman, 532 S.E.2d 442, 449 (Ga. Ct. App. 2000) 6

Leib v. Merrill, Lynch, Pierce, Fenner & Smith, 461 F.Supp. 951, 952 (E.D. Mich. 1978) 6

SEC v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 191 (1963).. 5

Thropp v. Bache Halsey Stuart Shields, Inc., 650 F.2d 817, 819 (6th Cir. 1981) 6

Statutes

Employee Retirement Income Security Act, Pub L. 93-406, 88 Stat 832 (1974) (codified at 29 U.S.C. § 1001, *et seq.* (2012)) 3

Exemptions from prohibited transactions, 29 U.S.C. § 1108 (2012).. 13

Investment Advisers Act of 1940, ch. 686, 54 Stat. 847 (1940) (codified at 15 U.S.C. § 80b-1, *et seq.* (2012)).. 3

Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified at 15 U.S.C. § 77a, *et seq.* (2012)).. 2

Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified at 15 U.S.C. § 78a, *et seq.* (2012)) 2

Tax on Prohibited Transactions, Pub. L. 93-406, 88 Stat. 829, 971 (1974) (codified at 26 U.S.C. § 4975(e)(3) (2012)) 4

Regulations

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) 2, 15, 16

Amendments to Class Exemption for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, Investment Companies and Investment Company Principal Underwriters, 49 Fed. Reg. 13208-03 (Apr. 3, 1984) 15

Best Interest Contract Exemption, 81 Fed. Reg. 21002, 21076 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2550) 2, 11, 15

Class Exemption for Certain Transactions involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, Investment Companies and Investment Company Principal Underwriters and Employee Benefit Plans, 42 Fed. Reg. 32395 (June 24, 1977) 15

Definition of Fiduciary, 26 C.F.R. § 54.4975-9(c) (2016) 6

Definition of Fiduciary, 29 C.F.R. § 2510.3-21(j)(1) (2016) 6

Definition of the Term "Fiduciary"; Conflict of Interest Rule – Ret. Inv. Advice, 81 Fed. Reg. 20946 (Apr. 8, 2016) 1

Rules

FINRA Rule 2111 5

Other Authorities

Fed. Ins. Office, How to Modernize and Improve the System of Insurance Regulation in the United States 11 (2013) 4

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 9

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........... 9

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) 3

Joseph Pieffer, *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) 9

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.. 10

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.. 10

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).. 8

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/..... 8

Prof'l Designations Database – Rules and Resources, Fin. Indus. Regulatory Auth., http://www.finra.org/investors/rules-and-resources 8

Prof'l Designations Database, Fin. Indus. Regulatory Auth., http://www.finra.org/investors/professional-designations 8

Reorganization Plan No. 4 of 1978, § 102, 43 FR 47713 (1978).. 4, 13

SEC Staff, *Study on Inv. Advisers and Broker-Dealers*, p. 22 (2011),
https://www.sec.gov/news/studies/2011/913studyfinal.pdf 5

SEC, NASAA and FINRA, *Protecting Senior Investors: Report of Examinations of Sec. Firms Providing "Free Lunch" Sales Seminars*, p. 4 (Sept. 2007) 10

Spectrem Group, *Fiduciary – Do Investors Know What It Means* (2015), http://349ab54c3b58919c6638-ff70f51d4942f2bbd11ba0e41cfec577.r51.cf2.rackcdn.com/Fiduciary%20Whitepaper.pdf 9

Suitability in Annuity Transactions Model Regulation, MDL-275 (2015),
http://www.naic.org/store/free/MDL-275.pdf 4, 7

The Laws That Govern the Sec. Indus., Sec. & Exch. Comm'n.,
https://www.sec.gov/about/laws.shtml 2, 3

What We Do, Fin. Indus. Regulatory Auth., http://www.finra.org/about/what-we-do 5

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 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 and the amendment and partial revocation of Prohibited Transaction Exemption 84-24. 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") 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"). Plaintiff, Market Synergy Group, Inc. ("Market Synergy"), contests the amendment and partial revocation of PTE 84-24, arguing that the Department did not properly remove fixed index annuities from the purview of the exemption. 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. PIABA can also provide some background as to why the Department acted properly when moving fixed index annuities from PTE 84-24 to the Best Interest Contract Exemption, Best Interest Contract Exemption, 81 Fed. Reg. 21002, 21076 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2550). For these reasons, Market Synergy's request for a preliminary injunction should be denied and full implementation of the rule should proceed.

BACKGROUND

I. Laws Governing the Securities Industry and 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*

---

[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.

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 interpreted the antifraud section of the Advisers Act to establish a federal

fiduciary duty on the part of investment advisers, but has interpreted the antifraud section of the 1934 Act as not establishing such duty on the part of securities brokers. *See SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 191 (1963) (holding that under the Advisers Act, a relationship between an investment advisor and a client is fiduciary in nature); *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976) (holding that scienter is a necessary element of the antifraud section of the 1934 Act).

The Advisers Act fiduciary standard 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]

---

[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.

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, 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 the nature of their relationship with their customer. However, the duties vary widely across the country.

Individuals providing investment advice with respect to retirement accounts may have been fiduciaries, so long as they met the five-part test for rendering investment advice which had been promulgated by the Department following the enactment of ERISA. *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 would avoid meeting this definition by entering into agreements whereby they would disclaim the investor's

---

[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.").

[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).

reliance on their advice. This definition was the subject of the Department's Conflict of Interest Rule Proposal, and was amended with the final rule.

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.

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.*

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/.

Equally troubling as the confusing titles is the industry's advertising, which creates the perception that the industry is acting in the best interests of its customers. 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 implies 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 Led to Significant Harm

Conflicted advice harms investors every day. PIABA members have witnessed firsthand the devastating effects of the 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 Pieffer, *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. *See Id.*

The products identified in the PIABA Comment Letters are similar to products which have raised concerns in the past for regulators. 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.

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 had been left open when the Department adopted the five-part test in 1975, and protects investors who receive retirement investment advice.

ARGUMENT

The Department has the authority to issue the Conflict of Interest Rule and the related exemptions. It is necessary that the Department amend its definition of "investment advice" as originally set forth in its 1975 regulation to adequately protect retirement investors and to fully effectuate the definition of fiduciary set forth in ERISA and the Code. Pursuant to the authority set forth in ERISA and the Reorganization Plan established by President Carter, the Department is responsible for the fiduciary standard and for determining appropriate exemptions. The Department exercised that authority when it adopted the Conflict of Interest Rule and the accompanying exemptions. The Conflict of Interest Rule and accompanying exemptions, in particular, the Best Interest Contract Exemption, 81 Fed. Reg. 21002 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2550) (the "BICE"), and PTE 84-24, is essential to protect retirement investors from conflicts of interest present throughout the financial services industry. Those conflicts are harming retirement investors, undermining the purpose of ERISA and the rationale for Congress having established fiduciary standards in the first place. Accordingly, the Department's Conflict of Interest Rule should be

permitted to go forward, and Market Synergy's requests should be denied in their entirety as they are without merit.

I. The Department of Labor Has the Authority to Issue the Conflict of Interest Rule and Accompanying Exemptions

Market Synergy has filed this lawsuit to stop the implementation of the Department's Conflict of Interest Rule and undermine the Department's efforts to protect all retirement investors with professional accountability standards. Market Synergy argues the Department failed to provide notice that it would remove fixed index annuities from the scope of PTE 84-24. Pl. Br. at 23. Further, Market Synergy criticizes the Department for treating fixed index annuities differently from all other fixed annuities. Pl. Br. at 27. Market Synergy characterized the Department's actions as the improper manipulation of the financial product market as opposed to the regulation of fiduciary conduct. Pl. Br. at 37. However, Market Synergy fails to acknowledge the authority that has been allocated to the Department by Congress. Market Synergy also ignores the obvious differences between fixed index annuities and fixed annuities which justify the Department's actions.

The Department's 1975 regulation, and the parallel Code regulation, defined investment advice in such a way that it narrowed Congress's statutory definition of 'fiduciary," and created a loophole which would lead to significant investor harm. The industry relied on the five-part test to ensure they did not fit into the definition of "fiduciary," avoiding the obligations that accompany the title of fiduciary.

Knowing they would not be held to the fiduciary standards, the industry created ambiguous titles and misleading advertising, leading investors to believe they could be trusted. The industry then abused the trust it developed with investors by dispatching financial advisors with little or no professional accountability to push expensive, inferior investment products. Over time, as the method for retirement saving became more self-directed, investor abuses became more commonplace and, for many, what was supposed to be their golden years became a retirement

nightmare. Now, that the Department has taken a momentous step toward correcting the rampant conflicts of interest which have driven investment advice and has closed the loopholes created by the five-part test, the same group cries foul and claims the Department does not have the authority to act at all. However, as will be shown below, the Department does have the authority to issue the Conflict of Interest Rule as well as the accompanying exemptions.

The Department has the authority to issue exemptions pursuant to ERISA section 408. Exemptions from prohibited transactions are found in 29 U.S.C. § 1108 (2012). In order to grant an exemption, the Secretary of the Department must find that the exemption is "(1) administratively feasible, (2) in the interests of the plan and of its participants and beneficiaries, and (3) protective of the rights of participants and beneficiaries of such plan." *Id.* Over the years, the Department has issued several exemptions.

The authority to oversee fiduciary conduct and prohibited transactions applicable to IRAs has been under the jurisdiction and authority of the Department since 1978. Reorganization Plan No. 4 of 1978, § 102, 43 FR 47713 (1978) transferred from the Secretary of the Treasury to the Secretary of the Labor the ultimate authority over certain rule making authority, interpretations, and exemptions relating to IRAs under § 4975 of the Code.

> § 102 Reorganization Plan No. 4
>
> Except as otherwise provided in Section 105 of this Plan, all authority of the Secretary of the Treasury to issue the following described documents pursuant to the statutes hereinafter specified is hereby transferred to the Secretary of Labor: (a) regulations, rulings, opinions, and exemptions under section 4975 of the Code [26 U.S.C. 4975] . . .

Id. President Carter, in explaining the Reorganization Plan to Congress, was explicit: "Labor will have statutory authority for fiduciary obligations." *Id.* President Carter's Order enabled the Department to direct its rule making attention to the activities of conflicted investment professionals who let self-dealing influence their investment recommendations.

Courts have recognized that § 102 of Reorganization Plan No. 4 grants much authority to the Department. *Baizer v. Comm'r of Internal Revenue,* 204 F.3d 1231 (9th Cir. 2000); *See also Comm'r of the Internal Revenue Serv. v. Keystone Consol. Indus., Inc.* 508 U.S. 152 (1993) ("[B]oth the Internal Revenue Service and the DOL administer §4975 prohibited transaction provisions."). The United States Supreme Court has consistently accorded considerable weight to an executive department's construction of a statutory scheme it is entrusted to administer. *Chevron, U.S.A., Inc. v. NRDC, Inc.*, 467 U.S. 837, 866 (1984) (**"**When a challenge to an agency construction of a statutory provision, fairly conceptualized, really centers on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail.").

II. The Department of Labor has the Authority to Adopt and Amend Prohibited Transaction Exemption 84-24 and the Best Interest Contract Exemption

Market Synergy attempts to defeat the Department's exemptive treatment of fixed rate annuity contracts by claiming that the Department is not authorized to favor one financial product (fixed rate annuity contracts), over another (fixed indexed annuities). Put another way, Market Synergy argues that the Department is only authorized to regulate the conduct of fiduciaries, not regulate access to particular financial products. Pl. Br. at 37-38.

However, Market Synergy's argument misses the mark. The Department does have the authority to craft exemptions from prohibited transactions as long as that authority is exercised in the best interests of retirement investors:

> The Department has clear authority under ERISA section 408(a) and the Reorganization Plan to grant administrative exemptions from the prohibited transaction provisions of both ERISA and the Code. Congress gave the Department broad discretion to grant or deny exemptions and to craft conditions for those exemptions, subject only to the overarching requirement that the exemption be administratively feasible, in the interests of plans, plan participants and beneficiaries and IRA owners, and protective of their rights.

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. at 21160 (citing ERISA section 408(a) and Code section 4975(c)(2)).

PTE 84-24 was initially adopted in 1977 as PTE 77-9. Class Exemption for Certain Transactions involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, Investment Companies and Investment Company Principal Underwriters and Employee Benefit Plans, 42 Fed. Reg. 32395 (June 24, 1977). The exemption allowed certain transactions involving the purchase of insurance or annuity contracts and the purchase or sale of securities issued by an investment company (mutual funds). The insurance agents and brokers involved in the transactions would be exempted from the prohibited transaction rules if certain conditions were met. The exemption was amended in 1984, and reissued as PTE 84-24. Amendments to Class Exemption for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies, Investment Companies and Investment Company Principal Underwriters, 49 Fed. Reg. 13208-03 (Apr. 3, 1984).

The Department has now determined that PTE 84-24 should be limited to fixed annuities, while other investments, including fixed index annuities, variable annuities, and mutual funds, should be excluded from this exemption and, instead, covered by the Best Interest Contract Exemption ("BICE"). Best Interest Contract Exemption, 81 Fed. Reg. 21002, 21076 (Apr. 8, 2016) (to be codified at 29 C.F.R. § 2550).

In this instance, the Department clearly sets forth why it believes that an exemption for fixed annuities is appropriate noting that payments from such products "are the subject of insurance companies' contractual guarantees and are predictable." 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. at 21152. Unlike fixed index annuities, "the benefits of [fixed

annuities] do not vary, in part or in whole, based on the investment experience of a separate account or accounts maintained by the insurer or the investment experience of an index or investment model." *Id.* at 21154. The Department notes that fixed index annuities "typically require the customer to shoulder significant investment risk and do not offer the same predictability of payments as Fixed Rate Annuity Contracts." *Id.* 21152 – 21153. The Department has appropriately made the determination that there are significantly more conflicts of interest when these products are sold, and therefore they should be sold under the Best Interest Contract Exemption in order to protect retirement investors:

> The Department has determined that these annuities, which are often quite complex and subject to significant conflicts of interest at the point of sale, should be sold under the more stringent conditions of the Best Interest Contract Exemption. The Best Interest Contract Exemption contains important safeguards which address the conflicts of interest associated with investment recommendations in the more complex financial marketplace that has developed since PTE 84-24 was granted.

Id. at 21153.

In addition, Market Synergy's argument that the Department has no authority to regulate how products are sold is belied by the fact that the Department has been creating exemptions for how products are sold for decades. PTE 84-24 has long exempted mutual funds, insurance and annuities. Products have never been treated uniformly; and, up until now, the Department's regulation of how these products can be sold has not been challenged as being somehow a "wrongful" regulation of the products themselves. It is only now, after stricter regulations are being enacted, that the industry is raising a complaint.

CONCLUSION

The Department has promulgated a necessary and important rule and accompanying exemptions in order to protect retirement investors. The Conflict of Interest Rule properly defines investment advice under ERISA and the Code, and the rule should be upheld. Market Synergy's request for a preliminary injunction should be denied.

Dated: August 24, 2016 Respectfully submitted,

BY: */s/ Diane A. Nygaard*

Diane A. Nygaard
Kenner Nygaard DeMarea Kendall LLC
117 W. 20th St., Suite 201
Kansas City, MO 64108
Tel: 816-531-3100
Fax: 816-531-3600
diane@kndklaw.com

Counsel for Amicus Curiae
Public Investors Arbitration Bar Association

CERTIFICATE OF SERVICE

I certify that on August 24, 2016, I filed and served the foregoing brief using the CM/ECF system, which sent notification to all counsel who have consented to electronic service, as all counsel have in this case.

Dated: August 24, 2016 *_/s/Diane A. Nygaard_*