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B-327985

April 25, 2016

The Honorable Lamar Alexander
Chairman
The Honorable Patty Murray
Ranking Member
Committee on Health, Education, Labor, and Pensions
United States Senate

The Honorable John Kline
Chairman
The Honorable Robert C. “Bobby” Scott
Ranking Member
Committee on Education and the Workforce
House of Representatives

Subject: *Department of Labor, Employee Benefits Security Administration: Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice; Best Interest Contract Exemption; Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs*

Pursuant to section 801(a)(2)(A) of title 5, United States Code, this is our report on a major rule promulgated by the Department of Labor, Employee Benefits Security Administration (EBSA) consisting of seven documents entitled:

- “Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice” (Conflict of Interest Rule);
- “Best Interest Contract Exemption” (Exemption 1);
- “Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs” (Exemption 2);
- “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” (Amendment 1);
- “Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 86–128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Amendment to and Partial Revocation of PTE 75–1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks” (Amendment 2);
- “Amendment to Prohibited Transaction Exemption (PTE) 75–1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks” (Amendment 3); and
- “Amendments to Class Exemptions 75–1, 77–4, 80–83 and 83–1” (Exemption 3).

The Conflict of Interest Rule was published with RIN 1210-AB32 and the other documents with ZRIN: 1210-ZA25. We received the rule on April 8, 2016. The Conflict of Interest Rule was published in the *Federal Register* as a final rule, three of the other documents were published as adoptions of class exemptions, and the remaining three documents were published as adoptions of amendments to and partial revocation of certain PTEs. They were published on April 8, 2016. 81 Fed. Reg. 20,946; 21,002; 21,089; 21,139; 21,147; 21,181; 21,208.

The Conflict of Interest Rule defines who is a “fiduciary” of an employee benefit plan as a result of giving investment advice to a plan or its participants or beneficiaries. Under the rule, persons who provide investment advice or recommendations for a fee or other compensation with respect to assets of a plan or individual retirement account (IRA) are treated as fiduciaries in a wider array of advice relationships. Exemptions 1 and 2 provide exemptions from certain prohibited transactions requirements. The requirements at issue in Exemption 1 generally prohibit fiduciaries with respect to employee benefit plans and IRAs from engaging in self-dealing and receiving compensation from third-parties in connection with transactions involving the plans and IRAs. Exemption 1 allows entities such as registered investment advisers, broker-dealers, and insurance companies, and their agents and representatives, that are fiduciaries by reason of the provision of investment advice, to receive compensation that may otherwise give rise to prohibited transactions as a result of their advice to plan participants and beneficiaries, IRA owners, and certain plan fiduciaries (including small plan sponsors). The exemption is subject to protective conditions to safeguard the interests of the plans, participants and beneficiaries, and IRA owners. The requirements at issue in Exemption 2 generally prohibit fiduciaries with respect to employee benefit plans and IRAs from purchasing and selling investments when the fiduciaries are acting on behalf of their own accounts (principal transactions). The exemption permits principal transactions and riskless principal transactions in certain investments between a plan, plan participant or beneficiary account, or an IRA, and a fiduciary that provides investment advice to the plan or IRA, under conditions to safeguard the interests of these investors. Exemptions 1 and 2 affect participants and beneficiaries of plans, IRA owners, and fiduciaries with respect to such plans and IRAs.

Amendment 1 amends and partially revokes Prohibited Transaction Exemption (PTE) 84–24 to allow fiduciaries and other service providers to receive compensation when plans and IRAs purchase Fixed Rate Annuity Contracts, as defined in the exemption, securities of investment companies, and certain related transactions. The amendments increase the safeguards of the exemption. Amendment 1 revokes the exemption as it applies to plan and IRA purchases of annuity contracts that do not satisfy the definition of a Fixed Rate Annuity Contract, and the revocation of the exemption as it applies to IRA purchases of investment company securities. Amendment 2 amends PTE 86–128 to increase the safeguards of the exemption. It also revokes a portion of PTE 86–128 regarding transactions involving investment advice fiduciaries and IRAs, and portions of PTE 75–1 to conform to changes made in other documents included in this final rule. Amendment 3 amends PTE 75–1, Part V, to permit investment advice fiduciaries to receive compensation when they extend credit to plans and IRAs to avoid a failed securities transaction. Exemption 3 requires the fiduciaries receiving compensation or other benefits as a result of the use of their fiduciary authority, control, or responsibility in connection with investment transactions involving plans or IRAs to satisfy uniform Impartial Conduct Standards in order to obtain the relief available under each exemption. Amendments 1, 2, and 3 and Exemption 3 affect participants and beneficiaries of plans, IRA owners, and certain fiduciaries and service providers of plans and IRAs.

Enclosed is our assessment of EBSA’s compliance with the procedural steps required by section 801(a)(1)(B)(i) through (iv) of title 5 with respect to the rule. Our review of the procedural steps taken indicates that EBSA complied with the applicable requirements.

If you have any questions about this report or wish to contact GAO officials responsible for the evaluation work relating to the subject matter of the rule, please contact Shirley A. Jones, Assistant General Counsel, at (202) 512-8156.

signed

Robert J. Cramer
Managing Associate General Counsel

Enclosure

cc: Phyllis C. Borzi
Assistant Secretary, EBSA
Department of Labor

REPORT UNDER 5 U.S.C. § 801(a)(2)(A) ON MAJOR RULES
ISSUED BY THE
DEPARTMENT OF LABOR,
EMPLOYEE BENEFITS SECURITY ADMINISTRATION
ENTITLED
“DEFINITION OF THE TERM “FIDUCIARY”; CONFLICT OF
INTEREST RULE—RETIREMENT INVESTMENT ADVICE;
BEST INTEREST CONTRACT EXEMPTION;
CLASS EXEMPTION FOR PRINCIPAL TRANSACTIONS IN
CERTAIN ASSETS BETWEEN INVESTMENT ADVICE
FIDUCIARIES AND EMPLOYEE BENEFIT PLANS AND IRAS”
(RIN: 1210-AB32; ZRIN: 1210-ZA25)

The Department of Labor, Employee Benefits Security Administration (EBSA) submission of this major rule consisted of seven documents:

- “Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice” (Conflict of Interest Rule);
- “Best Interest Contract Exemption” (Exemption 1);
- “Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs” (Exemption 2);
- “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” (Amendment 1);
- “Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 86–128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Amendment to and Partial Revocation of PTE 75–1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks” (Amendment 2);
- “Amendment to Prohibited Transaction Exemption (PTE) 75–1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks” (Amendment 3); and
- “Amendments to Class Exemptions 75–1, 77–4, 80–83 and 83–1” (Exemption 3).

(i) Cost-benefit analysis

The Conflict of Interest Rule contained a cost-benefit assessment. The assessment states that EBSA expects the final rule to deliver large gains for retirement investors. Because of limitations of the literature and other available evidence, EBSA was able to quantify only some of these gains. Focusing only on how load shares paid to brokers affect the size of loads IRA investors holding load funds pay and the returns they achieve, EBSA estimates gains to investors of up to \$3.1 or \$3.4 billion (at a 7 percent discount rate) and up to \$3.8 or \$4.2 billion (at a 3 percent discount rate), annualized over April 2017 to April 2027. EBSA estimates compliance costs to be \$2.0 billion (at a 7 percent discount rate) and \$1.9 billion (at a 3 percent discount rate) annualized over the same period. EBSA also estimated insurance premium transfers from insured service providers without claims to insured service providers with claims—funded from a portion of the increased insurance premiums—to be \$73 million at both discount rates annualized over the same period. In Exemptions 1, 2, and 3 and Amendments 1, 2, and 3, EBSA stated that it has undertaken an assessment of the costs and benefits for the proposal.

(ii) Agency actions relevant to the Regulatory Flexibility Act (RFA), 5 U.S.C. §§ 603-605, 607, and 609

In the Conflict of Interest Rule and Exemptions 1 and 2, EBSA states that it determined that the final rule will have a significant economic impact on a substantial number of small entities and that it conducted a

Final Regulatory Flexibility Analysis. As described by EBSA, this analysis includes a statement describing the need for the rule; projected reporting, recordkeeping, and other compliance costs of the rule; changes intended to reduce the costs affecting small and large businesses; and significant alternatives considered. The Act is not discussed in Amendments 1, 2, or 3, or Exemption 3.

(iii) Agency actions relevant to sections 202-205 of the Unfunded Mandates Reform Act of 1995, 2 U.S.C. §§ 1532-1535

In the Conflict of Interest Rule, EBSA stated that it expects the final rule may result in an expenditure of \$100 million or more (adjusted annually for inflation) in any one year by state, local, and tribal governments, in the aggregate, or by the private sector. EBSA stated that it assessed the anticipated benefits and costs and concluded that its benefits would justify its costs. EBSA determined that the final rule's material benefits and costs generally would be confined to the private sector, where plans and IRA investors would reap both social welfare gains and transfers from the financial industry. According to EBSA, it would benefit from increased efficiency in its enforcement activity, and the public and overall U.S. economy would benefit from increased compliance with the law and increased confidence in advisers, as well as from more efficient allocation of investment capital. EBSA stated that together these welfare gains and transfers justify the associated costs. The Act is not discussed in any of the other documents.

(iv) Other relevant information or requirements under acts and executive orders

Administrative Procedure Act, 5 U.S.C. §§ 551 et seq.

EBSA published a proposed rule on October 22, 2010. 75 Fed. Reg. 65,263. After receiving over 300 comment letters and holding a public hearing on March 1 and 2, 2011, EBSA announced it was withdrawing that proposed rule. On April 20, 2015, the agency published a notice withdrawing the 2010 proposal and published a new proposed rule. 80 Fed. Reg. 21,928. On the same date, it also published proposed new and amended exemptions from the prohibited transaction rules designed to allow certain broker-dealers, insurance agents, and others that act as investment advice fiduciaries to nevertheless continue to receive common forms of compensation that would otherwise be prohibited, subject to appropriate safeguards. 80 Fed. Reg. 21,960; 21,989; 22,004; 22,010; 22,021; 22,035.

EBSA extended the comment periods by 15 days to July 21, 2015, and held a public hearing on August 10–13, 2015, at which over 75 speakers testified. 80 Fed. Reg. 34,869. The transcript of the hearing was made available on September 8, 2015, and EBSA provided additional opportunity for interested persons to submit comments on the proposal and proposed related exemptions or transcript until September 24, 2015. A total of over 3,000 comment letters were received on the new proposals. There were also over 300,000 submissions made as part of 30 separate petitions submitted on the proposal. These comments and petitions came from consumer groups, plan sponsors, financial services companies, academics, elected government officials, trade and industry associations, and others, both in support of, and in opposition to, the proposed rule and proposed related exemptions. EBSA addressed the comments in the documents comprising this rule.

Paperwork Reduction Act (PRA), 44 U.S.C. §§ 3501-3520

In the Conflict of Interest Rule, EBSA stated that it includes information collection requirements under the Act with an estimated total burden of 57,000 hours at a cost of \$6.2 million. The rule also contains a new information collection requirement entitled "Conflict of Interest Final Rule, Fiduciary Exception Disclosure Requirements" which EBSA has submitted to the Office of Management and Budget (OMB) and been assigned OMB Control Number 1210-0155. EBSA estimated the total burden for this new requirement to be 56,833 hours.

In Exemption 1, EBSA stated that, overall, it estimates that in order to meet the conditions of the class exemption, financial institutions and advisers will distribute approximately 74.6 million disclosures and contracts during the first year and 73.3 million disclosures and contracts during subsequent years, which will have a burden of 2.5 million hours each year for a cost of \$201.5 million in the first year and \$201.2 million in subsequent years and an outsourced labor, materials, and postage cost burden of \$1.6 billion during the first year and \$380.7 million during subsequent years. EBSA also identified new information

collections with the titles “Best Interest Contract Exemption” and “Final Investment Advice Regulation” (OMB Control Number 1210–0156) with an estimated total annual burden of about 2.70 million hours during the first year and 2.83 million hours in subsequent years with an estimated total annual burden cost of about \$2.48 billion during the first year and \$574 million during subsequent years.

In Exemption 2, EBSA identified new information collections with the titles “Prohibited Transaction Exemption for Principal Transactions in Certain Assets between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs” and “Final Investment Advice Regulation” (OMB Control Number 1210–0157) with an estimated total annual burden of about 85,000 hours during the first year and 56,000 hours in subsequent years with an estimated equivalent cost burden of \$4.7 million in the first year and \$3.1 million in subsequent years and which will result in an outsourced labor, materials, and postage cost of \$2.0 billion during the first year and \$431.5 million during subsequent years.

In Amendment 1, EBSA identified a new information collection requirement entitled “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” (OMB Control Number 1210–NEW) with an annual estimated burden of 172,000 hours at an equivalent cost of \$18.2 million and which will result in a total annual cost burden of over \$1.3 million.

In Amendment 2, EBSA identified revisions to an approved existing collection entitled “Amendment to and Partial Revocation of Prohibited Transaction Exemption (PTE) 86–128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Amendment to and Partial Revocation of PTE 75–1” and “Final Investment Advice Regulation” (OMB Control Number 1210–0059). EBSA estimates these information collection requirements will result in approximately 71,000 hours during the first year and 67,000 hours during subsequent years, at an equivalent cost of \$8.7 million and \$8.3 million, respectively. EBSA also expects this exemption will result in a total annual cost burden of almost \$736,000 during the first year and \$734,000 during subsequent years.

EBSA determined that the information collection requirements in Amendment 3 impose no additional burden on respondents. EBSA did not discuss the Act in Exemption 3.

Statutory authorization for the rule

EBSA issued the Conflict of Interest Rule pursuant to the authority of section 505 of the Employee Retirement Income Security of 1974 (ERISA) and section 102 of Reorganization Plan No. 4 of 1978 (Reorganization Plan). 29 U.S.C. § 1135; 5 U.S.C. App. 237. In Exemption 1 and 2, EBSA stated that it has the authority under section 408(a) of ERISA and the Reorganization Plan to grant administrative exemptions. Amendments 1, 2, and 3 and Exception 3 state that they were done pursuant to section 408(a) of ERISA and section 4975(c)(2) of the Internal Revenue Code.

Executive Order No. 12,866 (Regulatory Planning and Review)

EBSA stated in the Conflict of Interest Rule that the action is a significant regulatory action and submitted it to OMB for review. Exemptions 1, 2, and 3, and Amendments 1, 2, and 3 stated that OMB determined the action was significant under the Order and that it was reviewed by OMB.

Executive Order No. 13,132 (Federalism)

In the Conflict of Interest Rule, EBSA determined that the final rule has no substantial direct effect on the states, on the relationship between the national government and the states, or on the distribution of power and responsibilities among the various levels of government. The Order was not discussed in the Exemptions or Amendments.