United States Senate

COMMITTEE ON
HOMELAND SECURITY AND GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510–6250

March 11, 2016

The Honorable Shaun Donovan
Director
Office of Management and Budget
725 17th Street, NW
Washington, D.C. 20503

The Honorable Howard Shelanski
Administrator
Office of Information and Regulatory Affairs
Office of Management and Budget
725 17th Street, NW
Washington, D.C. 20503

Dear Director Donovan and Administrator Shelanski:

The Committee on Homeland Security and Governmental Affairs recently issued a majority staff report about the Labor Department's Conflict of Interest Proposed Rule.[1] The Committee continues to examine the Labor Department's rulemaking process, including the review of the rule by the Office of Information and Regulatory Affairs (OIRA) within the Office of Management and Budget (OMB). Pursuant to Executive Order (EO) 12866, federal agencies must submit "significant rules" to OIRA for review before they become final.[2] It is then OIRA's responsibility to "provide meaningful guidance and oversight so that each agency's regulatory actions are consistent with applicable law, the President's priorities, and the principles set forth in this Executive order and do not conflict with the policies or actions of another agency."[3]

The report found that the Labor Department's proposed rule—submitted to OIRA for review on February 23, 2015[4]—did not comply with the requirements of EOs 12866 and 13563.[5] Despite these deficiencies, the Labor Department issued its proposed rule on April 20, 2015.[6] The Labor Department subsequently submitted its final rule to OIRA for review on January 28, 2016.[7] Although it is unknown whether the Labor Department has remedied the deficiencies that

[1] S. Comm. on Homeland Security & Governmental Affairs, The Labor Department's Fiduciary Rule: How a Flawed Process Could Hurt Retirement Savers (Feb. 24, 2016) [hereinafter "Fiduciary report"].
[2] Exec. Order 12866 § 6(a)(3)(B), (C), 3 C.F.R. 638 (1994).
[3] *Id.* § 6(b).
[4] Reginfo.gov, http://www.reginfo.gov/public/do/eoAdvancedSearchMain# (Search Criteria: RIN=1210-AB32).
[5] Fiduciary report, *supra* note 1, at 31–33.
[6] Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21,928 (proposed Apr. 20, 2015) (to be codified at 29 C.F.R. pts. 2509, 2510).
[7] Reginfo.gov, http://www.reginfo.gov/public/do/eoDetails?rrid=125914.

existed in the proposed rule, observers have speculated that the timing of the rule's arrival at OMB indicates that the Labor Department "likely tweaked rather than gutted the original proposal"[8]:

> It confirms there's going to be no wholesale overhaul of the rule, as some opponents wanted. . . . If they were going to make substantial changes, they might have taken longer. It's largely going to be a rule that is the same proposal, with changes here and there.[9]

If the Labor Department has indeed failed to remedy the rule's deficiencies, I urge OMB to uphold its regulatory review responsibilities and to return the proposed rule to the Labor Department for further consideration.

In particular, the Committee's inquiry into the Labor Department's rulemaking included the following findings:

1. Lack of a Quantitative Cost-Benefit Analysis of Alternatives

When the Labor Department submitted its proposed rule in 2015, the regulatory impact analysis lacked the required quantitative analysis of the costs and benefits of alternatives. Moreover, communications obtained by the Committee suggest that the Labor Department declined to even consider alternatives to its proposal.

EOs 12866 and 13563 require the Labor Department to consider alternatives, including the alternative of not regulating, and to conduct quantitative cost-benefit analysis of alternatives. EO 12866 provides that agencies should promulgate regulations only if they are "made necessary by compelling public need, such as material failures of private markets."[10] EO 12866 further provides that "in deciding whether and how to regulate, agencies should assess all costs and benefits of available regulatory alternatives, including the alternative of not regulating."[11] EO 12866 directs an agency to "select, in choosing among alternative regulatory approaches, those approaches that maximize net benefits,"[12] and to "identify and assess available alternatives to direct regulation."[13] EO 12866 further directs an agency "to quantify anticipated present and future benefits and costs as accurately as possible."[14]

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[8] Mark Schoeff Jr., *DOL Fiduciary Rule Arrives at OMB*, InvestmentNews (Jan. 29, 2016, 5:33 AM), http://www.investmentnews.com/article/20160129/FREE/160129908/dol-fiduciary-rule-arrives-at-omb.
[9] *Id.*
[10] Exec. Order No. 12866 § 1(a); *see also* Exec. Order No. 13563 § 1(b), 3 C.F.R. 215 (2012) (providing that an agency must "propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs").
[11] Exec. Order No. 12866 § 1(a).
[12] *Id.* § 1(b)(3).
[13] *Id.* § 1(b)(5).
[14] *Id.* § 1(c).

Expert staff at the SEC urged the Labor Department to conduct this required quantitative analysis, but the Department declined, stating, "[w]e think this would be extraordinarily difficult and would appreciably delay the project for very little return."[15] Instead, the Labor Department's regulatory impact analysis contained only qualitative analysis of alternatives.[16]

Although EOs 12866 and 13563 permit agencies to conduct qualitative analysis in place of quantitative analysis where the costs and benefits are "difficult or impossible to quantify,"[17] the costs and benefits associated with the Labor Department's proposed fiduciary rule do not meet the "difficult" or "impossible" threshold. The EOs and OIRA guidance explain, through examples, that factors that qualify as "difficult" or "impossible" to quantify are factors with inherently intangible or subjective properties, such as human dignity, fairness, privacy, ecological gains, improvements to quality of life, and aesthetic beauty.[18] Monetary costs and benefits very clearly do not fit into this category because they are both countable and objective. The fact that determining costs and benefits may involve complex calculations and future uncertainties is a distinguishable obstacle. In fact, OIRA emphasizes the importance of providing a quantifiable analysis, even when it involves complex calculations or future uncertainties.[19]

Even for factors where quantification or monetization is not possible, OIRA instructs that the agency is not exempt from providing a quantitative analysis altogether and should still "present all available quantitative information."[20] OIRA instructs that while forecasts about the future may be uncertain, those uncertainties should be analyzed—agencies should specify potential scenarios, calculate the benefits and costs associated with each scenario, and construct ranges of values.[21] OIRA further emphasizes that this is the minimum agencies should do, and that agencies should assign probabilities and calculate expected values based on those probabilities, if possible.[22]

The EOs and the OIRA guidance do not exempt the Labor Department from conducting a quantitative analysis simply because the analysis would involve complicated calculations and future projections. While the Labor Department might not be able to capture every potential cost and benefit of the rule, OIRA's guidance to agencies indicates that the Labor Department should provide monetary and quantitative analysis of as many factors as possible. The Labor Department's approach of determining that it would be difficult to calculate costs and benefits, and thus abandoning the effort altogether, starkly contrasts with the guidance provided by OIRA.

[15] Items of Concern Chart, SEC-DOL003234–003239.
[16] Dep't of Labor, Fiduciary Investment Advice: Regulatory Impact Analysis (2015).
[17] Exec. Order No. 13563 § 1(b)(c).
[18] OIRA, Regulatory Impact Analysis: A Primer, at 12, 13.
[19] *Id.*
[20] *Id.* at 12.
[21] *Id.*
[22] *Id.* at 14–15.

Furthermore, communications suggest that the Labor Department did not even contemplate alternatives to its proposal. The communications indicate that the Labor Department was predetermined to regulate the industry and sought evidence to justify their preferred action. In an email to a senior political advisor in the Executive Office of the President, a Labor Department policy advisor wrote of the "challenges in completing the [regulatory impact analysis]."[23] In particular, he noted, "we need to determine whether the available literature, our work with RAND, and any other data we have not yet identified can be woven together to demonstrate that there is a market failure and to monetize the potential benefits of fixing it."[24] In another email to the same official, a Labor Department policy advisor discussed plans for packaging the rulemaking re-proposal.[25] The email noted a GAO report that the Labor Department intended to use to "build[] the case for why the rule is necessary."[26] Seemingly, the Labor Department worked backwards—it first determined that it wanted to create the rule, and then searched for evidence to justify it. The way in which the Labor Department approached the regulatory impact analysis is opposite to the methodology required by executive order.

2. Failure to Coordinate with Government Experts and to Consider Existing and Planned Regulation

The Committee obtained communications and draft versions of the rule that reveal that the Labor Department failed to sufficiently coordinate with its expert colleagues across the government. EO 12866 requires an agency to "avoid regulations that are inconsistent, incompatible, or duplicative with its other regulations or those of other Federal agencies."[27] EO 13563 further requires an agency to "seek the views of those who are likely to be affected."[28] EO 13563 provides that:

> Some sectors and industries face a significant number of regulatory requirements, some of which may be redundant, inconsistent, or overlapping. Greater coordination across agencies could reduce these requirements, thus reducing costs and simplifying and harmonizing rules. In developing regulatory actions and identifying appropriate approaches, each agency shall attempt to promote such coordination, simplification, and harmonization.[29]

[23] E-mail from Zachary A. Epstein, DOL, to Brian C. Deese, Exec. Office of the President, et al. (Oct. 25, 2011, 7:30 PM), SEC-DOL005872–005873.
[24] *Id.*
[25] Email from Chris Cosby, DOL, to Brian C. Deese, Exec. Office of the President, et al. (Nov. 2, 2011, 5:47 PM), SEC-DOL006041–006042.
[26] *Id.*
[27] Exec. Order No. 12866 § 1(b)(10).
[28] Exec. Order No. 13563 § 2(c).
[29] *Id.* § 3.

However, the report found that career, non-partisan professional staff at the Securities and Exchange Commission (SEC), regulatory experts at the OIRA, and Treasury Department officials expressed numerous concerns to the Labor Department about its proposed rule.[30] However, these communications and documents indicate that officials at the Labor Department disregarded many of these concerns and declined to implement recommendations from the SEC, OIRA, and the Treasury Department. The Committee found that the Labor Department frequently prioritized the expeditious completion of the rulemaking process at the expense of thoughtful deliberation.

Former SEC Commissioner Daniel Gallagher confirmed that there was a lack of coordination with the SEC. Commissioner Gallagher emphasized that the Labor Department did not collaborate with the SEC in the rulemaking process.[31] Commissioner Gallagher called the rulemaking a "fait accompli" and criticized the comment process for being "merely perfunctory."[32] Commissioner Gallagher dispelled Labor Secretary Thomas Perez's claims that the Labor Department "met substantively" with career, non-partisan staff at the SEC, pointing out that Commissioner Gallagher was not included in any such conversations.[33] Commissioner Gallagher wrote that, in contrast to Secretary Perez's claims, "the [Labor Department's] actions, and the substance of the [Labor Department] Fiduciary Proposal, reflect a lack of concern for the [SEC's] views on these issues."[34] He continued:

> Strikingly, the Fiduciary Proposal does not contemplate or even mention potential SEC rules or the SEC's existing regime for regulating broker-dealers and investment advisers. If the DOL were actually serious about working together with the SEC on an implementable standard, it could have—and should have—included in its proposal some type of substituted compliance mechanism, in which compliance with an SEC fiduciary standard would satisfy the DOL rules.[35]

Upon review of the Labor Department's proposed rule, FINRA criticized the rule for its failure to incorporate securities laws and FINRA rules. FINRA wrote that the rule "established principles that employ imprecise terms with little precedent in the federal securities laws or, in many cases, ERISA," and that "[i]n some respects these principles even conflict with FINRA rules."[36]

Experts caution that the Labor Department's rule—especially in light of the SEC's plan to propose a rule in late 2016—will likely create overlapping and conflicting regulatory regimes. Alice Joe, the managing director of the Chamber of Commerce's Center for Capital Markets

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[30] *See* Fiduciary report, *supra* note 1.
[31] Letter from Daniel Gallagher, Comm'r, SEC, to Hon. Thomas Perez, Sec'y, DOL (July 21, 2015).
[32] *Id.*
[33] *Id.*
[34] *Id.*
[35] *Id.*
[36] Letter from Marcia E. Asquith, Sr. Vice President & Corp. Sec'y, FINRA, to DOL, at 11 (July 17, 2015).

Competitiveness stated, "[i]f the rule becomes final, there will be no fewer than six different 'rules of the road' for nearly identical customer relationships—some regulated by the SEC, some regulated by the [Labor Department] and with Treasury peering over everyone's shoulder."[37]

The Labor Department's failure to harmonize its work with experts across the government contrasts with the requirements of EOs 12866 and 1363, which necessarily required the Labor Department to coordinate with agencies with overlapping or jurisdiction, including the SEC, Treasury Department, and FINRA.

3. The Rule's Complexity and Creation of Uncertainty

EO 12866 directs an agency to "draft its regulations to be simple and easy to understand, with the goal of minimizing the potential for uncertainty and litigation arising from such uncertainty."[38] However, experts have repeatedly and emphatically criticized the rule's complexity, cautioning that the rule will create uncertainty for investment advisors, especially for small firms and advisors that serve small accounts. SEC staff raised at least 26 items of concern about the rule to the Labor Department, many of which related to the rule's complexity."[39] Additionally, according to investment advisors, the rule will increase litigation risk because of its confusing and complex compliance requirements. The owner of a small investment firm testified to Congress that, as a small-business owner, she feels "great concern over subjecting [her] business to increased business and litigation risk."[40]

I strongly urge OIRA to carefully analyze the Labor Department's rule and return the rule to the Department for further consideration if the Department has not remedied the deficiencies that existed in the proposed rule. I am confident that OIRA will uphold its obligations and will enforce the stringent standards for regulatory review as set by executive orders across Administrations. Please do not hesitate to contact me or my staff if we can be of further assistance to you.

Sincerely,

Ron Johnson

Ron Johnson
Chairman

cc: The Honorable Thomas R. Carper
Ranking Member

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[37] Tim Devaney, *Emails Suggest Discord in Administration over Financial Adviser Rule*, The Hill (Feb. 25, 2016), http://g.thehill.com/regulation/finance/270761-emails-suggest-discord-in-administration-over-financial-adviser-rule.
[38] Exec. Order No. 12866 § 1(b)(12).
[39] Email from Lona Nallengara, SEC, to Sharon Block, DOL (Jan. 26, 2015), SEC-DOL003274–003276.
[40] *Id.*