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December 13, 2022

Division of Regulations, Legislation, and Interpretation
Wage and Hour Division
U.S. Department of Labor
200 Constitution Avenue NW, Room S-3502
Washington, DC 20210

Via electronic submission to <https://www.regulations.gov>.

Re: Employee or Independent Contractor Classification Under the Fair Labor Standards Act;
RIN 1235-AA43

Dear Sir or Madam:

The Alternative and Direct Investment Securities Association (ADISA),¹ is writing to provide its comments on the proposal to modify Wage and Hour Division (the “Division”) regulations revising its analysis for determining employee or independent contractor classification under the Fair Labor Standards Act (the “Proposal”).

ADISA members play an important role in bringing non-correlating, diversifying investments to a significant part of the investing population. Based on its review of the Proposal, ADISA believes that the Division should reevaluate the applicability of the Proposal to broker-dealers, registered investment advisers, registered representatives and financial advisers.

ADISA believes that the 2021 IC Rule² provides more certainty in determining whether an individual should be classified as an employee or independent contractor. Our understanding is that classification of employees in the financial services industry is not subject to abuse and, in fact, typically reflects the amount of true independence that persons treated as independent contractors enjoy. ADISA also believes that the strong regulatory framework in place under the rules and regulations of the Financial Industry Regulatory Authority, Inc. (FINRA) and the

¹ADISA is the largest association of the retail direct investment industry in the United States. ADISA has approximately 4,500 members who employ over 220,000 investment professionals, together serving the interests of more than 2 million investors throughout the country. Approximately 3,200 of our members are broker-dealers, registered investment advisers, registered representatives and financial advisers. Direct and alternative investment programs serve a critical need in the creation and ongoing management of diversified investment portfolios.

² Independent Contractor Status Under the Fair Labor Standards Act 86 Fed. Reg. 1168, *et seq.* (January 7, 2021)

Securities and Exchange Commission (SEC) applicable to broker-dealers, registered investment advisers, registered representatives and financial advisers; the licensing, training and ongoing educational requirements imposed by FINRA and the SEC on such entities and individuals; and the policies/rules/limits surrounding the compensation paid to those entities and individuals mean that broker-dealers, registered investment advisers, registered representatives and financial advisers are not the class of individuals the Division is looking to protect by the implementation of the Proposal.³

As stated above, persons who are currently categorized as independent contractors by broker-dealers and registered investment advisers function independently and effectively support their own business endeavors with the compensation received from their positions. This independence is built into the financial models that their firms employ, models which are based on the assumption that independent contractors will bear significant costs of their business operations and operate with significant freedom relative to the firms with whom they are associated. To the extent that it might cause the re-classification of many independent contractors as and into employees, the Proposal has the potential to dramatically impact this carefully calibrated and mutually advantageous model. Below we provide some examples of how the Proposal will upend the decades long independent broker-dealer and registered investment adviser business model.

Degree of Permanence of Relationship

All registered representatives must become licensed by FINRA through initial testing requirements, must maintain their license through ongoing training and continuing education, and are required to hold their license through a FINRA registered broker-dealer. Financial advisers are licensed by the SEC (or the various states) and ordinarily hold their license through an SEC or state registered investment adviser.

While there is no prohibition from being registered with more than one broker-dealer or registered investment adviser, from a practical standpoint independent registered representatives and financial advisers are not able to bounce from firm to firm. Any time a registered representative or financial adviser moves firms, this causes significant disruption in the relationship between the registered representative or financial adviser and his or her clients as a result of the move and the resulting required paperwork from the new firm to 'onboard' an independent registered representative's or financial adviser's clients. This can cause the registered representative or financial adviser to lose clients they worked long and hard for, causing those clients unexpectedly into establishing a relationship with a different registered representative or financial adviser, which takes time and is disruptive and potentially harmful to the investment objectives and growth of the client's portfolio. Each broker-dealer and/or registered investment adviser has different criteria and requirements with respect to onboarding new registered representatives and/or financial advisers.

³ The State of California specifically recognizes the need for and validity of multiple methods of determining worker classifications, by exempting registered securities' broker-dealers, investment advisors, their agents or representatives, from that state's ABC Test in favor of the right of control test similar to that used by the I.R.S. (Section 2750.3 of the California Labor Code).

Nature and Degree of Control

Registered representatives and financial advisers create their own business plan, incur their own marketing expenses, hire employees, pay for office space, and build a book of business – they run their own business. They gain clients through their own efforts, their compensation is tied to their own efforts, and on a day-to-day basis, they are running their own business under the umbrella of the firm’s supervisory control framework.

FINRA and SEC rules and regulations require supervision by a broker-dealer over registered representatives that are registered with that broker-dealer; and supervision by a registered investment adviser over financial advisers that are registered with that investment adviser. As a result, the control over the registered representatives and financial advisers is limited to complying with the supervisory regime put in place by the broker-dealer and registered investment advisor, as required by FINRA and the SEC.

The proposed rule states: “Control implemented by the employer for purposes of complying with legal obligations, safety standards, or contractual or customer service standards may be indicative of control.” Broker-dealers are required by FINRA, and registered investment advisers by the SEC, to have a fully functioning supervisory control framework within which the registered representative and financial adviser must operate its financial advisory business. To implement the Proposal and its control framework would fundamentally change the businesses of independent registered representatives and financial advisers, as they are not permitted to conduct their business outside of the FINRA and SEC required supervisory control framework.

Pricing

If a registered representative is selling an investment product which has selling commissions or trailing commissions/fees, those are set by the investment product itself and sometimes lowered by the broker-dealer to be in compliance with its supervisory control framework. One factor that may drive the lowering of commissions is the SEC’s Regulation Best Interest, which focuses on compensation paid to broker-dealers in connection with selling one investment product over another, among other items. Those commissions are paid to the broker-dealer, who then pays the agreed upon commission to the registered representative. The independent registered representative has no say in how the pricing of the commissions is set by the investment product sponsor.

Extent to Which Work Performed is Integral Part of Business

As stated above, an independent registered representative is prohibited from being in business without being registered with a FINRA registered broker-dealer; and similarly, a financial adviser cannot be in business without being part of and associated with a registered investment adviser. We point to the analysis directly above.

Costs of Implementation

In the event the Proposal is implemented, the increase in costs to broker-dealers and registered investment advisers will be far greater than presented in the Proposal (total regulatory familiarization costs to a business in Year 1 of \$24.97, per business, and total regulatory familiarization costs to an independent contractor in Year 1 of \$5.34, per independent contractor) and will in fact fully undermine the existing cost allocation approach adopted by many broker-dealers and registered investment advisers. This will create a sea change in what is currently a carefully calibrated approach to determining which party pays for which business expenses and open a Pandora's box of potential changes to business structures and associated economics. We asked an ADISA member who is a medium sized independent broker-dealer to estimate the costs of implementing the Proposal. After a lengthy call with their external accounting firm, they had more questions than answers and provided the following preliminary feedback:

- Typically, most registered representatives and investment advisers pay their own state and federal annual licensing and registration fees, rent and office expenses, office supplies, and employee compensation – all of these costs would shift to the broker-dealer/registered investment advisor.
- Typically, the broker-dealer/registered investment adviser pays for E&O insurance and technology (back office) platforms, in exchange for charging a fee to the registered representative/financial adviser to cover the individual's pro rata portion – this expense would shift completely to the broker-dealer/registered investment adviser.
- Typically, registered representatives and financial advisers have set up their small business as an S corporation or limited liability company and can claim their business expenses on the Schedule C. Implementation of the Proposal and classification of registered representatives and financial advisers as employees would mean that they would no longer be able to conduct business as an S corporation or limited liability company, losing those tax advantages as well as the liability protections.
- Reclassification of registered representatives and financial advisers as employees would fundamentally and significantly alter the determination of who pays which costs and expenses and would require replacing existing independent contractor agreements with employment agreements to accomplish such changes.
- The ADISA member estimates that the average expense increase would start at approximately 10% and go up from there. Such increase would include half of the self-employment tax, workers' compensation, and state/federal unemployment taxes. Because every state has different rates for the latter two taxes, it is impossible to give a universal percentage number of increased costs and expenses at this time.

We note the following additional costs:

- With a transition of many individuals from independent contractor status to employee status, the costs for the employer will go up which will necessarily decrease the amount of compensation that it will be able to share with the reclassified employee. This would have the effect of dramatically changing and likely lowering the compensation that the individual can derive from practicing his or her profession and would likely result in individuals not being able to continue in their chosen professions or choosing a different

career, eliminating broad access to financial services. This will necessarily have a greater impact on small businesses' ability to provide services or even stay in business since small businesses have less ability to absorb increased costs than larger businesses.

- The employer may not continue to allow reclassified employees to work in their current location, if they are located in a rural location or a location where the employer does not wish to have an office. Again, this could cause many current independent contractors to forfeit their financial services business, resulting in the elimination of financial services in these communities.

The independent registered representatives and financial advisers exercise their own efforts to create and manage a book of business that does not belong to the employer. To require reclassification of these individuals from independent contractor status to employee status would effectively take this asset away from the independent registered representative or financial adviser and place it in the hands of the employer, as well as restrict how and in what manner they serve their clients, potentially restricting these financial services from being offered to those who need these services. In addition, what are clients of the individual representative would become clients of the firm, thus dramatically changing the wealth-creation elements associated with the independent contractor model.

Effect of Implementation

Independent registered representatives and financial advisers are a crucial part of the financial services industry. The Proposal could create a situation where a large number of registered representatives, regardless of their current business model, would be reclassified as employees, thus upending a significant portion of the financial services industry. In turn, this would restrict investment opportunities and investment product choices for investors from all walks of life, including seniors managing their retirement savings and new investors (young and minority groups) attempting to gain investment knowledge and build an investment portfolio.

An unintended consequence of the Proposal would be to upend the existing business model which provides financial advice to many in the middle-income bracket. The effect of reduced financial advice has been well researched and would have a disproportionate impact on those of lesser means seeking to grow their wealth - particularly minority groups.⁴

Conclusion

Implementing the Proposal would impact the independent financial services industry in a materially negative way for both firms and financial service professionals providing financial services as well as consumers of those same services. In addition, it is likely to have a disparate impact on financial services professionals who are trying to build a business and/or increase their impact on underserved communities. For those reasons, and because the current system does not impose unfair results or impacts on persons who enjoy independent contractor status in the


⁴ For a summary of research on how reduction of financial advice would affect minority communities, see: Hispanic Leadership Fund. 2021. *Analysis of the Effects of the 2016 Department of Labor Fiduciary Regulation on Retirement Savings and Estimate of the Effects of Reinstatement*. Washington, DC.

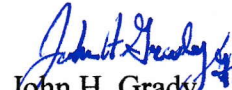
www.HispanicLeadershipFund.org.

financial services industry, the Proposal should either be reverted back to its prior form or financial services professionals and firms should be exempted from its application.

ADISA appreciates very much the work of the Department. We ask that you give our comments consideration. We stand ready to assist further in any way we can and to discuss our comments at your convenience.

Sincerely,


Catherine Bowman
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ADISA Leg/Reg Cmte


John H. Grady
Co-chair
ADISA Leg/Reg Cmte

cc: Drafting Committee—Catherine Bowman, John H. Grady, Deborah Froling, Mike Bendix