sifma
Invested in America

December 12, 2022

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

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

Dear Secretary Walsh,

The Securities Industry Financial Markets Association[1] appreciates the opportunity to comment on the Department of Labor's proposal to modify Wage and Hour Division regulations to revise its analysis for determining employee or independent contractor classification under the Fair Labors Standards Act (FLSA).[2] Independent contractors have long been an important part of the securities industry, and though we appreciate that this proposal will allow our members who choose to be independent contractors to continue to be able to do so, we believe the proposal could benefit from some improvement to best serve the public interest.

I. Executive Summary

The Department's proposal is intended to put into regulation an analysis for determining independent contractor versus employee status. While the last administration put in place a

[1] SIFMA is the leading trade association for broker-dealers, investment banks and asset managers operating in the U.S. and global capital markets. On behalf of our industry's one million employees, we advocate on legislation, regulation and business policy affecting retail and institutional investors, equity and fixed income markets and related products and services. We serve as an industry coordinating body to promote fair and orderly markets, informed regulatory compliance, and efficient market operations and resiliency. We also provide a forum for industry policy and professional development. SIFMA, with office in New York and Washington, DC, is the US regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org

[2] 87 Federal Register 197 (October 13, 2022); See also, SIFMA Comment to the Department of Labor on Independent Contractor Status Under the Fair Labor Standards Act (RIN 1235-AA34)(October 26, 2020)

regulation which this Administration is now revising, previously there was only sub-regulatory guidance to assist businesses and individuals to determine worker classification. We welcome this opportunity to share with the Wage and Hour Division some perspective on the securities industry usage of the independent contractor model, as well as to suggest some revisions to improve the proposal. We will cover:

- An explanation of how the securities industry independent contractors serve retirement savers and others;
- Our concern about treating all factors of an economic realities test as equal versus previous Court analysis that has highlighted as the primary factors (1) the nature and degree of the worker's control over the work and (2) the worker's opportunity for profit or loss;
- The public policy concern with implying that regulatory compliance can turn a worker into an employee;
- A proposal that the Department consider the inclusion of certain written contracts as an additional factor, whether independently or in relation to control; and
- Concerns about the justification for rulemaking that reverses a new rule put in place less than two years ago.

In sum, while the Department's proposal is intended to provide certainty with regard to an individual's status as an employee or independent contractor, as written, it could have an inadvertent adverse impact on financial advisors who are currently properly classified as independent contractors.

II. Understanding the Securities Industry Brokerage Model

Independent contractors have long been an important part of the securities industry. Independent broker-dealers and the nearly 140,000 FINRA registered individuals that affiliate with them as independent financial advisors (and possibly up to a half a million people as found in a recent NERA study)[3] serve millions of clients across the U.S., [4] with tailored investment advice. Independent financial advisors own and operate approximately 130,000 financial advisory and insurance brokerage firms, employing approximately 330,000 people. Independent contractor-operated financial advisory firms and insurance agencies account for an estimated $31-47 billion of annual economic output.[5]

[3] NERA The Role of Independent Contractors in the Finance and Insurance Sectors 2022 (https://www.nera.com/publications/archive/case-project-experience/the-role-of-independent-contractors-in-the-finance-and-insurance.html)

[4] Discovery Data FINRA Series 7 licensed producing registered representatives.

[5] Broker-Dealer Data Center Independent Survey – Total Revenue 2020; NERA The Role of Independent Contractors in the Finance and Insurance Sectors 2022

Many clients of these independent contractors are modest to middle income investors seeking to create a nest egg or advice on retirement planning. They may be looking for thoughts on funding for a child or grandchild's education, as well as dealing with both the blessings and tribulations of other life events.

For financial advisors who choose to be independent contractors instead of being an employee of a broker-dealer, their independent contractor status allows them to own and operate their own small business (formed as sole proprietorships, professional corporations, partnerships, LLCs, or other legal entities) and control the manner and means of its operation. Their business as a financial advisor bears the hallmark of an independent contractor. They benefit from a decentralized business structure, which gives them responsibility for the operational tasks associated with being a small business owner: buying or renting their own office space, determining their own hours, purchasing technology and equipment, and selecting and managing vendors. They are also responsible for the strategic direction and growth of their business because they generate their own clients and may choose to market under their own brand and conduct business under their own trade name rather than the name of the brokerage firm with which they are registered. Importantly, independent financial advisors are small business owners who have discretion over the number of employees they hire and take on the responsibility of being a competitive employer who offers benefits, access to retirement savings, and other workplace necessities.

Independent contractor financial advisor' compensation is traditionally based on commissions, fees, or other transaction-based consideration that is carefully recorded on the books and records of the broker-dealer and reported on IRS Form 1099. Importantly, independent financial advisors are the primary maintainer of the relationship with clients – and that relationship is the most valuable asset in the securities industry. This is an important reason that some individuals choose to be an independent contractor. If an advisor wishes to affiliate with another broker-dealer, it is more likely the clients will follow that independent advisor to his or her new firm than will clients of an employee of a firm.

Notably, financial advisors work in a highly regulated industry and are required by the securities laws and regulations to associate with a broker-dealer, which could be a firm that has a fully independent contractor business model or offers advisors a choice between an independent contractor or employee model, and be licensed with the Financial Industry Regulatory Authority ("FINRA").[6] Each affiliated financial advisor has a written contract with the broker-dealer that clearly details his or her status as an independent contractor and specifies that he or she is not an employee of the broker-dealer. There is no potential for misunderstanding each side's role in the

[6] Exchange Act § 15(b)(8), 15 U.S.C. § 78o(b)(8).

arrangement. Association with a broker-dealer is grounded in important public policy. The broker-dealer handles licensing and registration of financial advisors with both FINRA and the states and supervises them for the protection of investors and compliance with securities laws and regulations. Independent financial advisors contract with broker-dealers not only to meet their own regulatory obligations, but also to carry out various operational components needed to meet their clients' goals. For instance, the broker-dealer offers custody of client funds, provides trade execution, and takes care of the required reporting so that the financial advisors can focus on serving their clients.

Financial advisors operating as independent contractors in our industry are entrepreneurs who build small businesses in their local communities and assume the risks and rewards of entrepreneurship. Many independent financial advisors began their careers as employees of broker dealers, banks and insurance companies. Those individuals have experienced both models and made the conscious decision to be independent because of the many benefits they have discovered including the opportunity to control their own profit or loss. Operating as an independent contractor encompasses the flexibility that these entrepreneurs seek to be successful. Our members who have chosen to make significant financial investments to work as independent contractors in the financial services industry prefer to remain independent contractors and should be able to do so

III. Using an economic realities test is the right test; however, the worker's control over the work, and the worker's opportunity for profit or loss should be the primary factors to be considered

We appreciate the Department's decision to use the economic reality test to evaluate whether the workers are either economically dependent on the employer for work or are in business for themselves. We believe it is important that the Department's guidelines make clear that individuals who work in the securities industry and who have historically been treated as independent contractors meet the multi-factor test and will continue to be treated as independent contractors for purposes of the FLSA. However, some areas of the proposed changes may be less clear than others and should be improved.

The Department of Labor is correct to note that it is the totality of the circumstances that one must look at to properly determine status. The courts have found that there is no "rule of thumb", but that they must instead look at "the total situation."[7] Various courts have looked at whether the individual is in business for himself or herself – as a matter of economic reality.[8] Courts have looked at whether workers are wage earners, or whether they are entrepreneurs who

[7] United States v. Silk, 331 U.S. 704 at 716; See also Rutherford Food Corp. v. McComb, 331 U.S. 722.
[8] Parrish v. Premier Directional Drilling, L.P., 917 F. 3d 369, 380 (5th Cir. 2019); Saleem v. Corporate Transp. Group, Ltd., 854 F. 3d 131, 139 (2d Cir. 2017)

create work opportunities for themselves.[9] It is important to note that in the securities industry, independent contractors are entrepreneurs seeking new opportunities and should be found to be independent under such a test.

Further, we recommend that the Department consider the court cases that have found certain factors to be better indicators of appropriate worker classification. In particular, decisions have focused on (1) the nature and degree of the worker's control over the work and (2) the worker's opportunity for profit or loss as the primary factors indicative of employee or independent contractor status.

Over the years, courts have stated that when individuals have significant control over meaningful parts of their work, those individuals stand as a separate economic entity and therefore should be considered independent contractors.[10] In addition, courts have indicated that even if a company or firm takes actions to specify the work to be performed and follows up on an individual to ensure adequate performance, this does not by itself create an employer-employee relationship. Certain control, such as "indirect" supervision of an individual's performance is distinct from that which indicates an employment relationship.[11] We believe that this is a crucial factor for a court to review.

When examining an individual's opportunity for profit or loss, courts have considered whether an individual controls the assignments they accept, federal and state tax forms they filed, the autonomy to create one's own work hours, as well as other factors. When evidence shows that an individual's opportunity for loss and profit is based on factors that the individual has significant control over, courts have determined that this tips the balance of the economic realities test resulting in the individual being an independent contractor. [12] Many courts have also considered the capital expenditures in helpers, equipment, and materials as well. This would all contribute to the ultimate profit or loss of such an independent contracting firm.

The Department's proposal weakens the test by putting control and opportunity on equal footing with the other factors, thus no longer giving the factors of control and opportunity the primary weight they should have. In addition to being inconsistent with prior legal precedent, this approach creates less certainty for businesses and individuals involved in classification decisions.

We also point out that several of the factors elevated by the proposal would be challenging to apply in the securities industry. In particular, the notion that a long-term at-will relationship would imply employee status is inconsistent with standard securities industry practice for

[9] Mr. W Fireworks, 814 F. 2d 1042, 1051 (5th Cir. 1987)
[10] Parrish at 381. Se also Mid-Atl. Installation Servs., 16 F. App'x at 106.
[11] Moreau v. Air France, 356 F. 3d 942, 950-951 (9th Cir. 2003)
[12] Karlson, 860 F. 3d at 1094-1095; McFeeley, 825 F. 3d at 243 ("The more the worker's earnings depend on his own managerial capacity rather than the company's…the less the worker is economically dependent on the business and the more he is in business for himself and hence an independent contractor."); Express Sixty-Minutes, 161 F. 3d at 304 ("driver's profit or loss is determined largely on his or her skill, initiative, ability to cut costs, and understanding of the courier business")

independent contractors. Rather than connote employee status, a long-term relationship between the independent financial advisor and the broker-dealer demonstrates the parties' mutual satisfaction with the relationship and appreciation for stability. As investors in the marketplace, consumers would appreciate an advisor who works with the same financial institutions for a long period of time. Although financial advisors can choose to affiliate with a different broker-dealer, that choice is made after careful deliberation because of the disruption it can cause for clients, and because of the significant amount of paperwork (required by the SEC and FINRA) that needs to be done to repaper client accounts. There are also costs and other burdens on both the advisors and the clients when an advisor switches from one firm to another. For this reason, many of these relationships between independent broker-dealers and independent advisors tend to be long term, and when advisors exercise their right to choose which broker-dealer, and which affiliation model, it is done with careful deliberation.

We respectfully submit that the Department should amend its proposal to make the worker's control over the work, and the worker's opportunity for profit or loss the primary factors to be considered in the economic reality test. This would be the most accurate and clearest interpretation for determining classification status.

IV. The proposal promotes poor public policy by implying control in connection with regulatory compliance could be an indicator of employee status

The proposal is further weakened by suggesting that indicia of a firm's control over an individual for the purpose of ensuring regulatory compliance is evidence of employee status. This is poor public policy since compliance with securities laws and regulations is intended to protect the investing public. As noted above, financial advisors work in a highly regulated industry. They are licensed by FINRA, which works under the supervision of the Securities and Exchange Commission – and they are subject to state securities laws and regulations. FINRA writes and enforces rules governing the activities of both registered broker-dealer firms and the individual registered representatives, who have an independent obligation to comply with securities regulations.[13] In many circumstances, the supervisory activities of the firms are intended to assist the registered representative fulfill his or her individual compliance obligations. The proposed new guidelines raise the prospect that this factor would weigh towards securities industry workers possibly being considered employees because their firms are required to exercise some degree of control over them to ensure their compliance with industry regulations.

It is important for the highly regulated securities industry that independent contractors do not morph into employees merely because they must remain in compliance with federal and state securities, banking, and insurance laws. It is due to securities regulations and FINRA rules that broker-dealers must adopt and maintain a system of supervision reasonably designed to ensure

[13] In other circumstances, it may be proper to consider compliance with the laws as an example of control, when the burden of regulatory compliance is only on the employer and not also on the worker.

compliance with applicable securities laws, regulations, and rules. To facilitate compliance, broker-dealers adopt written policies and procedures that representatives must follow regardless of their worker classification.

The investing public has an interest in a strong system of compliance. The worker classification test should not create a disincentive for broker-dealers to exercise compliance controls, or for independently contractor representatives to adhere to such controls, in an effort to avoid employee classification. Further, these rules are in place to protect the investor, not the financial advisor. We understand that employers in other industries are supervising their workers to ensure productivity level and to monitor performance, or because of workplace standards and this supervision is for the benefit of the worker and for the employer, not a third party. Supervision of financial advisors, which is a regulatory requirement, is not intended to protect the financial advisors and is fundamentally different from supervision that the Department references in the rule proposal.

More than 26 years ago, Congress specifically recognized the unique status of worker classification in the securities industry when it passed a "duty to supervise" safe harbor for broker-dealers under the tax laws in 1997.[14] Congress was acting in response to the IRS, which at the time was looking at the term "supervision" critically, and was leaning toward classifying independent financial advisors as "employees" because securities regulations required broker-dealers to "supervise" them for investor protection purposes. But after review of the arrangement in the securities industry, the IRS chose to provide a safe-harbor particular to broker-dealers under the tax laws for precisely the public policy reason outlined above. We believe the Department should take a similar approach. It would be inconsistent to hold that compliance with regulations could cause an individual to be deemed under control, and therefore an "employee" under one set of laws, while also holding that the same factors do not result in employee status under another set of laws. The securities industry should not be discouraged from exercising compliance controls to avoid a particular worker classification outcome.

For the reasons outlined above, we believe the appropriate public policy here would be to clarify that supervision for purposes of compliance with applicable laws, rules and regulations does not provide evidence of employee status.

V. The Department's interpretation of integral is too vague

The Department proposes eliminating the "integrated unit of production" factor in favor of the concept of "whether the work is critical, necessary, or central to the employer's business."[15] Our

[14] Section 921 of the *Taxpayer Relief Act of 1997* (PL 105-34).
[15] 87 Federal Register 197, p. 62275

concern is that the test could lead to multiple reasoned outcomes resulting in legal and operational uncertainty which would have negative consequences for everyone involved. It would result in confusion and uncertainty for small business owners, their employees, and the clients that rely on their advice. Financial advice is a discrete, segregable service provided for individual clients.

The example in the proposed rule states, "an accountant [providing] non-payroll accounting support, including filing [the farm's] annual tax return" is "not critical, necessary, or central the principal business of the farm, thus the accountant is not integral to the business." Without such a declaration by the Department it would be reasonable for the business to conclude that filing its annual taxes to local, state, and federal government is critical, necessary, and central to operating its principal business [of farming] because failure to do so could result in the business' closure. Thus, such services would end up being interpreted by many as employee work; however, often such services are provided by independent contractors to multiple businesses. This proposed change is confusing in the proposal, creating unnecessary additional uncertainty.

VI. The Department should add a written contract as an additional factor

We recommend the Department consider adding an additional factor to the proposed test. While control and opportunity for profit or loss should be primary factors, considering the intent of the parties through a written contract would also be an important factor for review. In the securities industry, our members sign contracts with broker-dealers to make their position as an independent contractor clear and unambiguous and to spell out which aspects of the enterprise will be controlled by each party. These are sophisticated parties who understand the nature of the agreement and are choosing to be held to these agreements due to the benefits to both parties to the agreement.[16] This ensures that those who choose to be independent contractors retain the opportunity to benefit from their own entrepreneurship.[17] The Department should recognize that the existence of a written contract that specifies whether the relationship is one of employment or independent contractor, and that is between parties who are sophisticated in the relevant industry, is a factor in the decision.

VII. The Department does not justify additional rulemaking here

The Department of Labor has not justified proposing a new rule here, since the current rule has only been in place for less than two years. During that time period, firms have been adapting to

[16] The fact that many advisors have been employees and understand both the benefits and burdens of that classification indicates that they possess sophistication that is sufficient to overcome any presumption of economic dependence.

[17] While the Department might be concerned to rely too heavily on a contract, the Department could consider allowing the existence of a contract where the parties have equal bargaining power. This was analyzed in the case of Taylor v. Waddell & Reed, Inc., 2013 WL 435907

the new interpretations, which has provided significant clarity for firms. This new rule provided certainty to hiring firms and individuals working in an independent capacity. It was particularly helpful for our firms who operate nationally, as well as those independent contractors who move from one state to another. We would appreciate better understanding the Department's decision to undertake new rulemaking before the current rule has had an opportunity to be fully implemented.

The Department underestimates the cost burdens that could result from a reclassification of independent contractors to being employees of financial services firms. These costs include the transfers of financial advisor registrations, which includes fees charged by the securities regulators to switch members, as well as the costs to financial services firms who have gained employees to add to their employee benefit programs, including retirement plans, health care plans and other related benefits.

Further, the Department assumes that the only costs will be compliance expenses for firms and ignores the significant burdens that will be placed on advisors including loss of value of the independent entities that they own and, presumably, hope to monetize at some point.

VIII. Conclusion

We appreciate the opportunity to comment on this proposal. We believe that financial advisors who choose to be independent deserve the ability to remain independent. The Department's proposal could have an inadvertent adverse impact on financial advisors who take advantage of the many benefits of being independent contractors. We look forward to further discussing this proposal with the Department. If you have any questions, please contact Lisa Bleier at lbleier@sifma.org or 202-962-7329.

Sincerely,

Kenneth E. Bentsen, Jr.
President & CEO
Securities Industry and Financial Markets Association