FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA ELECTRONIC MAIL

December 13, 2022

Ms. Jessica Looman
Principal Deputy Administrator
Wage and Hour Division, U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: Regulatory Information Number (RIN) 1235-AA43: Employee or Independent Contractor Classification under the Fair Labor Standards Act

Dear Ms. Looman,

On October 13, the U.S. Department of Labor (DOL) published its request for public comment on a proposal to modify Wage and Hour Division regulations governing the analysis for determining whether a worker is an employee or an independent contractor under the Fair Labor Standards Act (FLSA).[1] The Financial Services Institute (FSI) appreciates the opportunity to comment on this important proposal (the Proposed Rule).[2]

Executive Summary

While FSI supports the Department's stated goal to bring clarity and consistency to the important question of worker classification under the FLSA, we have substantial legal and policy concerns that prevent us from supporting the Proposed Rule.

DOL should not finalize its proposal to rescind its 2021 Rule.[3] By hastily jettisoning the clarifying "core factors" framework of the existing regulations—adopted less than two years ago in DOL's comprehensive rulemaking on this same topic—the Proposed Rule would undermine its own stated objective of regulatory clarity. It would also contravene the Administrative Procedure Act (APA), the FLSA, and Supreme Court precedent.

DOL also should not finalize its proposal to adopt a new, totality-of-the-circumstances test for FLSA worker classification. That novel test would be independently unlawful, unpredictable, and inappropriately slanted toward employee classification across the board. Among other missteps, the new test improperly expands the critical "control" factor to count regulatory

[1] Employee or Independent Contractor Classification Under the Fair Labor Standards Act, 87 Fed. Reg. 62,218.
[2] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial-services industry and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.
[3] Independent Contractor Status Under the Fair Labor Standards Act, 86 Fed. Reg. 1168 (Jan. 7, 2021).

compliance requirements such as those imposed by federal and state governments—not by the employer—even though these requirements have nothing to do with economic dependence and are not probative of independent contractor status. And it improperly refuses to consider the "integrated unit of production" factor required by Supreme Court precedent, substituting instead an unhelpful and irrelevant inquiry into whether a worker is "integral" or important to a business.

DOL's cost-benefit analysis in support of the Proposed Rule is also fatally flawed. It neglects major categories of costs, deviates without explanation from the cost analysis in the 2021 Rule, and significantly underestimates the costs that the Proposed Rule would impose if adopted.

Finally, the Proposed Rule is bad policy that should not be adopted even aside from the substantial legal obstacles standing in its way. Its adoption would impose significant uncertainty and costs both on the financial-services industry and on the broader American economy. Of particular concern to FSI, the Proposed Rule would create significant uncertainty—and, therefore, costs—for independent financial advisors and the independent financial services firms with which they affiliate, which in turn would reduce the availability of high-quality investment advice and other financial, tax, and estate-planning services for underserved communities, including minority and rural communities.

For all these reasons, FSI urges DOL to withdraw the Proposed Rule and to adhere to the stable, lawful framework of its existing regulations.

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The Interests of FSI and its Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the United States, there are more than 500,000 independent contractors in the financial and insurance industries, including 160,000 independent financial advisors, who account for approximately 52.7 percent of all producing independent financial advisors.[4] These financial advisors are self-employed independent contractors, rather than employees of independent financial services firms.[5] They own and operate approximately 130,000 financial advisory and insurance brokerage firms, employing approximately 330,000 people and accounting for 27 percent ($47 billion) of the output of the financial-advisory and insurance-brokerage industry. Between 2015 and 2019, independent contractors in the financial services sector created approximately 54,000 new businesses and 174,000 new jobs.[6]

FSI's member independent financial services firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring.

FSI's members serve ordinary Americans across all income levels. Independent financial services firms enable independent financial advisors to provide financial advice that helps the advisors' clients save for common financial needs such as college tuition, homeownership, retirement, and support for their aging parents. These advisors' services are especially important in underserved minority and rural communities that lack access to a robust financial-services market, because they frequently offer a one-stop shop for affordable investing advice, tax preparation, financial education, and estate planning.

Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals. The business model has two players: financial advisors and independent financial services firms. Financial advisors normally establish their own business without any coordination with or approval required by the firm. Some advisors engage in limited operations, such as purchasing and selling securities on behalf of clients. Others may have a more significant enterprise, offering a full range of financial planning, investment advice, insurance, tax, and estate-planning services.

Financial advisors affiliate with independent financial services firms in order to take advantage of economies of scale and to ensure regulatory compliance. The firms offer financial

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[4] Cerulli Associates, Advisor Headcount 2019, on file with author; NERA Economic Consulting, The Role of Independent Contractors in the Finance and Insurance Sectors (Nov. 2022), attached *infra* as Ex. B (finding that more than half a million people work as independent contractors in the financial and insurance sector and in financial-services occupations).

[5] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment advisor" or "advisor" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

[6] NERA Economic Consulting, The Role of Independent Contractors in the Finance and Insurance Sectors, *infra* Ex. B.

advisors business services like platforms and products. They also help individual advisors comply with federal and state regulations. In particular, under the Securities Exchange Act of 1934 (Exchange Act), anyone who effectuates securities transactions or offers advice concerning investing in securities, including independent financial advisors, must register with the SEC or affiliate with a corporation that is registered with the SEC, such as an independent financial services firm. 15 U.S.C. § 78o(a)(1). Federal regulations also require registered investment advisors to implement written policies and procedures designed to prevent violations of the federal securities laws. 17 C.F.R. § 270.38a-1. Individual advisors who choose to satisfy these requirements by affiliating with a corporation do not individually register as broker-dealers but instead agree to supervision by their firms, which assume responsibility for ensuring compliance with applicable laws. *Id.*; FINRA Rule 3110. The firms thus oversee the securities operations of their financial advisors, including by establishing written procedures (as required by law) to ensure compliance with federal law and the conduct rules of the Financial Industry Regulatory Authority, Inc. (FINRA).

Critically, *financial advisors are not employees of independent financial services firms*. The industry's business model is successful because the key relationship is the one between a client and his or her financial advisor—not the separate, symbiotic relationship between the financial advisor and his or her affiliated independent financial service firm. Thus, the focal point of a financial advisor's business is his or her interactions with clients. Financial advisors frequently switch their firm affiliations, taking their clients and preexisting businesses with them. The firms do not control financial advisors, who set their own hours and rates, maintain their own physical premises, and hire and supervise their own staffs. Financial advisors make significant investments in their own businesses and realize profits or losses according to their own successes or failures. They generally do not follow instructions from firms (unless required to by law), and they offer clients services wholly unrelated to their firm affiliation, like tax advice and estate planning.

Financial advisors benefit from their status as independent contractors, which allows them the flexibility to manage their own businesses, set their own hours, offer their preferred products and services, and enjoy a healthy work-life balance. According to a June 2022 U.S. Financial Advisor Satisfaction Study conducted by J.D. Power—which surveyed 1,570 employee advisors and 1,469 independent-contractor advisors—independent-contractor advisors reported overall levels of satisfaction with their affiliated broker-dealer that were 5% higher than employee advisors, and were 45% more likely to recommend that broker-dealer to a colleague than were employee advisors. They also reported greater satisfaction than employee advisors along all dimensions of measured relationships—satisfaction with compensation was 3% higher, leadership and culture 5% higher, operational support 7% higher, technology 4% higher, products and marketing 9% higher, and professional development 4% higher.[7] These survey results indicate just some of the reasons why many advisors choose to work as independent contractors.

This industry overview makes clear that financial advisors are independent contractors operating with a significant degree of independence, while complying with certain contractual obligations such as legally required regulatory compliance measures. These advisors are therefore

[7] *Wealth Management Firms Need Advisors as Brand Evangelists to Attract New Talent, J.D. Power Finds* (July 6, 2022), https://www.jdpower.com/business/press-releases/2022-us-financial-advisor-satisfaction-study, attached *infra* as Ex. C.

not correctly classified as employees for FLSA purposes. Rather, they are independent contractors and businesspeople.[8]

The Department Should Withdraw the Proposed Rule

I. The Department Erroneously Discards the 2021 Rule and its "Core Factor" Framework.

DOL fails to justify the proposed dramatic overhaul of its own recent, comprehensive rulemaking on this same topic in the 2021 Rule. It does not support its hasty decision to retreat from that rule, which it has doggedly pursued from the very beginning of the current administration through a procedurally irregular process despite significant protests from regulated parties and adverse judicial precedent faulting the Department for cutting corners in multiple ways. *See Coal. for Workforce Innovation v. Walsh*, No. 1:21-cv-130, 2022 WL 1073346 (E.D. Tex. Mar. 14, 2022) (vacating DOL's prior attempt to withdraw the 2021 Rule for both substantive and procedural flaws). Indeed, it fails to identify any experience under the currently governing regulation that supports its sudden proposal to shift course in a radically different direction.

The 2021 Rule brought much-needed structure and clarity to FLSA worker classification by adopting a "core factor" framework. By abandoning that framework, the Proposed Rule threatens to undercut DOL's stated objectives to promote regulatory clarity and consistency. It rests on fundamentally mistaken views of case law, including misreadings of Supreme Court precedent and improper deference to non-authoritative circuit case law without assessing the cases' reasoning and results (which, properly read, support the 2021 Rule). And it improperly abandons the clarifying focus on "actual practice" that the 2021 Rule required consistent with the Supreme Court's decisions defining the economic reality test.

A. The Proposed Rule undermines, not furthers, DOL's stated purposes.

DOL undermines its own professed goals of regulatory clarity and consistency by destroying the streamlined, easier-to-apply, and even-handed framework of the 2021 Rule, making it harder for workers and businesses to figure out the correct classification of any given worker. In explaining "why the Department is considering action" to overhaul its current regulations less than two years after promulgating them, DOL repeatedly states that its "objective[]" is to "be helpful for both workers and employers" by "providing a consistent approach" that will "reduce confusion" and "provide clarity behind the meaning of economic dependence." 87 Fed. Reg. at 62,229, 62,272 (capitalization altered); *see also id.* at 62,219, 62,225, 62,229–30, 62,232, 62,252, 62,254, 62,259–60, 62,271. But in fact, the Proposed Rule will have the opposite effect of destroying the clarity achieved by the 2021 Rule's more structured analysis, rendering DOL's action unreasonable on its own terms.

The 2021 Rule brought much-needed clarity and rigor to FLSA worker classification by identifying two "'core' factors—the nature and degree of the worker's control over the work and the worker's opportunity for profit or loss"—that "typically carry greater weight in the analysis" of the economic reality test prescribed by the FLSA and Supreme Court precedent. 86 Fed. Reg. at

[8] To be clear, a range of independent workers and businesspeople fall outside the FLSA "employee" definition, including some whose principal function is to provide services to some other third party—their customer—rather than to a company with which they have a symbiotic business relationship. For convenience, this letter uses "independent contractor" as shorthand to refer to this broad range of relationships, some of which might be more accurately characterized as co-ventures or joint ventures. The key point for purposes of this rulemaking is that all of these relationships fall outside the FLSA's covered classification of employees.

1176; *see* 29 C.F.R. § 795.105(c)–(d). As the Department explained at the time, those factors "drive at the heart of what is meant by being in business for oneself: Such a person typically controls the work performed in his or her business and enjoys a meaningful opportunity for profit or risk of loss through personal initiative or investment." 86 Fed. Reg. at 1196. By contrast, other factors commonly considered as part of the economic reality test are "less probative" of worker classification because they often describe *both* employees and independent contractors. *Id.* Consistent with that insight, the current regulations instruct that if the two core factors "both point towards the same classification, whether employee or independent contractor, there is a substantial likelihood that is the individual's accurate classification," and the remaining factors "are highly unlikely, either individually or collectively, to outweigh the combined probative value of the two core factors." 29 C.F.R. § 795.105(c). The 2021 Rule adopted this framework and other measures to "sharpen[]" the economic reality inquiry with the express intention to "improve the certainty and predictability of the economic reality test" for the benefit of workers and businesses. 86 Fed. Reg. at 1168, 1196; *see also id.* at 1172, 1178, 1191, 1197, 1203, 1208, 1210, 1214, 1216, 1240.

The Proposed Rule wrongly jettisons this clarifying framework and substitutes a freewheeling "totality-of-the-circumstances analysis in which the economic reality factors are not assigned a predetermined weight." 87 Fed. Reg. at 62,220. That sprawling, "flexible" analysis will not, as the Department claims, "provide more consistent guidance to employers" and workers attempting to comply with the law on worker classification. *Id.* Rather, "th'ol' 'totality of the circumstances' test" is the kind of inquiry "most feared by litigants who want to know what to expect." *United States v. Mead Corp.*, 533 U.S. 218, 241 (2001) (Scalia, J., dissenting). By expanding the range of relevant factors and expressly refusing to give guidance on how to weigh them against each other, DOL actively undermines the clarifying improvements of the 2021 Rule and works against its own stated objectives. Although the 2021 Rule acknowledged that "[a]dditional factors" beyond those identified in the regulations "may be relevant" in some situations, 29 C.F.R. § 795.105(d)(2)(iv), that limited consideration fit into a framework recognizing two core factors and streamlining the other identified factors. By contrast, the Proposed Rule offers six overlapping factors *plus* unnamed "additional factors" without any clarifying focus on any core factors. Lacking the structure of the core factor framework, the Proposed Rule's new six-factor-plus test cannot give anyone (business or worker) confidence that they have accurately identified workers as independent contractors or employees.

In sum, the Proposed Rule's imposition of a nebulous multifactor inquiry will impose great uncertainty and costs as regulated parties struggle to understand and comply with this brand-new standard—which, in DOL's words, "could take years of appellate litigation in different Federal circuits to sort out." 87 Fed. Reg. at 62,229. In all this, the clear losers are "clarity" and "consistency"—DOL's own stated goals in this rulemaking. *Id.* at 62,232.

A regulation that "will undermine the [agency's] own objective" is arbitrary and capricious. *In re FCC 11-161*, 753 F.3d 1015, 1143 (10th Cir. 2014). In introducing the Proposed Rule, DOL asserts without support that rescinding and replacing the 2021 Rule "would provide greater clarity" for workers and businesses. 87 Fed. Reg. at 62,232. The agency has failed to "articulate a satisfactory explanation" for that claim. *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983). To allow the Proposed Rule to go forward on this basis "would be to accept an agency's blanket conclusions at face-value and to abdicate [the Administrative Procedure Act's requirement] to ensure that the agency has considered 'important aspect[s] of the problem' and rendered a decision that is at least rational." *Sierra Club v. Dep't of the Interior*, 899 F.3d 260, 294 (4th Cir. 2018) (second alteration in original).

B. DOL misapplies case law in abandoning the core factor framework.

In departing from the existing regulation's framework, DOL relies heavily on citations to case law—and in particular recent cases from circuit and district courts. In doing so, it makes three distinct types of mistakes: (1) it misinterprets Supreme Court precedent interpreting the FLSA, (2) it improperly defers without sufficient analysis to non-authoritative circuit case law, and (3) it also misinterprets circuit precedent, which in fact supports the 2021 Rule approach.

1. DOL misinterprets Supreme Court precedent, which supports the 2021 Rule.

The Proposed Rule incorrectly suggests that Supreme Court precedent is "contrary to" the current regulations' core factor framework. 87 Fed. Reg. at 62,228. The existing framework, however, is fully consistent with the Court's precedents, as the 2021 Rule explained.

FSI agrees with the Department that the FLSA and Supreme Court precedent interpreting it govern worker classification under the statute. As the Proposed Rule recognizes, this analysis "begins with the Act's definitions" and draws further substance from the economic reality test "developed by the Supreme Court" to interpret those statutory provisions. 87 Fed. Reg. at 62,218, 62,234 (citing 29 U.S.C. § 203(d), (e)(1), (g); *United States v. Silk*, 331 U.S. 704 (1947)). DOL thus properly acknowledges that it is "legally constrained from adopting" tests that depart from the Supreme Court's controlling interpretation of the FLSA, such that "it could only implement" such departures "if the Supreme Court revisits its precedent or if Congress passes legislation that alters the applicable analysis under the FLSA." *Id.* at 62,231.

Yet DOL goes astray in suggesting that these authorities require that it abandon the 2021 Rule's core factor framework. Specifically, the Department now contends that the 2021 Rule improperly made worker classification turn on "isolated factors" rather than "the circumstances of the whole activity," and also "err[ed]" by "elevating the importance of control" as a core factor and thereby "bringing the test closer to the common law test" for worker classification, which Supreme Court precedent has rejected as the wrong standard to apply under the FLSA. 87 Fed. Reg. at 62,227–28, 62,236 (internal quotation marks omitted). The Department thus invokes Supreme Court case law as a purported justification to demote the control factor from "core" status to merely the fourth in a completely unweighted, free-for-all list of six non-exhaustive factors. *Id.* at 62,246.

In fact, the current regulations are fully consistent with Supreme Court precedent. The 2021 Rule explained that, "[i]n the very case that announced the economic reality factors, the Supreme Court listed five factors that are 'important for decision' but did not treat them equally," and "instead emphasized the most probative factors"—specifically, "'the control exercised [and] the opportunity for profit'"—"while deemphasizing less probative ones in that case." 86 Fed. Reg. at 1197–98 (alteration in original) (quoting *Silk*, 331 U.S. at 719). The focus on core factors thus adheres to the Court's application of the economic reality test.

The 2021 Rule also explained and discussed in detail the specific ways in which "[t]he Supreme Court has interpreted the 'suffer or permit' language to define FLSA employment to be broad and more inclusive than the common law standard," which focused more exclusively on control. 86 Fed. Reg. at 1169. And the 2021 Rule expressly considered and rejected the criticism that adopting control as a core factor "would effectively adopt the narrower scope of employment under the common law control test"—which is simply not true. *Id.* at 1200. As the 2021 Rule explained, "[t]he implied logic behind this concern is that if one test gives greater weight to a factor that is also given

greater weight by a second test, the two tests necessarily have an equal scope of employment. But that does not follow." *Id.* And the fact that control is not "'the sole criterion to be applied'" under the FLSA, *see* Proposed Rule, 87 Fed. Reg. at 62,222, does not mean that control is not a core consideration under the FLSA. Employment under the FLSA is broader than the common-law control test, but the Supreme Court's seminal decision in *Silk* still prominently identified "degrees of control" as the first factor in its list of factors relevant to the economic reality inquiry. 331 U.S. at 716. Control remains a significant touchstone under the FLSA test, and Supreme Court precedent does not dictate otherwise.

2. DOL inappropriately relies on lower-court case law.

DOL also errs by reflexively and uncritically invoking lower-court case law as a justification for its proposal without fulfilling the agency's independent obligation of reasoned decisionmaking. Unlike Supreme Court precedent, these cases are not binding on DOL's promulgation of a nationwide rule and cannot independently justify the Department's actions. *See* Proposed Rule, 87 Fed. Reg. at 62,219 (acknowledging that the test will be applied through "litigation in different Federal circuits"). Just last year, by contrast, the Department approached lower-court decisions with independent judgment, assessing their reasoning on the merits and affirmatively declining to follow them where "[t]he Department believe[d] that circuit courts . . . have deviated from the Supreme Court's guidance" as well as the governing statute. 2021 Rule, 86 Fed. Reg. at 1194. But in the new Proposed Rule, the Department ignores that these often-conflicting decisions are binding precedent only in their own respective jurisdictions—or in the case of unpublished circuit decisions and district court decisions, not binding precedent anywhere.

DOL repeatedly cites the views of "the circuit courts" as its guiding star in interpreting the economic reality test. *E.g.*, 87 Fed. Reg. at 62,218, 62,222, 62,226, 62,228, 62,229–30, 62,232–33, 62,235–37, 62,240, 62,242, 62,245, 62,249, 62,254–55, 62,257, 62,271. And it specifically justifies the abandonment of the core factor framework, in particular, as an effort to "align[]" its regulations with "circuit case law" and what "most courts" have done. *Id.* at 62,220, 62,228. At other times, the Proposed Rule reaches even further and cites "district court" cases to support its preferred approach. *E.g.*, *id.* at 62,247, 62,249. Elsewhere, the Department generally refers to case law in a context that makes clear it is focused solely on lower courts rather than Supreme Court precedent. *E.g.*, *id.* at 62,225 (referring generally to the views of "the courts" and "decades of case law").

Unfortunately, the Department often treats the analysis of lower-court case law as a head-counting exercise—supposing that it can cite a majority or plurality view of modern cases and then call it a day, without engaging in reasoned analysis of its own. But invoking the weight of decisions from particular jurisdictions does not discharge DOL's duty to act in a manner both "reasonable and reasonably explained," *FCC v. Prometheus Radio Project*, 141 S. Ct. 1150, 1158 (2021)—particularly in promulgating a rule that will apply throughout the country (not just in the cited circuits). Indeed, an agency acts arbitrarily when it does not "appreciate the full scope of [its] discretion" but instead wrongly considers itself "*bound*" by authorities that do not in fact control. *Dep't of Homeland Sec. v. Regents of the Univ. of Cal.*, 140 S. Ct. 1891, 1910–11 (2020).

DOL relies on this uncritical approach to lower-court case law in attempting to justify its abandonment of the core factor framework. It states, "[u]pon further review of judicial precedent," that the 2021 Rule's core factor approach is inconsistent with the "broader approach" that "most courts have taken in determining worker classification." 87 Fed. Reg. at 62,227–28. Strikingly, DOL does not meaningfully engage on the merits with the 2021 Rule's substantive explanation of *why*

the two core factors are more reliably probative of worker classification under the terms of the economic reality test. Instead, the Proposed Rule elides the substance by appealing to the authority of circuit precedents and faulting the 2021 Rule for "alter[ing]" the framing offered in those opinions. *Id.* at 62,228. But those opinions are not binding outside their jurisdictions, and the Department cannot mechanically defer to them instead of offering its own reasoned explanation for rejecting the core factor framework.

3. DOL fails to recognize that circuit precedent supports the core factor framework.

In any event, the Department also misreads the circuit precedent that it purports to rely on. Properly read, this case law actually supports the 2021 Rule's framework—as the Proposed Rule's own citations confirm.

The 2021 Rule explained that "the Department's review of the results of appellate decisions since 1975 applying the economic reality test" revealed a "remarkably consistent trend" identifying the control and opportunity for profit or loss factors as the most probative. 86 Fed. Reg. at 1196. In particular, "the Department did not uncover a single court decision where the combined weight of the control and opportunity factors was outweighed by the other economic reality factors"—whereas, "[i]n contrast, the classification supported by other economic reality factors was occasionally misaligned with the worker's ultimate classification, particularly when the control factor, the opportunity factor, or both, favored a different classification." *Id.* at 1197. Because "courts of appeals have effectively been affording the control and opportunity factors greater weight, even if they did not always explicitly acknowledge doing so," the 2021 Rule's explicit identification of them as "core" factors carrying greater weight had the benefit of "improv[ing] the certainty and predictability of the economic reality test" for regulated parties. *Id.* at 1196, 1198; *see supra* section I.A.

In flipping its position in the Proposed Rule, the Department offers only a superficial criticism of its own prior analysis. It notes that past court decisions have not themselves "explicitly" articulated the core factor framework "as a general and fixed rule." 87 Fed. Reg. at 62,227–28. But that ignores the role of this analysis in the 2021 Rule, which expressly focused on the *results* of past cases to reveal what courts are "effectively" doing, "even if they did not always explicitly acknowledge doing so." 86 Fed. Reg. at 1198. DOL is well aware of that sort of distinction, as indicated both by its 2021 Rule and by its reasoning elsewhere in the Proposed Rule. *E.g.*, 87 Fed. Reg. at 62,238 (looking past what circuits "articulate . . . expressly" to consider how they actually "apply" the factors in practice).

Rather than disputing the core factor analysis on the merits, DOL criticizes the 2021 Rule's survey of case law as "not complete." 87 Fed. Reg. at 62,227. But DOL fails to identify any overlooked cases that contradict the 2021 Rule's findings—either in the Proposed Rule or in the Withdrawal Rule on which it relies (and which a court vacated as arbitrary and capricious and in violation of the APA's procedural requirements). *See id.* (citing Independent Contractor Status Under the Fair Labor Standards Act (FLSA): Withdrawal, 86 Fed. Reg. 24,303, 24,309–10 (May 6, 2021)); *see also Coal. for Workforce Innovation*, 2022 WL 1073346 (vacating the Withdrawal Rule).

Indeed, a survey of DOL's *own* cited authorities proves the accuracy of the core factor framework. As detailed in the attached table, *see infra* Ex. A, the preamble to the Proposed Rule cites 49 circuit cases since 1975 that have applied the economic reality test to distinguish employees from independent contractors. In the overwhelming majority of those cases (44/49, or 90%) the

2021 Rule's two core factors both pointed in the same direction as the classification ultimately reached by the circuit court. In a handful (5/49, or 10%), one of the two core factors either was uncertain or pointed in the opposite direction. But in *no case* did they both point the other way—bearing out the reasoning of the 2021 Rule on this point. *See* 86 Fed. Reg. at 1197. So, contrary to DOL's representations, 87 Fed. Reg. at 62,220, a close look at circuit case law reveals that it is, in fact, entirely consistent with the 2021 Rule's more structured framework.

C. DOL wrongly abandons "actual practice."

DOL erroneously departs from the 2021 Rule by suggesting that theoretical possibilities can outweigh the "actual practice"—that is, *the economic reality* of the relationship at issue—when determining the proper classification. This, too, contravenes Supreme Court precedent and DOL's stated goals of promoting regulatory certainty and predictability.

Under the 2021 Rule, DOL's regulations clarify that, "[i]n evaluating the individual's economic dependence on the potential employer, the actual practice of the parties involved is more relevant than what may be contractually or theoretically possible." 29 C.F.R. § 795.110. But the Proposed Rule summarily deletes this entire section of the governing regulations for being "overly mechanical" and "prescriptive" in its guidance. 87 Fed. Reg. at 62,257–58.

DOL's abandonment of actual practice as the touchstone of FLSA worker classification analysis is contrary to Supreme Court precedent. As the 2021 Rule explained, the focus on actual practice is not a matter subject to DOL's discretion, but a longstanding "principle . . . derived from the Supreme Court's holding that '"economic reality" rather than "technical concepts" is to be the test of employment' under the FLSA." 86 Fed. Reg. at 1203 (quoting *Goldberg v. Whitaker House Co-op., Inc.*, 366 U.S. 28, 33 (1961)). Thus, "[a]ffording equal relevance to reserved control and control that is actually exercised"—as the Proposed Rule now suggests—"would ignore the Supreme Court's command to focus on the 'reality' of the work arrangement, which places a greater importance on what actually happens than what a contract suggests *may* happen." *Id.* at 1204 (citation omitted) (quoting *Silk*, 331 U.S. at 713). In support of this conclusion, the 2021 Rule analyzed the key Supreme Court precedents at length, including *Silk* and *Bartels v. Birmingham*, 332 U.S. 126 (1947), and added that "[s]everal Federal courts of appeals decisions have explicitly made this observation." *Id.* (collecting cases). It also cited other DOL regulations indicating that "prioritizing substance over form is consistent with the Department's general interpretation and enforcement of the FLSA" going back through decades of prior regulations. *Id.* at 1204 & n.58.

The Proposed Rule does not engage with the Department's own prior explanation or with this governing authority, despite recognizing elsewhere that these same Supreme Court precedents "legally constrain[]" DOL's application of the economic reality test. 87 Fed. Reg. at 62,231, 62,270–71; *see supra* p. 8. Indeed, the preamble section explaining DOL's abandonment of "actual practice" does not even cite the controlling precedents of *Silk* and *Bartels*—much less rebut the 2021 Rule's analysis concluding that these precedents require a focus on actual practice. *See* 87 Fed. Reg. at 62,257–58. In a single footnote, DOL does acknowledge "the longstanding case law" in the circuits "that looks to the actual behavior of the parties," as the 2021 Rule highlighted. *Id.* at 62,258 n.500. But DOL's only comment on this body of law is a conclusory assertion that it "does not intend to minimize or disregard" it, *id.*—even though the substance of the Proposed Rule would do exactly that. This dismissive footnote is, of course, in striking contrast to other areas in which DOL takes the mere existence of a body of circuit precedent as a sufficient reason for deference to those cases. *See supra* section I.B.2; *infra* section II.A.1. Nor does DOL address the disjuncture between its new approach and the other longstanding regulations discussed in the 2021 Rule.

Because DOL does not engage the relevant authorities, the precise rationale for its about-face is difficult to discern. But it appears to rest on a purported distinction between "economic realities"—which DOL concedes "[t]he focus is always on"—versus "actual practice." 87 Fed. Reg. at 62,258. Even if there is some extraordinarily subtle, lawyerly distinction between "real" and "actual," which is doubtful, embracing it in a regulatory interpretation is the opposite of the kind of clear, helpful guidance that DOL should be providing to working Americans seeking to comply with the law. Even if the governing legal authorities permitted this move, it would directly disserve DOL's stated goals of avoiding "confusion and uncertainty on the topic of independent contractor status, to the detriment of workers and businesses alike." *Id.* at 62,229; *see supra* section I.A.

II. The Department Erroneously Analyzes the Multifactor Economic Reality Test.

Not only does DOL fail to justify its rescission of the current regulations' core factor framework, *supra* part I, but the new totality-of-the-circumstances test that it proposes to substitute is also independently unlawful. "[I]f [an agency] action is based upon a determination of law . . . [the action] may not stand if the agency has misconceived the law." *Sec. & Exch. Comm'n v. Chenery Corp.*, 318 U.S. 80, 94 (1943). Here, DOL's substitute test lacks support in any precedent, distorts the inquiry by overemphasizing entrepreneurial drive, and improperly relies on putative statutory purpose to slant its analysis in favor of employee classification. And its analysis of each specific factor also contravenes Supreme Court precedent and rests on faulty reasoning.

A. DOL's articulation of its multifactor test misconstrues the law and fails to reflect reasoned decisionmaking.

1. DOL fails to assess circuit cases' reasoning and cherry-picks non-representative decisions' articulation of the governing factors.

In promulgating the Proposed Rule, DOL repeatedly stresses its intention to adopt regulations "fully aligned with the text of the FLSA as interpreted by the courts" under "existing precedent" applying the economic reality test to distinguish independent contractors from employees. 87 Fed. Reg. at 62,230; *see also*, e.g., *id.* at 62,220 (similar); *id.* at 62,233 (stating preference for analysis that "accurately represents th[e] case law"). In truth, DOL's treatment of the case law is flawed in multiple respects.

As an initial matter, DOL's approach is flawed insofar as it relies on uncritical appeals to authority in lists of circuit cases (or even non-precedential district court decisions) without assessing their reasoning. *E.g.*, 87 Fed. Reg. at 62,240 (launching DOL's framing of the investment factor by invoking "the approach of most courts" and "many circuit courts of appeals"); *id.* at 62,249 (citing the analysis of "multiple district courts" regarding scheduling flexibility); *see supra* section I.B.2 (discussing similar flaws in DOL's treatment of the "core factor" framework). For example, DOL acknowledges a split of circuit authority on whether the exclusive nature of a work relationship is properly considered "under the control factor rather than the permanence factor." *Id.* at 62,245. Instead of offering analytical reasons favoring one side over another, the Proposed Rule simply states that "the weight of circuit authority appears to consider exclusivity and ability to work for others primarily under permanence," and then concludes in summary fashion that, "[*a*]*s such*, the Department believes it is appropriate to include exclusivity under this factor." *Id.* (emphasis added). It is legally insufficient to cite nonbinding decisions as a justification for agency action not supported by independent reasoning. And that approach is particularly problematic when DOL relies heavily on very recent circuit cases, many of which have inappropriately "depart[ed] from the Supreme

Court's original articulation of the economic reality test" in cases closer in time to the 1938 FLSA. 2021 Rule, 86 Fed. Reg. at 1193; *see, e.g.*, *infra* section II.B.2.

Moreover, the Proposed Rule, while purporting to return to a supposedly conventional six-part inquiry, actually constructs a novel test that has never been articulated by any court—let alone the Supreme Court in its precedents authoritatively construing the FLSA. By stitching together disparate pieces of different (and often outlier) circuit cases, DOL distorts the economic-reality inquiry to create a new multifactor test that is uniquely unfavorable to identifying workers as independent contractors.

To begin with, DOL identifies no court decision—over more than eighty years of precedent from jurisdictions across the country—that has ever endorsed its peculiar articulation of the multifactor test to distinguish independent contractors from employees under the FLSA. Certainly, it does not appear in *Silk* or other Supreme Court cases. And despite claiming "significant and widespread uniformity among the circuit courts in the application of the economic reality test," 87 Fed. Reg. at 62,218–19, DOL strikes out on its own. The Proposed Rule ventures well beyond what DOL identifies as a "slight variation" among different circuits' articulations of the Supreme Court's test thus far. *Id.* at 62,219.

DOL first goes astray by hand-picking non-representative circuit case law as its starting point. It embraces *Scantland v. Jeffry Knight, Inc.*, 721 F.3d 1308 (11th Cir. 2013), as its primary "example" and model articulation of the economic reality factors "first articulated in *Silk*," 87 Fed. Reg. at 62,222 & n.53; *see also id.* at 62,236, 62,241, 62,246, 62,247, 62,249, 62,251 (returning to *Scantland* time and again as DOL's first citation of choice on numerous points). But just last year, DOL repeatedly criticized this recent Eleventh Circuit decision for adopting outlier, "minority" positions that departed from and "expanded" the factors "originally" articulated "under *Silk*." 86 Fed. Reg. at 1170, 1174, 1183; *see also* Proposed Rule, 87 Fed. Reg. at 62,222 (acknowledging disagreements with *Scantland*'s formulation by the Second, Fifth, and D.C. Circuits, among others); *infra* p. 19 (elaborating on *Scantland*'s misarticulation of the control factor). Similarly, the Proposed Rule repeatedly relies on the Third Circuit's recent framing of the analysis in *Razak v. Uber Techs., Inc.*, 951 F.3d 137, *amended*, 979 F.3d 192 (2020). *See* 87 Fed. Reg. at 62,237, 62,243, 62,249, 62,251, 62,255. But at no point does DOL acknowledge the 2021 Rule's criticism of this decision for departing from the governing Supreme Court precedents regarding the focus on "actual practice" and the articulation of the "integrated unit of production" factor. 86 Fed. Reg. at 1194–95, 1198 n.48, 1203–04; *see also infra* section II.B.2 (discussing this and other problems with the Proposed Rule's deletion and replacement of the "integrated" factor). DOL does not adequately explain its choice to embrace these particular decisions, which are both outliers among recent precedent and also exhibit what DOL itself previously characterized as the modern trend of "depart[ing] from the Supreme Court's original articulation of the economic reality test." 2021 Rule, 86 Fed. Reg. at 1193.

Even after embracing such outliers as its starting point, DOL moves the goalposts still further. For example, instead of quoting the Eleventh Circuit's recitation of the governing factors in *Scantland*, DOL paraphrases the opinion in a manner that materially alters its meaning. 87 Fed. Reg. at 62,222. *First*, DOL inserts new language into the articulation of the key factor analyzing "control" over the work done. Where *Scantland* considered "the nature and degree of the alleged employer's control as to the manner in which the work is to be performed," 721 F.3d at 1312, the Proposed Rule substitutes "the degree of the alleged employer's *right to* control the manner in which the work is to be performed." 87 Fed. Reg. at 62,222 (emphasis added). That reworking of the

analysis misrepresents the position of Eleventh Circuit precedent, which holds that "[i]t is not significant how one 'could have' acted under the contract terms" or rights in conducting this inquiry. *Scantland*, 721 F.3d at 1311 (citation omitted); *see also Usery v. Pilgrim Equip. Co.*, 527 F.2d 1308, 1312 (5th Cir. 1976) (focusing on "the way one actually acts" to evaluate control in a working relationship rather than, e.g., "the right to set hours"). As DOL said in 2021, this focus on actual practice is one respect in which *Scantland* properly follows governing Supreme Court precedent—yet DOL now ignores its statement from last year. *See* 86 Fed. Reg. at 1204; *supra* section I.C. *Second*, DOL also rearranges the cited precedent's ordering of the factors in an apparent attempt to downplay its disfavored factors. Consistent with the Supreme Court's original ordering of the factors in *Silk*, 331 U.S. at 716, circuit cases including *Scantland* list the control factor first in keeping with its significance, 721 F.3d at 1311–12; *see also* FSI Comments on Proposed Withdrawal of 2021 Rule at 4 (Apr. 12, 2021) (previously highlighting this point). But the Proposed Rule places this factor *fourth* out of six. 87 Fed. Reg. at 62,275. This departure from precedent is of a piece with the Proposed Rule's broader, unjustified abandonment of the 2021 Rule's focus on control and opportunity for profit or loss as the "core" factors. *See supra* part I.

2. DOL distorts the relevance of entrepreneurial drive.

DOL pushes its test further off track by misapprehending the goal of the worker-classification inquiry. Of course, "[n]o test—yea, not even a five-part test—can possibly be successful unless one knows what he is testing *for*." *Vieth v. Jubelirer*, 541 U.S. 267, 297 (2004) (plurality opinion). And the Proposed Rule displays fundamental confusion about what it is testing for—*i.e.*, what truly distinguishes independent contractors from employees.

In particular, DOL's interpretation of various factors distorts the relevance of entrepreneurial drive, contrary to the original meaning of the economic reality test. In several parts of its six-factor-plus test, the Proposed Rule indicates that the lack of entrepreneurialism and business acumen suggests a worker should be classified as employee. These considerations have not historically been so important to the test and are not well tailored to the task at hand. By injecting these considerations into multiple separate "factors," DOL's test effectively gives them an outsized role and instructs that the same facts should weigh multiple times in favor of employee classification. Thus, the Proposed Rule counts a worker's "capital or entrepreneurial investment" in a business as a "separate, standalone factor in the analysis," distinct from the "opportunity for profit or loss" factor. 87 Fed. Reg. at 62,238, 62,240. Similarly, the Proposed Rule imports the consideration of "initiative" or "managerial" skill into its discussion of the separate "control," "skill," and "permanence" factors. *Id.* at 62,243, 62,247, 62,252, 62,257. In other words, DOL pushes the overall inquiry toward employee classification by making a lack of entrepreneurial drive or skill count multiple times, across different factors, against independent contractor status.

This approach is not only contrary to the proper interpretation of the individual factors, *see infra* section II.B, but also improperly skews the inquiry as a whole. DOL's excessive focus on the *absence* of entrepreneurial drive inappropriately narrows the category of independent contractors to include *only* particularly *driven* or successful independent contractors. As the 2021 Rule explained on a related point, "profits are hardly guaranteed for anyone in business for him/herself," and "a lack of profit viewed in hindsight says little about a worker's economic independence." 86 Fed. Reg. at 1188. To be clear, a high level of entrepreneurial drive and skill is characteristic of financial advisors and further confirms that they are properly classified as independent contractors. These qualities are properly considered as supporting independent contractor status, but it does not follow that their *absence* indicates *employee* status.

To the contrary, the Proposed Rule's flawed approach would improperly suggest employee classification for many classic examples of independent contractors, such as plumbers, gardeners, or handymen. Many of these contractors surely exhibit entrepreneurial zeal. But plenty of them may be working a job without exhibiting the managerial skills or drive to expand their businesses that are typical of entrepreneurs. Indeed, many workers choose to be independent contractors precisely because they want a lifestyle that allows them to make a good living while maintaining a desired work-life balance—including in the financial-services industry, among other examples. *See* supra p. 5 (discussing superior work satisfaction survey results for independent financial advisors). Indeed, financial advisors cite scheduling flexibility, independence, and higher wages as the top three reasons they choose to work as independent contractors. NERA Economic Consulting, The Role of Independent Contractors in the Finance and Insurance Sectors, *infra* Ex. B, at 17 (Table 6). That does not somehow transform these workers into employees for purposes of FLSA worker classification, which is ultimately meant to measure economic dependence—not entrepreneurial drive as such. The Proposed Rule's elevation of these non-probative considerations adds up to a poorly drawn and unbalanced "test."[9]

3. DOL elevates putative purpose over statutory text and precedent.

One additional way in which DOL wrongly puts a thumb on the scale in favor of expanded employee classification is by placing unsustainable weight on Congress's putative "remedial purpose" in enacting the FLSA definitions at issue. 87 Fed. Reg. at 62,234 n.206; *see also id.* at 62,234 & n.202 (same). Indeed, DOL hardly ever invokes the "FLSA's text" without immediately appending "and purpose"—as if to suggest that the two are somehow entitled to equal authority. *See id.* at 62,218, 62,219, 62,225, 62,232, 62,233, 62,259, 62,271, 62,272. And in explaining the Proposed Rule, DOL repeatedly falls back on Congress's "purpose," "intent," and legislative history to justify its expansive conception of the employee category at independent contractors' expense. *Id.* at 62,234, 62,249 & n.393, 62,252, 62,267, 62,273.

This emphasis on the FLSA's perceived "remedial purpose" is contrary to recent Supreme Court precedent interpreting this very statute. In particular, the Court specifically "reject[ed]" such an atextual approach as a "guidepost for interpreting the FLSA" in *Encino Motorcars, LLC v. Navarro* (*Encino II*), 138 S. Ct. 1134, 1142 (2018). Dismissing "the flawed premise that the FLSA pursues its remedial purpose at all costs," the Court instructed that the statute's provisions must be given "a fair reading," not one slanted in favor of expanded coverage. *Id.* (internal quotation marks omitted) (quoting *Am. Exp. Co. v. Italian Colors Rest.*, 570 U.S. 228, 234 (2013)). That is because the enacted limitations on the Act's reach, such as the salesman exemption at issue in *Encino II*, "are as much a part of the FLSA's purpose as the overtime-pay requirement" or the other operative provisions. *Id.* And the Court reaffirmed that legislative history, like remedial purpose, "cannot defeat the better reading of the text and statutory context." *Id.* at 1143.

The Proposed Rule does not comport with or meaningfully address the *Encino II* principle. It buries its brief discussion of this recent and controlling precedent in a single conclusory footnote. 87 Fed. Reg. at 62,234 n.206. That is in stark contrast to the 2021 Rule, which engaged this precedent

[9] Of course, entrepreneurial drive is a distinct concept from the "entrepreneurial control" discussed in, *e.g.*, Restatement of Emp't Law § 1.01, cmt. d (Am. Law Inst. 2015). The latter refers to authority relevant to building a business, which favors independent contractor status, and situations in which a principal's control over the work performed deprives the worker of the *opportunity* to engage in similar business-building behavior. *Id.* The "control" factor already accounts for the prospect that this type of control might indicate employee status. But that does not itself have anything to do with zeal or initiative on the part of the worker.

repeatedly and at length in the body of the preamble. 86 Fed. Reg. at 1200, 1207–08, 1243. As the 2021 Rule explained, the "logic" of *Encino II* requires DOL to "reject" the flawed principle "that the Act's remedial purpose requires its coverage to be construed broadly." *Id.* at 1207. Remedial purpose gives no license for DOL to expand the employee classification at the expense of independent contractors, because "respecting the independence of workers whom the FLSA does not cover is as much a part of the Act's purpose as extending the Act's coverage to workers who need its protection." *Id.* at 1208.

The Proposed Rule's footnoted explanation for its about-face from this conclusion is deeply flawed on the merits. Confusingly, DOL first suggests in this footnote that FLSA worker classification should be "premised on the statutory text itself, not on any principle of how to interpret remedial legislation," 87 Fed. Reg. at 62,234 n.206—which of course invites the question why the preamble repeatedly invokes the legislation's supposed remedial purpose to justify its approach to the economic reality test. Next, DOL switches course and briefly suggests that *Encino II*'s textualist reasoning actually does *not* apply here because the decision should be cabined to the precise legal context it addressed—an exemption from the class of employees covered by the Act, rather than (as here) an inherent limit on the definitions of "employ" and its variations in § 203 of the Act. *Id.* The Proposed Rule thus posits that "[t]his decision did not apply to the Act's definitions," apparently giving DOL free rein to apply "remedial purpose[s]" to expand the class of employees covered under the FLSA. *Id.*

DOL's hairsplitting distinction between exemptions and definitions is illogical and foreclosed by Supreme Court precedent—as well as inconsistent with its own prior position in the 2021 Rule. *See* 86 Fed. Reg. at 1207. The point of *Encino II* was that *all* parts of this statute must be given "a fair reading," because the exemptions are equally—"as much"—"a part of the FLSA's purpose" as any other provision. 138 S. Ct. at 1142. Thus, DOL gets things exactly backward in suggesting that the Court's express rejection of the Department's interpretive approach in the exemption context somehow authorized that approach in other areas.

Thus, DOL's footnote stakes out an approach that has been rejected by recent Supreme Court precedent interpreting the FLSA, and by application of basic principles of statutory interpretation for even longer. Many years before the specific precedents discussed above, well-reasoned authorities rejected "[t]he false notion that remedial statutes should be liberally construed." A. Scalia & B. Garner, *Reading Law* 364 (2012) (citing 1 Joseph Story, *Commentaries on the Constitution of the United States* § 429, at 304 (2d ed. 1858)). So DOL cannot plausibly paint *Encino II* as an outlier or a limited deviation from the normal rules governing interpretation of the FLSA and other statutes.

DOL also appears to seek support from older precedents that did invoke broad notions of legislative intent in interpreting the FLSA. *See* 87 Fed. Reg. at 62,234 (citing *United States v. Rosenwasser*, 323 U.S. 360, 361–62 (1945)). DOL states in conclusory fashion that such cases "have not been called into question by" *Encino II*. *Id.* at 62,234 n.206. But in fact, to the extent that portions of these older opinions are inconsistent with *Encino II*, they have been abrogated. As the *Encino II* dissent highlighted without objection from the majority, that decision "unsettle[d] more than half a century of [the Court's] precedent" applying the remedial canon to the FLSA. 138 S. Ct. at 1148 n.7 (opinion of Ginsburg, J.). Lower courts have thus recognized *Encino II*'s abrogation of cases that give a broad remedial interpretation such as the cases that DOL seeks to rely on. *E.g.*, *McKay v. Miami-Dade Cnty.*, 36 F.4th 1128, 1133 (11th Cir. 2022) (noting that "the Court has recently rejected th[e] view" that it "had previously held" in a 1945 case on this point); *Patterson v. Dallas/Fort Worth Int'l Airport Bd.*, 490 F. Supp. 3d 1034, 1039 (N.D. Tex. 2020) (similar). DOL

fails to acknowledge or explain its disagreement with Justice Ginsburg (writing on behalf of four Justices) and these well-reasoned subsequent decisions.

The same abrogation applies *a fortiori* to the older lower-court precedents that DOL repeatedly invokes as supposedly supporting its interpretive approach. *E.g.*, 87 Fed. Reg. at 62,234 n.202 (quoting *Pilgrim Equip*, 527 F.2d at 1311, on "the remedial purposes of the legislation"). As other courts have properly recognized, the law no longer supports such reasoning from circuit cases "decided against the pre-*Encino* landscape." *Flood v. Just Energy Mktg. Corp.*, 904 F.3d 219, 232 n.7 (2d Cir. 2018); *see also*, e.g., *McKnight v. Helix Energy Sols. Grp., Inc.*, No. 21-20109, 2022 WL 2981420, at *1 (5th Cir. July 27, 2022) (Elrod, J., specially concurring) (criticizing analysis relying on "the pre-*Encino Motorcars ancien regime*"). Such precedent furnishes no support for the purpose-focused lens through which DOL approaches the "overarching framework" of its rulemaking, pervading the entire Proposed Rule. 87 Fed. Reg. at 62,234.

B. DOL incorrectly analyzes the specific factors that govern worker classification.

In addition to the overarching flaws in its approach, DOL misapplies the specific factors in the worker classification analysis.

1. DOL transforms the factor assessing "control" over the work being done.

The Proposed Rule makes major changes to the traditional treatment of the factor assessing "control" over the work being done—changes that DOL euphemistically describes as "[s]ignificant additional guidance . . . for the proposed control factor." 87 Fed. Reg. at 62,235–36. Through these changes, DOL both underplays the importance of control to worker classification analysis and also inappropriately expands the concept of control to increase the number of workers classified as employees.

As an initial matter, the proposed rule downplays the importance of the "control" factor by demoting it from "core" status to merely the fourth in an unweighted list of six factors. As discussed above, that alteration is not required by Supreme Court precedent, is not consistent with the (non-binding) circuit case law that the Proposed Rule relies on, and is inconsistent with the Proposed Rule's stated rationale. *See supra* part I.

The Proposed Rule also expands the definition of "control" in ways that are not supported by logic or precedent and that further slant the analysis in favor of employee classification. In particular, DOL inappropriately expands the *object* of the "control" at issue—*i.e.*, the question of *what* an employer must control in order to establish an employment relationship. The current regulations point to control over "key aspects of the performance of the work," 29 C.F.R. § 795.115(b)(1)(i), consistent with the Supreme Court's assessment in *Silk* of control over "the manner of performing service to the industry" and over "how 'work shall be done.'" 331 U.S. at 713, 714. But the Proposed Rule improperly expands this inquiry to assess control over "the performance of the work *and the economic aspects of the working relationship*." 87 Fed. Reg. at 62,275 (proposed 29 C.F.R. 795.110(b)(4) (emphasis added)). The Proposed Rule does not identify the provenance of the ambiguous new phrase "economic aspects of the working relationship," which does not appear in *Silk* or any other Supreme Court case applying the economic-reality test. DOL does not have authority to expand the object of "control" for these purposes beyond the contours of the statute. And the sudden addition at this late date of this nebulous additional object of control, which DOL does not explain, can only exacerbate confusion and uncertainty. To the extent this new phrase would sweep in any new and broader forms of "control" than have previously been considered, it

is illegitimate; and to the extent it does not add anything, it is needlessly confusing and should be deleted.

DOL overlooks that there are many circumstances where a party will "control" one or more contract terms without being an employer. Retailers, service providers, common carriers and others who sell into a large public market will often set a price at which they hope consumers will purchase their product or services, just as they typically pre-determine what that product will be (*e.g.*, in the case of the financial-services industry, what investment products a firm will make available for independent brokers to sell). Likewise, consumers of services often "control" the work that will be done for them—simply, they prescribe the service they wish to buy—but that is different than prescribing in minute detail *how* the work must be performed. For this and other reasons, the Department's departure from the type of "control" of work addressed by the Supreme Court is a serious flaw in the proposed rule.

Additionally, DOL improperly reverses the 2021 Rule's clarification that requiring compliance with safety and other regulations is not the kind of "control" that indicates an employer-employee relationship. *See* 2021 Rule, 86 Fed. Reg. at 1182–85. DOL now dictates in the Proposed Rule that a business's requirement of workers' "compliance with legal, safety, or other obligations" in fact "may be evidence" that those workers are employees. 87 Fed. Reg. at 62,247; *see id.* at 62,275 (proposed 29 C.F.R. § 795.110(b)(4)).

The current regulations correctly explain that "[r]equiring the individual to comply with specific legal obligations, satisfy health and safety standards, carry insurance, meet contractually agreed-upon deadlines or quality control standards, or satisfy other similar terms that are typical of contractual relationships between businesses (as opposed to employment relationships) does not constitute control that makes the individual more or less likely to be an employee under the Act." 29 C.F.R. § 795.105(d)(i). That is because "these types of requirements are generally imposed by employers on both employees and independent contractors," so that "insisting on adherence to certain rules to which the worker is already legally bound would not make the worker more or less likely to be an employee." 2021 Rule, 86 Fed. Reg. at 1182–83. Indeed, legally compelled requirements display *control by the regulator*, not control by the putative employer (which is just as much a regulated party as the worker). *See*, *e.g.*, *Loc. 777, Democratic Union Org. Comm. v. NLRB*, 603 F.2d 862, 875 (D.C. Cir. 1978) ("Government regulations constitute supervision not by the employer but by the state."); *Taylor v. Waddell & Reed Inc.*, No. 09-cv-2909, 2013 WL 435907, at *6 & n.27 (S.D. Cal. Feb. 1, 2013) (finding in the financial-services context that, "[i]mportantly, allegations of 'control' pursuant to legal requirements are not employment indicia," because "terms of a putative 'employment' relationship imposed by legal requirements do not suggest control by [an employer]").

For similar reasons, Congress has provided for a quarter-century in the context of the Internal Revenue Code that "in determining the status of a registered representative of a broker-dealer for Federal tax purposes, *no weight* may be given to instructions from the service recipient which are imposed only in compliance with government investor protection standards or investor protection standards imposed by a governing body pursuant to a delegation by a Federal or State agency." Taxpayers Relief Act of 1997, Pub. L. No. 105-34, § 921(a), 111 Stat. 788, 879 (codified at 26 U.S.C. § 3121 note).

In addition, contractual requirements to comply with such safety, quality, and risk-mitigation standards are not probative of employee classification even when they are not compelled directly by government regulations. Such requirements are also commonplace in contractual relationships

between independent businesses and so do not denote an employment relationship. For example, numerous companies impose such requirements on independent counterparties for business reasons, including builders dealing with contractors, manufacturers dealing with parts suppliers, and retailers dealing with producers—just to name a few examples. That is true in particular for heavily regulated industries such as financial services, where businesses often require their contracting partners to observe certain standards as a matter of best practices. *See infra* section IV.A (discussing contracting practices of independent financial services firms). The 2021 Rule thus correctly did not limit its discussion of compliance to "requirements to 'comply with specific legal obligations,'" but also recognized that other compliance standards are simply not probative of the kind of control that indicates employee classification. 86 Fed. Reg. at 1182.

Yet the Proposed Rule now reverses DOL's prior position on compliance requirements. It purports to base this reversal on "a thorough review of relevant case law." 87 Fed. Reg. at 62,247. But the case law it cites on this point is remarkably thin. It relies primarily on the Eleventh Circuit's statement in *Scantland* that "[i]f the nature of a business requires a company to exert control over workers . . . then that company must hire employees, not independent contractors," regardless of "*why* the alleged employer exercised such control." *Id.* (quoting *Scantland*, 721 F.3d at 1316). Yet as the 2021 Rule explained, *Scantland*'s reasoning here is faulty. It is in fact "necessary to consider 'why' the potential employer imposed a requirement" because "[i]f the reason for a requirement applies equally to individuals who are in business for themselves and those who are employees, imposing the requirement is not probative" of independent contractor status. 86 Fed. Reg. at 1183; *see also supra* p. 13 (highlighting the 2021 Rule's identification of other flaws in *Scantland*'s reasoning). The Proposed Rule fails to engage on the merits with this refutation of *Scantland*, and it also fails to acknowledge that this decision represents "the minority [view] among courts of appeals." 2021 Rule, 86 Fed. Reg. at 1183; *cf.* Proposed Rule, 87 Fed. Reg. at 62,247 (acknowledging only generally that "the case law is not uniform on this issue").

Besides the flawed outlier of the Eleventh Circuit in *Scantland*, the Proposed Rule identifies only three circuits that it claims support its position on compliance. These citations are buried in the footnotes to the preamble, and DOL's use of all three is flawed. *First*, DOL quotes a single, cryptic sentence from a Tenth Circuit precedent dating back more than fifty years. *See* 87 Fed. Reg. at 62,247 n.360. In *Shultz v. Mistletoe Exp. Serv., Inc.*, 434 F.2d 1267 (10th Cir. 1970), the court held that freight terminal workers qualified as employees primarily because their employer controlled their work in conventional ways—it "owns and supplies the physical properties except for local trucks, directs the operational details, instructs on the solicitation of business, pays a weekly allowance plus a commission, and may terminate the operator's contract on ten days notice"—and because the workers' operations were an "integrated part of the [employer's] transportation business." *Id.* at 1271. The court also stated, in one conclusory sentence now cited by DOL, that "[t]he arguments that an independent contractor relationship is shown by the furnishing of local trucks, the hiring and firing of local workers, and the need to comply with regulations of federal and state agencies do not persuade us." *Id.* But because the *Shultz* court did not explain its reasoning, it offers no persuasive authority to support the Proposed Rule now. Moreover, the case remains an outlier that no other circuit precedent has cited on this point in the five decades since.

Second, DOL suggests that the Fifth Circuit in *Hopkins v. Cornerstone America*, 545 F.3d 338 (5th Cir. 2008), reached a "similar" position on compliance. 87 Fed. Reg. at 62,247 n.361. But that case does not stand for the proposition that DOL suggests. In *Hopkins*, the Fifth Circuit found that the employer: "controlled the 'meaningful' economic aspects of the business" of the workers in question, including controlling "the hiring, firing, assignment, and promotion of the [workers']

subordinate agents"; "exclusively determined the type and price of insurance products that the [workers] could sell"; controlled "the number of sales leads the [workers] would receive"; and "determined the geographic territories where the [workers] and their subordinates could operate." *545* F.3d at 343–44. The court thus rejected, on factual grounds, the employer's contention that it "exerted little control beyond what insurance-industry regulations required." *Id.* at 343. But contrary to DOL's reasoning, the court did *not* conclude that requiring compliance with regulations constitutes control indicating employee status. To the contrary, the *Hopkins* court *omitted* such requirements from its list of the relevant indicia of control, suggesting that it agreed such factors are not legally relevant—consistent with other Fifth Circuit precedent that it cited on the control factor. *See id.* at 343 (citing *Brock v. Mr. W Fireworks, Inc.*, 814 F.2d 1042 (5th Cir. 1987)); *see also* 2021 Rule, 86 Fed. Reg. at 1183 (discussing *Mr. W Fireworks*' treatment of compliance requirements).

Third, DOL inserts a reference at the end of a string cite, 87 Fed. Reg. at 62,247 n.365, to the Ninth Circuit's decision in *Ruiz v. Affinity Logistics Corp.*, 754 F.3d 1093 (9th Cir. 2014). But that case concerned worker classification under California state law, not the FLSA. *Ruiz* therefore furnishes no support for DOL's position here.

Lacking support in circuit precedent for its compliance position, DOL then turns to a handful of district court cases. 87 Fed. Reg. at 62,247. These opinions are not binding precedent in any jurisdiction, and DOL's reliance on them here makes conspicuous the absence of any higher authority for its view. Moreover, DOL does not offer any substantive explanation (and there is none) of how these district cases support its reasoning and rebut the 2021 Rule's persuasive rejection of its position on compliance. For example, the district court in *Badon v. Berry's Reliable Res., LLC*, No. 19-cv-12317, 2022 WL 2111341 (E.D. La. June 10, 2022), simply passed over without explanation the employer's contention that state compliance requirements do not constitute employer control. *Id.* at *3–4. The court did ultimately find that the overall control factor weighed in favor of employee status, but it did not explain whether or how regulatory compliance requirements played into that conclusion. Such unreasoned passages from trial court opinions do nothing to buttress DOL's position.

DOL's position on compliance thus lacks support in either logic or precedent. It plainly fails to meet the bar that DOL itself relies on to justify much of the Proposed Rule—*i.e.*, majority support in recent circuit precedent. The most that DOL can say of its idiosyncratic view here is that it cannot identify a case explicitly *ruling out* the idea that regulatory compliance could be probative of employer control in a hypothetical case. 87 Fed. Reg. at 62,247–48. But that reliance on the absence of a negative is inconsistent with the standards that DOL applies to other factors. Because more than eighty years of FLSA precedent have failed to yield a single positive example of a well-reasoned opinion identifying a case in which such compliance actually suggests control by an employer, the 2021 Rule was right to rule out that possibility.

At the very least, DOL should withdraw its aggressive new position on regulatory compliance in the context of the control factor. In addition to its lack of legal foundation, it is also bad policy that will create a perverse incentive deterring businesses from insisting on compliance with safety regulations and other standards by the independent contractors with whom they do business, as discussed below. *See infra* p. 29. If the Department makes no other changes in the final rule, it should return to the commonsense and majority view of the 2021 Rule that an employer's requiring compliance with legal and similar obligations is not the kind of control that is probative of employee status.

2. DOL deletes and replaces the "integrated unit of production" factor.

The Proposed Rule unlawfully replaces wholesale one of the original factors identified by Supreme Court precedent interpreting the FLSA. The current regulations consider, as a non-core factor, "[w]hether the work is part of an integrated unit of production." 29 C.F.R. § 795.110(d)(2)(iii). As the 2021 Rule explained, 86 Fed. Reg. at 1193, that formulation follows the Supreme Court's original articulation of this factor as part of the economic reality test in *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947). This factor can be probative of worker classification because it asks whether workers "work alongside admitted employees" and so are harder to distinguish from them. *Id.* at 726 (internal quotation marks omitted).

The Proposed Rule entirely deletes this factor and substitutes another in its place. Jettisoning the "integrated unit of production" inquiry entirely, DOL now proposes to ask instead whether the work performed is an "integral part" of the employer's business. 87 Fed. Reg. at 62,275 (proposed 29 C.F.R. § 795.110(b)(5)); *see id.* at 62,253. Properly understood, this formulation could be synonymous with the "integrated unit of production" factor. For example, that is how the Supreme Court used the phrase "integral part" in passing, 331 U.S. at 716, picking up on the statement in a party's brief that the workers in question "were an integral part of respondent's business" in that they "were subject to the day-to-day orders of respondent's dispatcher to whom their every movement had to be reported," Brief for the Petitioner, *Harrison v. Greyvan Lines, Inc.*, 1947 WL 44401, at *33 (U.S. filed Feb. 20, 1947); *see* 2021 Rule, 86 Fed. Reg. at 1194 (explaining that such an understanding of integral "would more closely align with how 'integral part' was used by the Supreme Court in *Silk*"). But the Proposed Rule departs from that view and explains that the Department's new use of "integral" actually signifies a quite different inquiry into whether the work performed is "critical, necessary, or central to the employer's business." 87 Fed. Reg. at 62,275. Thus, while superficially similar to the old factor, this new factor functions very differently in practice and is contrary to precedent, not probative of independent contractor status, and difficult to administer.

As the 2021 Rule explained, the use of this alternative meaning of the "integral" factor by some lower courts improperly "deviate[s] from the Supreme Court's guidance" in *Rutherford*. 86 Fed. Reg. at 1194. Indeed, while the Court's opinion in *Silk* did use the phrase "integral part" in passing, it "was not one of the distinct factors identified in *Silk* as being 'important for decision.'" *Id.* (citing *Silk*, 331 U.S. at 716). Moreover, as noted above, *Silk* used "integral part" in a manner more "closely align[ed]" with the "integrated unit" framing, rather than the alternative "importance" inquiry now favored by DOL. *Id.* And no subsequent Supreme Court precedent has repeated this language or identified it as a relevant factor. But the Proposed Rule does not address these critical points of law. Instead, it uncritically cites this passage of *dicta* from *Silk* without context as supporting its use of "integral." 87 Fed. Reg. at 62,253–54. It does not respond to the 2021 Rule's explanation that the passing statement was not a part of the economic reality factors identified by the *Silk* Court.

The 2021 Rule's reading of precedent is not just correct—it is also the only reading consistent with common sense. Unlike the "integrated unit of production" inquiry, DOL's version of the "integral" question is simply not probative of independent contractor status. "[T]he relative importance of the worker's task to the business of the potential employer says nothing about whether the worker economically depends on that business for work," especially in a modern economy in which businesses often rely on independent-contractor arrangements. 86 Fed. Reg. at 1194 (internal quotation marks omitted). And besides not aiding the worker classification inquiry, DOL's "integral"

factor affirmatively pushes it off track by putting another thumb on the scale for employee status in virtually all cases. "As Judge Easterbrook [has] pointed out . . . '[e]verything the employer does is 'integral' to its business—why else do it?'" *Id.* (second alteration in original) (quoting *Sec'y of Labor v. Lauritzen*, 835 F.2d 1529, 1541 (7th Cir. 1987) (concurring opinion)). Indeed, numerous categories of people may be *essential* or *important* to a business—including customers, parts suppliers, retailers, marketing consultants, and regulators—without being employees. Asking what is "essential" simply fails to distinguish between employees and *anyone else* in the web of a company's relationships. The illogical and unhelpful nature of DOL's "integral" factor thus helps explain why Supreme Court precedent instructs courts to consider instead the "integrated unit of production" inquiry.

Because Supreme Court precedent settles this question, DOL cannot justify its alteration of this factor by relying on "circuit court precedent." 87 Fed. Reg. at 62,254. It is irrelevant what "most circuit courts" have held, *id.*, if those lower courts' positions are contrary to the statute as interpreted in the controlling precedent of a higher court. Indeed, DOL offers no rational explanation for its rejection of the 2021 Rule's understanding of the integrated unit of production factor, but simply repeats the conclusory and insufficient assertions that its new "integral" factor "better reflects the economic reality case law" in the circuit courts. *Id.* at 62,253. This lack of reasoned explanation further exposes the flaws in DOL's decisionmaking process.

Moreover, even if DOL could properly consider its new "integral" factor as an *additional* consideration in the economic reality test, the Proposed Rule would still be unlawful in failing to consider the "integrated" factor at all. Whatever the disputed passage in *Silk* signifies, the Court's subsequent decision in *Rutherford* is also binding precedent that squarely identifies the "integrated unit of production" as a relevant inquiry in FLSA worker classification. By omitting that factor entirely, the Proposed Rule has "entirely failed to consider an important aspect of the problem" as required by the APA. *State Farm*, 463 U.S. at 43.

3. <u>DOL improperly counts "investment" as a separate factor from "opportunity for profit or loss."</u>

In addition to improperly demoting the "opportunity for profit or loss" factor from "core" status, *see supra* part I, the Proposed Rule introduces redundancy and double-counting by assessing a worker's "investment" in the business as a "standalone factor." 87 Fed. Reg. at 62,240; *see id.* at 62,275 (proposed 29 C.F.R. § 795.110(b)(2)). Under the existing regulations, investment is properly considered as part of the evaluation of the worker's opportunity for profit or loss. 29 C.F.R. § 795.105(d)(1)(ii). As the 2021 Rule explained, that unified approach is more "consistent with the Supreme Court's opinion in *Silk*[,] which articulated the two factors separately but analyzed them together." 86 Fed. Reg. at 1186 (citing *Silk*, 331 U.S. at 719). Thus, "[a]s the Court explained decades ago . . . , investment is a pathway to opportunity for profit or loss." *Id.*

DOL fails to justify its departure from the 2021 Rule's treatment of this sub-factor under governing law. It notes in passing that *Silk* articulated the two points separately, 87 Fed. Reg. at 62,240, but fails to address the 2021 Rule's explanation that *Silk* actually analyzed them together and so favors the unified approach. And again, DOL inappropriately appeals to the authority of the majority of the circuits on this question as if that is itself a reasoned justification for adopting their view. *Id.* DOL's reversal on this issue is yet another way in which the Proposed Rule disserves the Department's stated goal of regulatory clarity, *see supra* section I.A, by undoing the 2021 Rule's clarifying efforts to articulate "an appropriately weighted test with less overlapping redundancy," 86 Fed. Reg. at 1240.

4. DOL errs by assessing a worker's investment on a relative basis to the company's investment.

DOL also misconceives the relevance of "investment" on the merits, wherever it fits in the analysis. As the 2021 Rule explained, a worker's capital investment in a business may indicate independent contractor status insofar as it "indicate[s] an independent business by the worker." 86 Fed. Reg. at 1187. But that inquiry does not depend on the relative amount of a worker's investment compared to a larger business with which he or she contracts. That is because "'a side-by-side comparison method' that directly compares the worker's individual investment to the investment by the potential employer . . . does not illuminate the ultimate question of economic dependence,' but instead 'merely highlights the obvious and unhelpful fact that individual workers—whether employees or independent contractors—likely have fewer resources than businesses.'" *Id.* (citation omitted). Thus, "[c]omparing their respective investments does little more than compare their respective sizes and resources" and is not probative of independent contractor status. *Id.* at 1188.

The Proposed Rule improperly departs from this view, instructing that henceforth "the worker's investments should be considered on a relative basis with the employer's investments in its overall business." 87 Fed. Reg. at 62,275 (proposed 29 C.F.R. § 795.110(b)(2)); *see id.* at 62,242. As at other points, DOL's primary justification for this reversal is an appeal to circuit authority: The fact that "[n]umerous circuit courts of appeals consider the worker's investment in the work in comparison to the employer's investment in its business" is improperly offered as an independent reason for the Department to do so. *Id.* at 62,242; *see also id.* at 62,243 (invoking "many appellate court decisions"). But aside from reciting those courts' conclusions, DOL offers no reasoned explanation *why* that relative inquiry is probative of independent contractor status, contrary to the 2021 Rule's conclusion that it measures an irrelevant comparison of respective organizational size. Indeed, a business may invest quite significantly in, for example, an internet platform that attracts people who use the platform for activities that generate personal income—but that does not make those users employees.

The example of the financial-services industry illustrates the risk that irrelevant considerations could be considered to weigh in favor of employee classification under DOL's new formulation of the investment factor. Independent financial services firms often provide businesses services to the financial advisors with whom they affiliate through their independent contractual relationships. *See infra* section IV.A (explaining the business model). Because financial advisors are typically small business owners, their own investment in these areas may often be small in relation to the firms' investments. In fact, financial advisors often affiliate with independent financial services firms precisely because they want to avoid the capital outlay to obtain support that can be acquired more economically at scale. Moreover, in many respects, *the firms* are actually dependent on the financial advisors despite the relevant size of their investment in the business, because it is the advisors who build and maintain relationships with the clients served. That symbiotic, mutually beneficial contractual relationship does not and should be thought to indicate that advisors are employees of the firms with which they affiliate.

5. DOL turns the "permanence of the work relationship" factor into a one-way ratchet in favor of employee classification.

DOL alters the articulation of the "permanence of the work relationship" factor in a way that improperly slants the analysis in favor of classifying workers as employees. The current regulations explain that this factor "weighs in favor of the individual being an independent contractor to the extent the work relationship is by design definite in duration or sporadic" and, conversely, that this

factor "weighs in favor of the individual being an employee to the extent the work relationship is instead by design indefinite in duration or continuous." 29 C.F.R. § 795.105(d)(2)(ii). For example, in the financial-services industry, independent financial advisors are free to terminate their relationship with an investment services firm and move their business to another firm. Indeed, financial advisors wield significant bargaining power relative to their affiliated firms because those firms rely upon them to generate clients and know they can often leave with their clients if they become dissatisfied with the firm.[10]

The Proposed Rule abandons the 2021 Rule's symmetrical approach. Under its new test, a permanent relationship definitely "weighs" in favor of employee classification, but a lack thereof is "not necessarily indicative of independent contractor status." 87 Fed. Reg. at 62,243; *see id.* at 62,275 (proposed 29 C.F.R. § 795.110(b)(3)). DOL thus articulates an unbalanced inquiry improperly slanted toward employee classification across the board. Going forward, permanence and impermanence may both be indicative of employee status, reducing the probative value of this factor and further undermining the Department's stated goal of regulatory clarity. *See supra* section I.A.

6. DOL improperly expands the "skill" factor.

Finally, DOL unlawfully expands and skews the "skill" factor by injecting the unrelated concept of "initiative." The current regulations consider the "amount of skill required for the work" as a non-core factor. 29 C.F.R. § 795.105(d)(2)(i). As the 2021 Rule explained, that formulation follows the Supreme Court's original articulation of this factor in *Silk*, which examined the "skill required" as part of the economic reality test. 86 Fed. Reg. at 1174 (quoting *Silk*, 331 U.S. at 716).

The Proposed Rule would expand this factor to encompass both "skill and initiative." 87 Fed. Reg. at 62,275 (proposed 29 C.F.R. § 795.110(b)(6)); *see id.* at 62,254. But this alteration contravenes Supreme Court precedent and creates confusing redundancy with other factors such as "control." The 2021 Rule explained that the addition of "initiative" to this factor is a late-breaking "modification[]" that "some courts of appeals have made to the economic reality factors as originally articulated . . . by the Supreme Court." 86 Fed. Reg. at 1170. Moreover, "the capacity for on-the-job initiative is already part of the control factor," so adding it to the skill factor yields redundancy and improperly double-counts this consideration. *Id.* at 1174. The Proposed Rule fails to engage with these critiques and instead improperly defers to the view of "[m]any circuit courts of appeals" embracing "skill and initiative." 87 Fed. Reg. at 62,255. But this section of DOL's analysis does not even mention the Supreme Court's decision in *Silk* or attempt to explain how its new, expanded version of this factor is consistent with that controlling precedent. Indeed, this alteration represents yet another way in which the Proposed Rule repeatedly and improperly emphasizes "entrepreneurial drive" as an overarching consideration across many factors. *Supra* section II.A.2. DOL's emphasis on that consideration may lead to erroneous classification decisions because, among other considerations, some workers may strongly prefer to work as independent contractors, not for the flexibility to grow their businesses, but for the flexibility to control their workloads and to work when they want to—for example, to remain in the workforce while raising children or caring for older parents, or to establish a healthier work-life balance. Thus, while initiative is an appropriate consideration in favor of independent contractor status, its absence does

[10] *See* NERA Economic Consulting, The Role of Independent Contractors in the Finance and Insurance Sectors, *infra* Ex. B, at 18 n.51 ("Because there are many IBD firms in a competitive market, independent financial advisors frequently switch broker-dealer affiliations taking their books of business with them." (quoting FSI Comments on 2021 Rule NPRM at 4 (Oct. 26, 2020))).

not indicate that a worker is not pursuing independence. Certainly, the lack of initiative should not take on the outsized role in the worker-classification inquiry that the Proposed Rule improperly assigns it across multiple factors.

III. The Department Fails to Consider Substantial Costs of the Proposed Rule.

DOL's cost analysis is also seriously flawed. Although the Proposed Rule may lead to misclassification of millions of workers and significant regulatory uncertainty for years to come, DOL implausibly asserts that the sole cost it will impose is the one-time cost of businesses and independent contractors familiarizing themselves with its updated guidance. 87 Fed. Reg. at 62,266. DOL's limited cost analysis neglects to consider other significant categories of costs including costs from wage cuts and layoffs, payroll taxes, disruption of specific industries, and increased litigation. Its analysis is inconsistent with its own prior conclusions in the recent 2021 Rule on this topic. And it fails to address reliance interests, the costs to businesses of shifting operations, and recordkeeping costs.

A. DOL overlooks the costs of misclassification.

The most glaring omission from DOL's cost analysis is its neglect of the considerable costs of misclassifying independent contractors as employees. DOL makes the wholly unwarranted assumption that workers will necessarily benefit from a test that errs on the side of employee classification. For example, financial advisors can generally choose between working as independent contractors or as employees of financial services firms. Many prefer to be independent contractors: Independent advisors reported overall levels of satisfaction with their broker-dealer that was 5% higher than employee advisors and were around 45% more likely to recommend their affiliated broker-dealer to a colleague than were employee advisors.[11]

Even though some independent contractors will benefit from reclassification as employees, others will not, and over-classification of workers as employees would likely harm workers as a whole.

First, DOL overlooks that reclassification may cause wage cuts or drive many independent contractors out of the workforce. Independent contractors enjoy numerous advantages that employees lack. For instance, independent contractors "maintain[] a great deal of freedom in choosing [their] working hours and choosing the services [they] would provide." *Wilde v. Cnty. of Kandiyohi*, 15 F.3d 103, 106 (8th Cir. 1994) (internal quotation marks omitted); *see also* 2021 Rule, 86 Fed. Reg. at 1210 (describing the "autonomy" of independent contractors). Independent contractors generally have the flexibility to manage their own staffs, choose where to work, and work with whichever clients they please. Thus, many workers "prefer[] to be independent contractors because they enjoy[] having the freedom to work at other [businesses], set their own work schedules, and keep the money they receive[] in tips." *Degidio v. Crazy Horse Saloon & Rest. Inc.*, 880 F.3d 135, 139 (4th Cir. 2018).

If reclassified as employees, "[w]orkers and managers alike might sorely miss the flexibility and freedom that independent-contractor status confers." *McFeeley v. Jackson Street Ent., LLC*, 825 F.3d 235, 243 (4th Cir. 2016). Reclassification could force many independent contractors to work set shifts or a fixed number of hours—something that many independent contractors cannot or do not want to do. Countless independent contractors, including financial advisors, value job flexibility and the freedoms to enjoy a work-life balance and to tailor their schedules to the availability of

[11] *Infra* Ex. C.

their clients by working on evenings and weekends. If these independent contractors were required to work set shifts, their work-life balance would suffer, as would their ability to serve their clients. Additionally, 21 percent of independent contractors in finance occupations report that they earn more money independently than they would as employees, raising concerns that their livelihoods would suffer or that they would leave the industry if reclassified as employees.[12]

Relatedly, DOL also overlooks the likelihood that extending the FLSA's coverage to former independent contractors will lead to job cuts, hiring freezes, or automation. "In general, increasing the federal minimum wage would raise the earnings and family income of most low-wage workers, lifting some families out of poverty—but it would cause other low-wage workers to become jobless, and their family income would fall." Congressional Budget Office, "How Increasing the Federal Minimum Wage Could Affect Employment and Family Income," https://www.cbo.gov/publication/55681 (last updated Aug. 18, 2022).

Indeed, the Proposed Rule does not meaningfully consider that businesses may offset the costs of FLSA benefits by adopting wage cuts or layoffs. *See* 2021 Rule, 86 Fed. Reg. at 1244. Although independent contractors "generally do not receive employer-sponsored health and retirement benefits," Proposed Rule, 87 Fed. Reg. at 62,267, it does not follow that reclassification of those workers as employees means that they necessarily *will* receive them. The cost of benefits such as paid leave, health insurance, and retirement accounts "could average more than $15,000 annually for full-time independent contractors and almost $6,000 annually for part-time independent contractors"—if employers even provide them. *Id.* Many employers that choose to provide benefits simply cannot afford to shoulder these financial burdens without cutting costs elsewhere and consequently will be forced to pass costs onto workers. Indeed, DOL concedes that some employers may respond by adopting "a downward adjustment in the worker's wage rate to offset a portion of the employer's cost associated with these new benefits." *Id.* But it does not analyze how many workers will face lower wage rates or how much lower those rates will be.

The Proposed Rule also does not acknowledge other foreseeable costs that will arise from businesses being forced to provide health insurance and other benefits to their former independent contractors. Employers may reduce the quantity or quality of benefits offered to all employees or cut employee hours such that full-time employees become part-time employees who are not entitled to health insurance under the Affordable Care Act. *See* 26 U.S.C. § 4980H. Most drastically, reclassification will foreseeably lead to layoffs. The Affordable Care Act imposes steep penalties on businesses that have over fifty full-time employees and do not provide their employees with "the opportunity to enroll in minimum essential [health insurance] coverage."[13] *Id.* If reclassification drives medium-sized businesses that frequently hire independent contractors above the fifty-employee threshold, they may respond by laying off employees in order to remain under the threshold and so avoid the requirement to provide health insurance. Large businesses may also impose sweeping layoffs in response to reclassification. Reclassification could thus impose millions or billions of dollars of additional labor costs on large corporations, many of which would respond by imposing hiring freezes or by significantly reducing the size of their workforces.

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[12] NERA Economic Consulting, The Role of Independent Contractors in the Finance and Insurance Sectors, *infra* Ex. B.

[13] This provision of the Affordable Care Act is contained in the Internal Revenue Code. The Proposed Rule assumes "employers are likely to keep the status of most workers the same across all benefits and requirements, including for tax purposes," 87 Fed. Reg at 62,268, and will accordingly impact worker classifications for the purposes of mandatory insurance coverage.

Second, DOL fails to fully consider the indirect costs that the Proposed Rule will impose as a result of higher taxes. Although the Proposed Rule technically "only addresses whether a worker is an employee or an independent contractor under the FLSA, the Department assumes . . . that employers are likely to keep the status of most workers the same across all benefits and requirements, including for tax purposes." 87 Fed. Reg at 62,268. Reclassification would therefore require employers to pay the "6.2 percent employer component of the Social Security tax and the 1.45 percent employer component of the Medicare tax." *Id*. DOL acknowledges these burdens on employers but fails to discuss their obvious downstream effects. In fact, employers will react to increased payroll tax burdens either by passing costs on to consumers (which will hurt American families and exacerbate the current inflation crisis) or by slashing expenses, including through wage and benefit cuts and layoffs. Again, while some individual workers may benefit from entitlement to FLSA protections, workers as a whole may not. *See* Congressional Budget Office, "How Increasing the Federal Minimum Wage Could Affect Employment and Family Income." The Proposed Rule does not address this possibility.

Third, DOL ignores the widespread effects that the costs of reclassification will have on occupations traditionally reliant on an independent-contractor model. Although the additional costs of employment may be minor in some industries, they will potentially disrupt vast segments of the American economy. For instance, independent contractors play a major role in the financial services and insurance industries, and constitute over half the workforce at several major financial and insurance institutions, which serve tens of millions of consumers.[14] But DOL neglects to mention that reclassification of independent contractors as employees could upend many industries. Businesses whose models are centered around the independent-contractor relationship often cannot afford the healthcare benefits and payroll taxes associated with employment. And independent contractors often place a premium on the flexibility of independent-contractor status and the ability to set their own hours or work for multiple businesses. DOL does not explain how the Proposed Rule will affect these industries or the millions of consumers who rely on them.

Fourth, DOL does not consider the likelihood of increased litigation costs resulting from the Proposed Rule's replacement of the 2021 Rule's clear core factors with a nebulous, totality-of-the-circumstances multifactor test. *Supra* section I.A (discussing examples of ways in which the Proposed Rule will create significant regulatory uncertainty). As the 2021 Rule explained, the adoption of the core factor framework and other clarifying changes in the existing regulations was designed to yield "increased clarity and reduced litigation." 86 Fed. Reg. at 1232. But the Proposed Rule does not once mention litigation costs or explain why repealing the 2021 Rule would not increase costly litigation. Nor does it discuss how the harms from litigation costs will fall disproportionately on small businesses, many of which cannot afford to hire attorneys every time an independent contractor alleges that he or she is misclassified. Instead, the Proposed Rule makes only the conclusory and implausible statement that adopting its indeterminate six-factor-plus test "would provide consistent guidance . . . [that] could help reduce the occurrence of misclassification." 87 Fed. Reg. at 62,266; *see supra* section I.A.

Fifth, DOL largely glosses over *all* costs after the first year. By contrast, the 2021 Rule thoroughly described and analyzed the long-term costs and benefits of adopting the current regulations. To start, it acknowledged $370.9 million in one-time familiarization costs in the first year alone. 86 Fed. Reg. at 1228. It then qualitatively discussed other enduring costs: impacts on workers, tax revenue, competition, inequality, women and minorities, tax filing, implementation, and

[14] NERA Economic Consulting, The Role of Independent Contractors in the Finance and Insurance Sectors, *infra* Ex. B.

income stability. *Id.* at 1228–32.[15] And it carefully considered potential costs in each area. For example, it rebutted the concern that the rule would strain welfare budgets by observing that workers newly identified as independent contractors would see larger wages due to a lack of payroll taxation. *Id.* at 1230. It also responded to fears of adverse disproportional impacts on women by discussing studies finding that stay-at-home mothers would return to the workforce if offered flexible jobs. *Id.* at 1231. This thorough discussion led DOL to conclude that the 2021 Rule would yield significant benefits in future years after its adoption. *Id.* at 1228 n.180.

This careful analysis of future effects is conspicuously missing from the Proposed Rule. Here, DOL acknowledges just one category of costs—one-time rule familiarization costs—and implausibly asserts that the Proposed Rule "is not expected to impose costs after the first year," as if its overhaul of the governing regulations will yield no costs other than rule familiarization. 87 Fed. Reg. at 62,266. DOL fails to square that unsubstantiated assertion with its own prior conclusion that the 2021 Rule would produce *benefits* of $452 million per year in perpetuity as a result of increased clarity and decreased litigation costs. 86 Fed. Reg. at 1211. Rescinding the 2021 Rule's clarifying changes—let alone going even further in the opposite direction, as the Proposed Rule does—will impose at least that much in costs by withdrawing the benefits the 2021 Rule provided. But DOL's cost analysis fails to address this possibility or to explain its departure from the 2021 Rule's cost-benefit analysis over an extended time horizon. Simply, the benefits identified last year are now costs under the proposal, and DOL is obligated to account for them in its assessment of the Proposed Rule's impact and, accordingly, its decision whether to adopt the Proposed Rule at all. Further, the Proposed Rule dubiously claims that these benefits will largely result from "[i]ncreased [c]onsistency." 87 Fed. Reg. at 62,266. That assertion is facially implausible given that the Proposed Rule would impose a freewheeling totality-of-the-circumstances test that could only erode predictability and consistency.

Sixth, DOL overlooks the prospect that extending the application of FLSA employee status may provide no benefits whatsoever to many workers. DOL's analysis baselessly assumes that workers are better off being classified as employees simply because employees are entitled to overtime payments and a minimum wage under the FLSA. In fact, many independent contractors will remain ineligible for FLSA protections even if reclassified as employees; they would not be entitled to overtime pay even if reclassified as employees because they work in exempt occupations. Moreover, the average independent contractor earns far more than the minimum wage and therefore would not benefit from eligibility to earn a minimum wage. Financial advisors, for example, generally earn commissions or other variable types of performance-based pay that result in compensation well above the minimum wage, and often qualify for one or more FLSA exemptions, so employee status would be of no benefit to them.

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[15] *See also* NERA Economic Consulting, The Role of Independent Contractors in the Finance and Insurance Sectors, *infra* Ex. B, at 8–9 ("Th[e] evidence demonstrates that, for many workers, *independent contracting is the preferred labor market choice*—that is, workers would be worse off if independent contracting were not available as an option. While some workers prefer traditional employment, the labor force is characterized by heterogenous preferences for different types of work arrangements. For example, women are more likely than men to report preferring independent contracting due to the flexibility it provides them. Thus, independent contracting allows more women to choose to work the hours or days that fit their personal needs. Similarly, older workers are more likely to have independent contracting as their primary source of income, but young workers are more likely to engage in supplementary contracting work, especially from online platforms. In these ways, the flexibility of independent contracting allows workers to adjust the amount of time worked (and earnings) in response to changes in their life situations, i.e., to optimize their 'labor-leisure' tradeoff." (footnotes omitted)).

Seventh, DOL fails to contemplate that the Proposed Rule will perversely deter companies from imposing safety requirements and other beneficial constraints on independent contractors with whom they do business. Under the Proposed Rule, evidence that a business requires workers to "compl[y] with legal, safety, or other obligations" supports a finding that those workers are employees. 87 Fed. Reg. at 62,247. The Proposed Rule thus provides a perverse incentive for companies to refrain from enforcing legal and safety obligations and from monitoring workers' compliance with applicable laws and regulations. A lack of company oversight would result in increased incidents of workers breaking safety regulations, consumer-protection laws, and other rules designed to protect the physical or financial wellbeing of workers, consumers, and the public at large.

B. DOL overlooks reliance interests and the cost of shifting operations.

DOL's various means of slanting FLSA worker classification analysis toward employee status fail to acknowledge significant reliance interests generated by the more balanced economic reality test originally developed and applied by the Supreme Court. *Cf. Encino I*, 579 U.S. at 224 ("In light of the serious reliance interests at stake, the Department's conclusory statements do not suffice to explain its decision."). For instance, DOL ignores or downplays the costs of making the operational changes necessary to comply with the Proposed Rule. The first and smallest step in implementing operational changes is regulatory familiarization, which DOL estimates will cost only $118 million in the year after implementation. 87 Fed. Reg. at 62,266. This is a significant underestimation. DOL posits that businesses will familiarize themselves with the rule by paying a single "Compensation, Benefits, and Job Analysis Specialist." *Id.* In doing so, the Department implausibly assumes that large corporations with substantial labor costs at stake will rely on the advice of a single specialist rather than seeking extensive review by in-house attorneys or outside counsel. *Id.* Indeed, in response to the Proposed Rule, law firms have recommended that employers "seek legal assistance to confirm they are complying with all federal and state rules."[16] And according to the preliminary results of an ongoing Oxford Economics survey, a substantial proportion of financial advisors anticipate needing to retain outside counsel to understand the implications of the Proposed Rule, at substantial cost. Perhaps in recognition of these expenses, the 2021 Rule estimated the first-year regulatory compliance cost of the 2021 Rule at $370.9 million. 86 Fed. Reg. at 1211. The Proposed Rule does not explain or even acknowledge this two-thirds decrease in estimated familiarization costs.

DOL also ignores the costs of actually implementing reclassification. Businesses will rely on attorneys and human-resources specialists to develop new policies and to make fact-intensive and often case-specific determinations as to whether each individual contractor must be reclassified. Consultants or economic analysists will then have to calculate increased labor costs and determine how the businesses can implement necessary changes. And these changes—like repricing goods and services or deciding which employees to lay off—will themselves prove costly to implement. The Proposed Rule fails to consider any of these important costs.

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[16] Fox Rothschild LLP, *DOL Proposes New Worker-Friendly Independent Contractor Rule* (Oct. 13, 2022), https://www.foxrothschild.com/publications/dol-proposes-new-worker-friendly-independent-contractor-rule; *see also* Ogletree Deakins, *DOL Proposes New Multifactor Rule for Determining Independent Contractor Status* (Oct. 11, 2022), https://ogletree.com/insights/dol-proposes-new-multifactor-rule-for-determining-independent-contractor-status/ ("Classifying more workers as independent contractors could be disruptive to the many companies across the United States that depend on the use of independent contractors. Although this new proposal is not a final rule, companies may want to consider how the proposal could impact their operations if the final rule that is adopted by the DOL is the same or highly similar to the proposed rule.").

Nor does DOL address costly actions by which many businesses may fundamentally change their operations in order to enhance independence from contractors and so avoid the risk of misclassification. These changes could result in the elimination of efficiencies, such as shared services, and could spur inconsistencies in training and other undertakings common to both businesses. They may also result in decreases in operational quality if services formerly provided by expert independent contractors are reassigned to less experienced employees. Alternatively, fearing lawsuits or regulatory actions, businesses may impose hiring freezes or otherwise decline to enter into business relationships with independent contractors. The result will be a decreased supply of services and the loss of economies of scale in production.

Additionally, DOL neglects costs that will arise when reclassified independent contractors decide that they do not want to be employees because of decreased flexibility, fixed schedules, or loss of control over their work. *Supra* pp. 25–26. Many of these workers likely would quit in order to pursue independent-contractor opportunities elsewhere. The firms with which they formerly contracted would then have to replace the worker or find another way to obtain the services that the worker previously provided. This process would necessitate significant additional expenses associated with conducting a search, interviewing and hiring, and training and onboarding new workers. Those expenses may include, for example, creating a new job description, posting the opening, third-party recruiting costs; time spent by HR, time spent by managers and others, time spent in training, background checks, FINRA registration fees, travel expenses, relocation expenses, and hardware and technology costs.

Finally, DOL overlooks litigation-related costs that it will impose. The Portal-to-Portal Act, 29 U.S.C. § 259, establishes an affirmative defense to FLSA violations: An employer cannot be held liable "if he pleads and proves that the act or omission complained of was in good faith in conformity with and in reliance on any written administrative regulation, order, ruling, approval, or interpretation" by the Department of Labor. By rescinding and replacing the 2021 Rule, DOL would substantially change the circumstances in which companies can rely on this affirmative defense, which will substantially undermine reliance interests.

C. DOL overlooks recordkeeping costs.

DOL generally ignores the extensive recordkeeping costs that the Proposed Rule will impose on employers. Although the rule itself technically "does not create any new reporting recordkeeping requirements," 87 Fed. Reg. at 62,272, it will have the predictable effect of increasing employers' recordkeeping obligations under existing law. Pursuant to the FLSA, "[e]very employer . . . shall make, keep, and preserve such records of the persons employed by him and of the wages, hours, and other conditions and practices of employment maintained by him, and shall preserve such records for such periods of time." 29 U.S.C. § 211(c). So if independent contractors are reclassified as employees, employers will be compelled to keep additional employment records in order to demonstrate compliance with the Proposed Rule and to avoid DOL investigations, adverse findings, and litigation. Simply put, more employees means more recordkeeping.

Recordkeeping is not cheap. Employers must gather and preserve information including: "[b]asic payroll and identifying employee data," "daily and weekly hours worked per pay period," "additions to or deductions from wages," dates of leave under the Family and Medical Leave Act (FMLA), various "[c]opies of employee notices of leave, [a]ny documents . . . describing employee benefits," "[p]remium payments of employee benefits," and disputes regarding FMLA leave. 29 C.F.R. § 825.500(c). Compiling this information requires considerable time and effort by employees including human-resources officers, and larger companies frequently purchase expensive software

in order to log and retain timekeeping and wage information. The Proposed Rule's wholesale omission of this significant category of costs thus marks a "fail[ure] to consider an important aspect of the problem" before the agency. *State Farm*, 463 U.S. at 43.

IV. The Proposed Rule Is Bad Policy.

In addition to raising a host of legal problems, the Proposed Rule is also bad policy that should be reconsidered before it imposes deleterious real-world effects. DOL's repeal and replacement of the recent 2021 Rule will create legal uncertainty that chills innovation of new types of work relationships and deepens inequality. In particular, the Proposed Rule will inflict considerable harm on the financial-services industry. Independent financial services firms will face increased litigation costs from increased accusations of misclassifying financial advisors. Financial advisors could lose the flexibility to change affiliations with firms and to engage in activities outside the scope of their relationships with firms.[17] Clients will suffer from increased costs—which in turn lead to a loss of access to financial advice and reduced ability to financially plan for their futures. And these harms will have economy-wide ramifications.

A. The Proposed Rule threatens significant harm to FSI's members and their business model.

Financial advisors are independent businesspeople who provide services for their clients, not for the independent financial services firms with which they affiliate. The firms provide financial advisors with a platform and suite of products, and the financial advisors function as the firms' distribution network. Firms do not pay financial advisors for their labor; instead, financial advisors' revenue comes directly from client payments, whether as commissions or asset-based fees. The firms and financial advisors are both in business for themselves and have a mutually beneficial arrangement that enables them to conduct that business.

That financial advisors are not employees of independent financial services firms should be clear under any valid formulation of the FLSA's economic reality test. Yet the Proposed Rule has multiple deficiencies that could be misconstrued to weigh in favor of concluding that financial advisors are employees or create uncertainty about their classification. *See, e.g.*, *supra* section II.B.1–2 (discussing how the Proposed Rule creates uncertainty by, among other changes, improperly altering the "control" and "integrated unit of production" factors). Misclassification would undermine the vitality of the financial-services industry, to the detriment of all parties involved.

First, the Proposed Rule will harm independent financial services firms. These firms provide business, technological, and administrative support to financial advisors in addition to supervising their business practices for compliance with regulatory requirements and arranging for the execution and clearing of customer transactions. The firms operate in a highly regulated environment overseen by the Securities and Exchange Commission, self-regulatory organizations such as FINRA, DOL's Employee Benefits Security Administration, and state insurance commissions and securities divisions. Under the Exchange Act, anyone who effectuates securities transactions, including independent financial advisors, must register with the SEC or affiliate with a corporation that is registered with the SEC, such as an independent financial services firm. 15 U.S.C. § 78o(a)(1). These corporations must become members of a self-regulated organization such as FINRA, which requires them to oversee the securities operations of their associated independent financial advisors by ensuring compliance with federal securities laws, reviewing certain correspondence with the public,

[17] Indeed, preliminary results from an ongoing Oxford Economics survey indicate that many financial advisors currently earn a substantial portion of their income from sources other than advisory fees and commissions.

and ensuring that an independent financial advisor's recommendations are in the best interest of the client. *Id.* § 78c-3; 17 C.F.R. § 240.15*l*-1.[18]

Because independent financial services firms oversee financial advisors to ensure compliance with comprehensive federal and state regulations, they could be erroneously accused of misclassifying those financial advisors under the Proposed Rule. *See, e.g.*, *Taylor v. Waddell & Reed, Inc.*, 2012 WL 3584942 (S.D. Cal. Aug. 20, 2012) (rejecting claim that independent financial advisors are employees). *See supra* pp. 18–20 (explaining the 2021 Rule's correct analysis that such regulatory compliance requirements do not indicate employer control). The Proposed Rule would greatly increase uncertainty about how the DOL distinguishes between employees and independent contractors under the FLSA, so it would increase worker misclassification and litigation, as well as the attendant costs.

Similarly, the fact that firms may provide training and other support services to financial advisors does not indicate an employment relationship. These services promote efficiency and consistency but do not exert control over the financial advisors' independent businesses. Yet these arrangements could improperly be argued to weigh in favor of employee classification under DOL's new, expansive formulation of the "control" and "investment" factors. *See supra* section II.B.1, 3, 4.

The uncertainty the Proposed Rule could create about the proper classification of financial advisors will lead to additional deleterious effects. It would reduce enterprise value for businesses that have been structured around an independent-contractor model by increasing their costs, whether from increased labor or compliance costs. Impairing the value of independent financial services firms would in turn harm their shareholders.

Second, the Proposed Rule will harm financial advisors. Under an employee model, firms keep 50–60% of a financial advisor's gross revenue. Employee-advisors often do not need all the resources that their employers provide but are forced to pay for them via reduced compensation. But an independent model avoids these shortfalls. Financial advisors who operate independently from independent financial services firms provide their own start-up capital, experience profit and loss based on their own success, and dictate their own business preferences. They also have the flexibility to hire and discharge their own personnel, set appropriate levels of compensation, develop their own marketing programs and clientele, and set their fee structure. *See supra* p. 15 (citing NERA study results indicating that financial advisors place a premium on the freedom of flexible working arrangements). Compared to employee-advisors, independent financial advisors keep substantially more of their earnings—90% or more of gross revenue—and do not pay firms for unnecessary resources, instead paying only for the services and supports they need to run their businesses. Preliminary results from an Oxford Economics survey indicate that financial advisors who choose to be independent contractors do so because they want to own their own business, choose their own clients, and believe that independent-contractor status allows them to better serve their clients. In short, independent financial advisors benefit from greater autonomy, higher wages, and more control over their businesses' finances, services, and culture.

If erroneously reclassified as employees because of the Proposed Rule's legally flawed analysis, financial advisors would suffer from reduced independence in other ways. For example,

[18] In addition to these examples, the financial-services industry is also subject to a broad array of other securities laws and regulations that mandate further oversight and supervisory control. *E.g.*, FINRA Rule 2210; 17 C.F.R. § 275.206(4)-1 (requiring supervision of advertising and other communications); FINRA Rule 4511; 17 C.F.R. § 275.204-2 (requiring retention of records and supervisory checks to ensure the appropriate records are being maintained); FINRA Rule 3270 (requiring careful supervision to prevent undisclosed outside business activities).

an employment relationship could impede the ability of financial advisors to switch affiliations between independent financial services firms. Today, in large markets with many independent financial services firms, financial advisors frequently switch affiliations, taking their books of business with them. Financial advisors do not have to start over when moving firms because it is understood that it is "their business" and "their clients;" clients are consistently more loyal to their advisors than their firms. This is different from a classic employment relationship where the worker switching employers must start their business anew. Under the Proposed Rule, however, imposing an employment classification endangers that business structure.

Additionally, many financial advisors engage in business activities outside the scope of their relationship with independent financial services firms. These activities include offering insurance, tax preparation, accounting, or other financial expertise that is outside the scope of the services requiring a financial advisor to hold a securities license and affiliate with a broker-dealer such as an independent financial services firm. The firms are legally required to approve these outside business activities but do not control them. An employment relationship would threaten this business model. Employers might forbid financial advisors from providing these services out of fear of liability or because they detract from financial advisors' securities-related services, thereby reducing profitability.

The rule may also result in unintended medium-term impacts on the financial-services industry. Independent financial advisors who do not want to be employees could switch their affiliation or form their own registered investment advisor or broker-dealer businesses in order to retain control over their own careers. Indeed, preliminary survey data from Oxford Economics indicate that the vast majority of financial advisors would respond to the adoption of the Proposed Rule by reconsidering their broker-dealer affiliation, and most financial advisors would form new broker-dealer or investment-adviser business entities. Furthermore, the overwhelming majority of advisors who would consider form new business entities anticipate significant start-up costs such as legal and compliance fees, marketing and branding, staffing, technology, and trading-platform costs—with preliminary survey results indicating that costs could easily reach $150,000 or even $200,000 or more for each firm. Some new businesses will eventually recoup these costs. Others will not.

Third, the Proposed Rule will harm investors. Independent financial services firms give financial advisors extensive flexibility to advise their clients as they see fit, subject only to regulatory requirements and firm policies. Traditional brokerage houses, in contrast, may encourage the marketing of their own proprietary investment products. This may reduce the investment options made available to consumers.

Financial advisors and independent financial services firms provide these services to Main Street Americans—not just to millionaires and sophisticated investors. Their advice and wealth-management strategies help lower- and middle-class Americans achieve financial goals such as saving for college tuition, homeownership, retirement, and estate planning. Because of the financial system's extreme complexity, millions of Americans lack the experience, knowledge, or time to reach these milestones without the help of trusted expert financial advisors.

The financial advisors who affiliate with financial services firms have a large impact on disadvantaged Americans living in underserved communities, including those with significant minority and immigrant populations. In these communities (particularly rural communities that lack easy access to financial services), a one-stop shop for investment management, retirement planning, tax filing, and estate planning is a vital resource. In addition to providing these financial services, financial advisors educate lower- and middle-class Americans in these communities about personal wealth and taxation, enabling them to become more self-sufficient.

If adopted, the Proposed Rule could undermine financial advisors' independence, negating the many advantages that their independence allows them to provide to ordinary Americans. Financial advisors are often able to offer reasonable prices and a diverse range of services because their primary relationship is with the consumer, not the independent financial services firm. If financial advisors were erroneously reclassified as employees of independent financial services firms, the cost of financial services would rise, potentially placing access to financial advice beyond the reach of countless Americans. Similarly, if reclassified financial advisors who do not want to be employees were to leave their firms, they would have to raise prices in order to replace the firms' support services. Initial survey data from Oxford Economics found that a substantial majority of financial advisors predict that the Proposed Rule would lead to increases in account minimums and fees because they would be less able to advise small clients under their new structure.

The Proposed Rule similarly will cause a reduction to the availability of financial services. According to preliminary data from the Oxford Economics survey, most advisors anticipate a decrease in services or investment options, such that a large minority of current clients would no longer be served. And a substantial fraction of advisors report that they would choose to retire if they could no longer work as independent contractors. The results could be disastrous for American investors and their families, especially those who are lower-income or unsophisticated investors.

B. <u>The effects of misclassifying independent financial advisors would be economy-wide.</u>

Misclassification of independent financial advisors could exact a multibillion-dollar toll on the American economy. FSI represents 85 financial services firms and their approximately 140,000 affiliated independent financial advisors. These members make substantial contributions to the nation's economy. According to Oxford Economics, FSI members nationwide generate $35.7 billion in economic activity, including indirect effects such as greater financial stability of investors who are able to save for college or pay off mortgages thanks to sound and affordable financial advice. This economic activity, in turn, supports 408,743 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI member activity generates $7.2 billion in annual federal, state, and local tax revenue.[19]

Similarly, economic experts from NERA Economic Consulting examined independent contracting in the financial and insurance industry and found that independent contractor-operated financial advisors and insurance agencies account for approximately $47 billion (27%) of the output of the financial advisory and insurance brokerage industries. NERA Economic Consulting, The Role of Independent Contractors in the Finance and Insurance Sectors, *infra* Ex. B, at 2. In just a four-year period from 2015 through 2019, independent contractors in the financial-services industry created approximately 54,000 new businesses and 174,000 new jobs that "would not have existed if independent contracting were prohibited." *Id.*

Furthermore, the advice given by independent financial advisors generates significant downstream economic benefits. Independent financial advisors facilitate investments in publicly traded companies, fueling innovation and job creation. Their tax advice spares ordinary consumers from hours of tax-preparation work and reduces the likelihood of costly IRS audits. And their estate-planning services simplify the intergenerational transfer of wealth.

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[19] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2020). This report was attached to FSI's April 12, 2021, comment letter submitted in response to DOL's proposal to withdraw the 2021 Rule and is available online at https://tinyurl.com/3csvfuc9.

C. The Proposed Rule will create uncertainty and erode the public's ability to rely on DOL guidance.

The Proposed Rule will hurt American businesses and workers alike by introducing significant uncertainty into an important regulatory classification decision affecting vast swaths of the economy. DOL is proposing significant changes to its regulations less than two years after the 2021 Rule comprehensively updated the agency's guidance on employee classifications under the FLSA. By generally ignoring compliance costs, *supra* section III.B, the Proposed Rule fails to account for the myriad ways that businesses and contractors structure their relationships and overlooks that companies make long-term investments premised on the continued legality of their independent-contractor arrangements. These businesses and contractors cannot modify their contractual arrangements, compensation structures, and benefit offerings overnight in order to account for mercurial shifts in agency interpretation. At minimum, they need time to carefully study any final rule, to ask for and receive compliance advice, and to negotiate employment arrangements with reclassified independent contractors. In short, these significant shifts in the law over short periods of time harm businesses and contractors who desire certainty and predictability.

Legal uncertainty can stifle innovation of new models of work relationships such as gig work, freelancing, and part-time remote work. The 2021 Rule recognized that legal clarity would promote job creation by "encourag[ing] firms to create independent contractor arrangements for roles that did not previously exist," whereas "[l]egal uncertainty prevents mutually beneficial independent contractor arrangements," especially "innovative economic arrangements that benefit both workers and business." 86 Fed. Reg. at 1209, 1235. The Proposed Rule would predictably chill vital economic innovation. Risk-averse companies, notably including small businesses and startups, will shy away from adaptable work models in favor of more rigid and traditional work relationships because of inability to afford compliance advice and litigation fees. In order to adapt to a post-pandemic world in which workers can enjoy the flexibility of telecommuting and other nontraditional work arrangements, companies need to know that their currently lawful employment and contracting relationships will remain lawful.

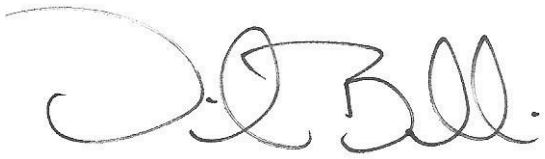
Legal uncertainty also exacerbates inequality and results in regressive redistribution of wealth. Workers with lower incomes and smaller businesses are more likely to be risk-averse due to a lack of financial capacity to absorb legal costs and regulatory fines. Larger corporations, in contrast, can afford to pay for compliance advice and litigation. The risk-averse will therefore refrain from innovation, whereas larger corporations will continue to innovate and reap considerable profits when successful, possibly driving their smaller competitors out of the market. The predictable result will be a regressive transfer of wealth from those with fewer resources to those who have more.

Conclusion

The Department should withdraw the Proposed Rule for the reasons outlined above. We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with DOL on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,



David T. Bellaire
Executive Vice President & General Counsel

Exhibit A to FSI Comment Letter
Table of Cases

	Post-1975 Circuit Case, Cited In 2022 NPRM, Applying Economic Reality Test	**Result Under Circuit's Multifactor Test**	**Result Under 2021 Rule's Two Core Factors**
1.	*Usery* v. *Pilgrim Equip.* Co., 527 F.2d 1308 (5th Cir. 1976)	Employee	Same
2.	*Real v. Driscoll Strawberry Assocs., Inc.*, 603 F.2d 748 (9th Cir. 1979)	Subject to material factual dispute	Same
3.	*Donovan v. Sureway Cleaners*, 656 F.2d 1368 (9th Cir. 1981)	Employee	Same
4.	*Robicheaux v. Radcliff Material, Inc.*, 697 F.2d 662 (5th Cir. 1983)	Employee	Same
5.	*Hickey v. Arkla Indus., Inc.*, 699 F.2d 748 (5th Cir. 1983)	Independent contractor	Same
6.	*Doty v. Elias*, 733 F.2d 720 (10th Cir. 1984)	Employee	Same
7.	*Donovan v. Brandel*, 736 F.2d 1114 (6th Cir. 1984)	Independent contractor	Same
8.	*Donovan v. DialAmerica Mktg., Inc.*, 757 F.2d 1376 (3d Cir. 1985)	Some employees; some independent contractors	Same in one category; mixed in the other
9.	*Brock v. Mr. W Fireworks, Inc.*, 814 F.2d 1042 (5th Cir. 1987)	Employee	Same
10.	*Halferty v. Pulse Drug* Co., 821 F.2d 261 (5th Cir. 1987)	Employee	Same
11.	*Sec'y of Labor v. Lauritzen*, 835 F.2d 1529 (7th Cir. 1987)	Employee	Same
12.	*Brock v. Superior Care, Inc.*, 840 F.2d 1054 (2d Cir. 1988)	Employee	Same
13.	*McLaughlin v. Seafood, Inc.*, 861 F.2d 450 (5th Cir. 1988), *on reh'g*, 867 F.2d 875 (5th Cir. 1989) (per curiam)	Employee	Same
14.	*Dole v. Snell*, 875 F.2d 802 (10th Cir. 1989)	Employee	Same
15.	*Martin v. Selker Bros.*, 949 F.2d 1286 (3d Cir. 1991)	Employee	Same
16.	*Lilley v. BTM Corp.*, 958 F.2d 746 (6th Cir. 1992)	Subject to material factual dispute	Same

17.	*Reich v. Circle C. Invs., Inc.*, 998 F.2d 324 (5th Cir. 1993)	Employee	Same
18.	*Carrell v. Sunland Constr., Inc.*, 998 F.2d 330 (5th Cir. 1993)	Independent contractor	Mixed
19.	*Baker v. Flint Eng'g & Constr. Co.*, 137 F.3d 1436 (10th Cir. 1998)	Employee	Same
20.	*Herman v. Express Sixty-Minutes Delivery Serv., Inc.*, 161 F.3d 299 (5th Cir. 1998)	Independent contractor	Same
21.	*Morrison v. Int'l Programs Consortium, Inc.*, 253 F.3d 5 (DC Cir. 2001)	Subject to material factual dispute	Same
22.	*Chao v. Mid-Atlantic Installation Servs., Inc.*, 16 F. App'x 104 (4th Cir. 2001)	Independent contractor	Same
23.	*Johnson v. Unified Gov't of Wyandotte Cnty./Kansas City*, 371 F.3d 723 (10th Cir. 2004)	Independent contractor	Mixed
24.	*Freund v. Hi-Tech Satellite, Inc.*, 185 F. App'x 782 (11th Cir. 2006)	Independent contractor	Same
25.	*Schultz v. Capital Int'l Sec., Inc.*, 466 F.3d 298 (4th Cir. 2006)	Employee	Same
26.	*Chao v. First Nat'l Lending Corp.*, 249 F. App'x 441 (6th Cir. 2007)	Employee	Same
27.	*Hopkins v. Cornerstone Am.*, 545 F.3d 338 (5th Cir. 2008)	Employee	Same
28.	*Cromwell v. Driftwood Electrical Contractors, Inc.*, 348 F. App'x 57 (5th Cir. 2009)	Employee	Mixed
29.	*Thibault v. Bellsouth Telecomms., Inc.*, 612 F.3d 843 (5th Cir. 2010)	Independent contractor	Same
30.	*Scantland v. Jeffry Knight, Inc.*, 721 F.3d 1308 (11th Cir. 2013)	Subject to material factual dispute	Same
31.	*Keller v. Miri Microsystems LLC*, 781 F.3d 799 (6th Cir. 2015)	Subject to material factual dispute	Same
32.	*Meyer v. U.S. Tennis Ass'n*, 607 F. App'x 121 (2d Cir. 2015)	Independent contractor	Same
33.	*Eberline v. Media Net, LLC*, 636 F. App'x 225 (5th Cir. 2016)	Independent contractor	Same
34.	*McFeeley v. Jackson Street Ent., LLC*, 825 F.3d 235 (4th Cir. 2016)	Employee	Same

35.	*Iontchev v. AAA Cab Serv., Inc.*, 685 F. App'x 548 (9th Cir. 2017)	Independent contractor	Same
36.	*Saleem v. Corp. Transp. Grp., Ltd.*, 854 F.3d 131 (2d Cir. 2017)	Independent contractor	Same
37.	*Karlson v. Action Process Serv. & Priv. Investigation, LLC*, 860 F.3d 1089 (8th Cir. 2017)	Independent contractor	Same
38.	*Acosta v. Paragon Contractors Corp.*, 884 F.3d 1225 (10th Cir. 2018)	Employee	Mixed
39.	*Acosta v. Off Duty Police Servs., Inc.*, 915 F.3d 1050 (6th Cir. 2019)	Employee	Same
40.	*Parrish v. Premier Directional Drilling, L.P.*, 917 F.3d 369 (5th Cir. 2019)	Independent contractor	Same
41.	*Agerbrink v. Model Service, LLC*, 787 F. App'x 22 (2d Cir. 2019)	Subject to material factual dispute	Same
42.	*Nieman v. National Claims Adjusters, Inc.*, 775 F. App'x 622 (11th Cir. 2019)	Independent contractor	Same
43.	*Hobbs v. Petroplex Pipe & Constr., Inc.*, 946 F.3d 824 (5th Cir. 2020)	Employee	Same
44.	*Franze v. Bimbo Bakeries USA, Inc.*, 826 F. App'x 74 (2d Cir. 2020)	Independent contractor	Same
45.	*Razak v. Uber Techs., Inc.*, 951 F.3d 137 (3d Cir.), *amended*, 979 F.3d 192 (3d Cir. 2020)	Subject to material factual dispute	Same
46.	*Nelson v. Texas Sugars, Inc.*, 838 F. App'x 39 (5th Cir. 2020)	Independent contractor	Same
47.	*Sanchez Oil & Gas Corp. v. Crescent Drilling & Prod., Inc.*, 7 F.4th 301 (5th Cir. 2021)	Subject to material factual dispute	Same
48.	*Walsh v. Wellfleet Commc'ns*, No. 20-16385, 2021 WL 4796537 (9th Cir. Oct. 14, 2021)	Employee	Same
49.	*Walsh v. Alpha & Omega USA, Inc.*, 39 F.4th 1078 (8th Cir. 2022)	Subject to material factual dispute	Same

Exhibit B to FSI Comment Letter

NERA Economic Consulting, The Role of Independent Contractors in the Finance and Insurance Sectors

NERA
ECONOMIC CONSULTING

The Role of Independent Contractors in the Finance and Insurance Sectors

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I. Introduction

More than seven million Americans work in the financial and insurance sector. While most of these workers are full-time employees, many choose to serve as independent contractors, especially in customer-facing occupations such as financial advisors, securities brokers and insurance agents.[1] As independent contractors, these workers do not earn a salary, but instead are compensated based on the results of their efforts, typically through commissions provided by the institutions with which they are associated. As entrepreneurs, these workers have the opportunity to build businesses and generate wealth as well as the flexibility to work part-time; in many cases their financial services work constitutes a second job. From the perspective of financial services providers, independent contracting allows for larger and more flexible retail networks than would otherwise be possible, thereby expanding the number and types of customers they are able to serve.

While a substantial body of economic research indicates that independent contracting in general is economically efficient and benefits both workers and consumers, critics argue that it can be used to exploit workers, for example by denying them fringe benefits (e.g., employer-provided health care) and legal protections (e.g., minimum wage, unionization rights) available to workers who are classified as employees. Based on such concerns, some legislators and policymakers at both the state and federal levels have sought to restrict the use of independent contracting by narrowing the criteria under which workers can legally be classified as independent contractors.

In this context, this paper examines the role of independent contracting in the financial and insurance services sector. Specifically, we explain the role of independent contracting in the economy generally; examine the roles played and economic benefits generated by independent contractors in the financial and insurance services industry; and, assess the impact of limiting or prohibiting the use of independent contracting on these markets.

Our findings suggest that independent contracting in these sectors benefits consumers, and that limiting or prohibiting its use would substantially reduce the supply of these services, especially to lower-income and disadvantaged populations. We also note that independent contracting allows financial and insurance professionals to become entrepreneurs by starting and growing their own businesses, thereby contributing to both new business formation and job creation. Specifically, we find:

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[1] Unless otherwise noted, we refer to the Finance and Insurance Sector as defined by the Bureau of Labor Statistics (BLS) (NAICS 52), and to financial and insurance occupations as Insurance Sales Agents ("insurance agents"), Personal Financial Advisors ("financial advisors") and Securities, Commodities and Financial Services Sales Agents ("securities agents") as those occupational categories are defined by BLS. See Bureau of Labor Statistics, "Finance and Insurance: NAICS 52" (July 15, 2022) (available at https://www.bls.gov/iag/tgs/iag52.htm). Bureau of Labor Statistics, "Occupational Employment and Wages, May 2021: 41-3021 Insurance Sales Agents" (March 31, 2022) (available at https://www.bls.gov/oes/current/oes413021.htm). Bureau of Labor Statistics, "Occupational Employment and Wages, May 2021: 41-3031: Securities, Commodities, and Financial Services Sales Agents" (March 31, 2022) (available at https://www.bls.gov/oes/current/oes413031.htm). Bureau of Labor Statistics, "Occupational Employment and Wages, May 2021: 13-2052: Personal Financial Advisors" (March 31, 2022) (available at https://www.bls.gov/oes/current/oes132052.htm).

- More than half a million people work as independent contractors in the financial and insurance industry and in financial service occupations. We estimate conservatively that independent contractors account for at least one of every seven insurance agents, financial advisors and securities agents.

- Independent contractors own and operate approximately 130,000 financial advisory and insurance brokerage firms, employing approximately 330,000 people. Many of these business entrepreneurs are able to build equity in the firms they own. Prohibiting independent contracting would severely disrupt these businesses and eliminate many of these jobs.

- Between 2015 and 2019, independent contractors in the financial services sector created approximately 54,000 new businesses and 174,000 new jobs, all or most of which would not have existed if independent contracting were prohibited.

- Independent contractor-operated financial advisors and insurance agencies account for approximately 27 percent ($47 billion) of the output of the financial advisory and insurance brokerage industries. Reducing the supply of these services would harm consumers, including by reducing financial literacy and harming their ability to accumulate wealth and save for retirement.

- The use of independent contractors allows financial service and insurance providers to reach otherwise difficult-to-serve customers, thereby expanding the availability of financial advice and related services to low- and moderate-income households. For some firms, independent contractors account for the overwhelming majority of their workforce.

- Workers in the financial services sector choose to become independent contractors because they value independence, flexibility and the opportunity to build a business and generate wealth. Prohibiting independent contracting would make these workers worse off.

The remainder of this report is organized as follows: Section II provides an overview of the role of independent contracting in the U.S. economy and of the economic motivations for using independent contracting. Section III focuses on the financial services sector, including presenting estimates of the number of independent contractors working in financial service and insurance related occupations and explaining from an economic perspective the roles they play in providing financial advisory and insurance agency services. Section IV presents our analysis of the economic effects of barring or substantially reducing the use of independent contracting in the financial services and insurance sectors. Section V presents a brief conclusion.

II. Independent Contracting in the U.S. Labor Market: An Overview

The first subsection below provides an overview of the roles played by independent contractors in the U.S. economy. The second subsection explains the economic foundations for independent contracting.

A. Extent and Nature of Independent Contracting

Independent contracting is a form of alternative work arrangement under which workers perform services under various forms of contractual arrangements but are not considered "employees" for legal purposes. The distinction has a variety of practical consequences. For example, independent contractors are treated differently from traditional employees with regard to a variety of Federal and state statutes regulating terms of employment.[2] The precise legal definition of independent contracting varies depending on context. At the Federal level, for example, the Department of Labor (which enforces the Fair Labor Standards Act (FLSA)) applies a different set of standards than the Internal Revenue Service.[3] As discussed further in Section II.B, definitional issues have important policy and economic implications. From an economic perspective, however, they also create challenges of measurement.

The commonly referenced source of data on the nature and extent of independent contracting is the Bureau of Labor Statistics' "Contingent Worker Supplement" (CWS), which is a survey of approximately 50,000 U.S. workers conducted, most recently, in May 2017.[4] The CWS reports detailed data on the number of workers engaged as independent contractors, classified by standard industry and occupational categories. In addition, the CWS gathers and reports data on the demographic characteristics of independent contractors, average and median earnings, and other worker characteristics, such as the reasons individuals give for choosing to work as independent contractors rather than employees.

It is generally understood, however, that the CWS estimates substantially undercount the number of independent contractors, in part because they only count individuals for whom independent contracting is their "main" source of work and therefore omit workers who engage in independent contracting as a "second" job.[5] In 2021, the Department of Labor concluded that the CWS survey

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[2] See generally Jeffrey A. Eisenach, *The Role of Independent Contractors in the U.S. Economy* (Navigant Economics 2010) (hereafter Eisenach, *The Role of Independent Contractors*) at 5.

[3] Department of Labor, *Independent Contractor Status Under the Fair Labor Standards Act; Withdrawal,* RIN No. 1235-AA34 (March 12, 2021). Internal Revenue Service, "Independent Contractor (Self-Employed) or Employee?" (available at https://www.irs.gov/businesses/small-businesses-self-employed/independent-contractor-self-employed-or-employee).

[4] U.S. Bureau of Labor Statistics, "Contingent and Alternative Employment Arrangements – May 2017," USDL-18-0942 (June 7, 2018) (available at https://www.bls.gov/news.release/pdf/conemp.pdf). Prior versions of the CWS survey were conducted in 2005, 2001, 1999, 1997, and 1995.

[5] There is an active debate about potential methodological improvements in the CWS. See, e.g., Bureau of Labor, "Frequently Asked Questions About Data on Contingent and Alternative Employment Arrangements" (August 7, 2018) (available at https://www.bls.gov/cps/contingent-and-alternative-arrangements-faqs.htm) ("The questions about contingent work and alternative employment arrangements are asked only about a person's main job. For people with more than one job, the questions referred to the characteristics of their main job – the job in which they worked the most hours."); Lawrence Katz and Alan Krueger, "Understanding Trends in Alternative Work Arrangements in the United States" *The Russell Sage Foundation Journal of the Social Sciences* 5;5 (December 2019) 132-146; Katharine Abraham *et al,* "The Rise of the Gig Economy: Fact or Fiction?" *American Economic Association Papers and Proceedings* 109 (2019) 357-361; Brett Collins *et al, Is Gig Work Replacing Traditional Employment? Evidence from Two Decades of Tax Returns,* IRS SOI Joint Statistical Research Program (March 25 2019) at 2 (available at https://www.irs.gov/pub/irs-soi/19rpgigworkreplacingtraditionalemployment.pdf); Barbara Robles and Marysol McGee, *Exploring Online and Offline Informal Work: Findings from the Enterprising and Informal Work Activities*

substantially understated the number of independent contractors in May 2017 by between 32 and 52 percent and also failed to account for subsequent growth in the labor force. It, therefore, adjusted the May 2017 estimate upward 78 percent (from 10.6 million to 18.9 million), which it concluded was "still an underestimate of the true independent contractor pool."[6]

Indeed, other estimates of the number of independent contractors are much higher. For example, a private sector survey conducted annually for the past decade by MBO Partners estimated there were 40.9 million independent workers in 2017, accounting for 26.5 percent of the workforce – nearly four times the contemporaneous CWS estimate.[7] Recent evidence also indicates that the number of independent workers is growing rapidly: Graphite, an online platform designed to connect businesses to independent experts, reported that spending on hiring on its platform grew by 170 percent in 2021 compared to 2020, and the number of new independent experts joining in 2021 grew by 39 percent compared to 2020.[8] Similarly, a study by Upwork examined the impact of COVID-19 on freelancing and found that 36 percent of the U.S. workforce (59 million people) had worked as a freelancer in 2020. Upwork found that the number of freelancers remained stable despite the short-term high unemployment that resulted from COVID-19.[9] While the total number of freelancers remained relatively constant between 2019 and 2020, COVID-19 created a large shift in the type of freelance work, with the number of full-time and part-time freelancers increasing and the number of full-time employees who earned additional income from freelance work decreasing.[10]

Table 1 below shows May 2017 CWS survey estimates for the number of independent contractors, by industry, in the U.S. workforce.

(EIWA) Survey, Federal Reserve Board Discussion Series 2016-089 (October 2016) at 7 (available at https://www.federalreserve.gov/econresdata/feds/2016/files/2016089pap.pdf) ("…IRS data from 1099Misc and 1099K income filers indicate a significant increase since the Great Recession, while self-employment and small business/sole proprietor data from Census surveys continue to decline.").

[6] Department of Labor, *Independent Contractor Status under the Fair Labor Standards Act, Final Rule*, RIN No. 1235-AA34 (January 2021) at 147. The Department based its conclusion on two studies, one from the U.S. Treasury and a second from Washington State Department of Commerce. See Katherine Lim *et al*, *Independent Contractors in the U.S.: New Trends from 15 years of Administrative Tax Data*, Department of Treasury (July 2019) at 61 (available at https://www.irs.gov/pub/irs-soi/19rpindcontractorinus.pdf). Washington Department of Commerce, *Independent Contractor Study* (July 2019) at 21 (available at https://deptofcommerce.app.box.com/v/independent-contractor-study).

[7] See MBO Partners, *The State of Independence in America 2017* (June 13, 2017) (available at https://www.mbopartners.com/state-of-independence/mbo-partners-state-of-independence-in-america-2017/). Workforce proportion is based on workforce as reported by BLS. The most recent MBO Partners survey indicated that the number of independent workers fell to 38.2 million in 2020, down from 41.1 million in 2019, primarily as a result of COVID-19. At the same time, the survey found that independent contractors continue to account for about 25 percent of the workforce. MBO Partners, *The State of Independence in America 2020* (December 9, 2020) at 3 (available at https://info.mbopartners.com/rs/mbo/images/MBO_Partners_State_of_Independence_2020_Report.pdf) (hereafter MBO 2020 Study). MBO also estimates independent contracting was responsible for $1.21 trillion in revenue, or 5.7 percent of Gross Domestic Product, in 2020. See MBO Study at 1.

[8] Graphite, *2022 State of On-Demond Hiring* at 5 (available at https://www.graphite.com/).

[9] Upwork, *Freelance Forward 2020* (September 2020) at 15 available at https://www.upwork.com/documents/freelance-forward-2020).

[10] Id. at 16.

TABLE 1:
INDEPENDENT CONTRACTORS BY GENERAL INDUSTRY (2017)

General Industry	Total Employed	Independent Contractors	% Independent Contractors
Real estate and rental and leasing	3,231,193	716,555	22.2%
Construction	10,484,172	2,047,784	19.5%
Administrative and support and waste management services	6,869,945	1,078,735	15.7%
Arts, entertainment, and recreation	3,319,230	507,588	15.3%
Other services, except private households	6,871,050	1,000,484	14.6%
Professional and technical services	11,462,217	1,581,045	13.8%
Transportation and warehousing	6,469,652	585,447	9.0%
Agriculture, forestry, fishing, and hunting	2,497,910	217,357	8.7%
Information	2,893,815	229,276	7.9%
Wholesale trade	3,383,361	157,992	4.7%
Retail trade	16,130,955	678,532	4.2%
Finance and insurance	7,408,455	305,234	4.1%
Private households	646,390	25,658	4.0%
Health care and social services	20,505,954	654,300	3.2%
Educational services	14,878,350	363,166	2.4%
Other	36,278,168	464,487	1.3%
Total	**153,330,818**	**10,613,639**	**6.9%**

Source: U.S. Bureau of Labor Statistics, "Current Population Survey: Contingent Worker and Alternative Employment Arrangements May 2017" (available at https://www.census.gov/data/datasets/time-series/demo/cps/cps-supp_cps-repwgt/cps-contingent.html). Note: The BLS considers "Management, Administrative and Support, and Waste Management Services" to be a major industry category, which combines the "Management of companies and enterprises" and "Administrative and support and waste management services" categories. "Other" includes Mining, Management of companies and enterprises, Manufacturing – durable goods, Utilities, Accommodation and food services, Manufacturing – non-durable goods, and Public Administration.

As the table shows, the CWS estimated that there were 10,613,639 independent contractors in the U.S. workforce in May 2017, or about 6.9 percent of the total workforce. The data also shows that independent contracting accounts for a significant portion of the labor force role in multiple sectors of the U.S. economy, including in industries as diverse as real estate, arts and entertainment, and agriculture and fishing – well beyond the so-called "gig economy" that has been a focus of much of the public policy debate around independent contracting.[11]

In Section III, we present data showing that independent contractors account for a higher proportion of the workforce in financial service occupations than in the economy overall.

[11] The extent to which the gig economy has resulted in increased independent contracting has been the subject of several studies. See e.g., Katherine Lim *et al*, *Independent Contractors in the U.S.: New Trends from 15 years of Administrative Tax Data*, Department of Treasury (July 2019) at 61 (available at https://www.irs.gov/pub/irs-soi/19rpindcontractorinus.pdf); Katharine Abraham *et al, Measuring the Gig Economy: Current Knowledge and Open Issues*, National Bureau of Economic Research Working Paper 24950 (August 2018) (available at http://www.nber.org/papers/w24950.pdf).

B. Economic Motivations for Independent Contracting

As the data above demonstrate, independent contracting is commonplace throughout the U.S. economy. From an economic perspective, the fact that workers and employers choose voluntarily to enter into such arrangements indicates they are enhancing economic welfare – i.e., that they generate gains from trade for both parties. Critics of independent contracting, on the other hand, argue that it can be used to exploit workers, for example by denying them fringe benefits (e.g., employer-provided health care) and legal protections (e.g., minimum wage, unionization rights) available to workers who are classified as employees. In this section, we review the evidence relating to the economic motivations for independent contracting for workers and for firms.[12]

1. Worker Motivations for Independent Contracting

Some critics of independent contractor relationships suggest employers frequently misclassify workers in order to benefit from a reduced worker costs and avoid having to follow labor laws that protect employees, i.e., that independent contracting is a form of exploitation of labor by business.[13] However, the argument that independent contracting results in labor exploitation is premised on the assumption that workers do not have a choice between being an independent contractor or an employee. Research into the preferences of workers clearly contradicts this view. Indeed, one of the most powerful economic explanations for the widespread use of independent contractor relationships is the well-researched fact that a majority of independent contractors are satisfied with their work arrangement *and* choose contracting because they prefer working as an independent contractor to an employment arrangement. That is, these workers have expressed what economists refer to as a "revealed preference" for independent contracting.[14]

A robust body of survey research finds that independent contractors express high levels of satisfaction with their work arrangements. For example, a 2020 survey by MBO Partners found that 76 percent of independent contractors were "very satisfied" with their work; another 2020 survey, conducted by the Coalition for Workforce Innovation, found that 62 percent of independent contractors were "very satisfied" another 32 percent "somewhat" satisfied.[15] Further, the majority of independent contractors prefer their work arrangements to traditional employment. As Table 2 shows, the 2017 CWS survey found that 79 percent of respondents preferred being an independent contractor to working as a traditional employee, whereas only nine percent would have preferred to be a traditional employee. Consistent with the reported preference for independent contracting

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[12] See also Eisenach, *The Role of Independent Contractors*.

[13] See, e.g., National Employment Law Project, *Independent Contractor Misclassification Imposes Huge Costs on Federal and State Treasuries* (October 2020) (available at https://s27147.pcdn.co/wp-content/uploads/Independent-Contractor-Misclassification-Imposes-Huge-Costs-Workers-Federal-State-Treasuries-Update-October-2020.pdf).

[14] For a discussion of revealed preference, see OMB Circular A-4 (September 2003) at 20-22 (available at https://www.whitehouse.gov/wp-content/uploads/legacy_drupal_files/omb/circulars/A4/a-4.pdf).

[15] MBO 2020 Study at 7 ("In 2020, 76 percent said they were very satisfied, with only 21 percent neutral."); Coalition for Workforce Innovation, *National Survey of 600 Self-Identified Independent Contractors* (January 2020) at 5 ("62% say they are very satisfied with their current independent work arrangement and 32% are somewhat satisfied."). The MBO survey also found that worker the level of job satisfaction among independent contractors has been increasing (MBO Survey at 7: "In 2011, 58 percent of independents proclaimed themselves very satisfied, while 38 percent were neutral. In 2020, 76 percent said they were very satisfied, with only 21 percent neutral.").

in the BLS survey, a McKinsey Global Institute survey found 70 percent of independent contractors chose this work arrangement over being an employee.[16]

TABLE 2:
INDEPENDENT CONTRACTOR
PREFERENCES FOR TRADITIONAL WORK (2017)

Preference	Independent Contractors	%
Prefer Independent Contracting Work	8,397,920	79.1%
Prefer Traditional Work	938,434	8.8%
Depends	801,320	7.5%
Did Not Respond	475,965	4.5%
Total	**10,613,639**	**100.0%**

Source: U.S. Bureau of Labor Statistics, "Current Population Survey: Contingent Worker and Alternative Employment Arrangements May 2017" (available at https://www.census.gov/data/datasets/time-series/demo/cps/cps-supp_cps-repwgt/cps-contingent.html). Note: "Did Not Respond" includes those that did not respond, refused to respond, or did not know.

Surveys of independent contractors also confirm the economic conclusion that workers choose to be an independent contractor when they prefer the characteristics of that work arrangement over that of a traditional employee, in addition to the other work arrangements available. Workers report a variety of reasons why they prefer working as an independent contractor. The top ranked characteristics of independent contracting are the ability to be your own boss and flexible working conditions.[17] The 2017 CWS survey results shown in Table 3 show that 28 percent of workers who are primarily independent contractors say they contract mainly because they prefer being their own boss, while 27 percent are motivated by flexibility of schedule.[18]

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[16] James Manyika *et al, Independent Work: Choice, Necessity, and the Gig Economy,* McKinsey Global Institute (October 2016) at 5 (hereafter Maniyika *et al* (2016)) (available at https://www.mckinsey.com/featured-insights/employment-and-growth/independent-work-choice-necessity-and-the-gig-economy). ("70% of independent workers are independent by choice and 40% of independent workers earn supplemental income from their independent work."). See also MBO 2020 Study at 9 ("The results have been consistently positive, with 83 percent of full-time independents saying they are "happier working on my own" and 71 percent saying that "working on my own is better for my health.").

[17] MBO 2020 Study at 6 ("A very consistent theme across the ten years of the MBO Partners State of Independence research series is that independent workers choose to be independent for the autonomy, flexibility, and control it provides.").

[18] Another survey of independent contractors in 2020 found 21 percent preferred contracting because they could be their own boss or work independently, 18 percent preferred contracting because it provided work flexibility, and another 18 percent reported preferring contracting because of the work hours. See Coalition for Workforce Innovation, *National Survey of 600 Self-Identified Independent Contractors* (January 2020) at 6.

TABLE 3:
REASONS FOR CHOOSING TO WORK AS AN INDEPENDENT CONTRACTOR (2017)

Main Reason	%
Enjoys being own boss/independence	28.4%
Flexibility of schedule	26.9%
Money is better	8.5%
Other personal	6.9%
Only type of work could find	5.6%
Other economic	4.1%
Other family/personal obligations	3.4%
For the money	2.6%
Nature of work/seasonal	2.2%
Retired/SS earnings limit	1.2%
All other reasons	4.7%
No Response	5.3%
Total	**100.0%**

Source: U.S. Bureau of Labor Statistics, "Current Population Survey: Contingent Worker and Alternative Employment Arrangements May 2017" (available at https://www.census.gov/data/datasets/time-series/demo/cps/cps-supp_cps-repwgt/cps-contingent.html). Note: "Did Not Respond" includes those that did not respond or refused to respond and those that didn't know or to whom the question did not apply.

This evidence demonstrates that, for many workers, *independent contracting is the preferred labor market choice* – that is, workers would be worse off if independent contracting were not available as an option. While some workers prefer traditional employment, the labor force is characterized by heterogenous preferences for different types of work arrangements.[19] For example, women are more likely than men to report preferring independent contracting due to the flexibility it provides them.[20] Thus, independent contracting allows more women to choose to work the hours or days that fit their personal needs. Similarly, older workers are more likely to have independent contracting as their primary source of income, but young workers are more likely to engage in

[19] Indeed, the evidence suggests that, overall, there is no measurable difference in overall quality of life between traditional employees and independent contractors. (See e.g., Gallup and Intuit-QuickBooks, *Gig Economy and Self-Employment Report* (2019) at 36 (available at https://quickbooks.intuit.com/content/dam/intuit/quickbooks/Gig-Economy-Self-Employment-Report-2019.pdf) ("When asked to rate where they are now, self-employed workers show no statistically significant difference with traditionally employed workers. Likewise, there is no difference in health status, using a 1-5 scale of overall health.").

[20] MBO 2020 Study at 6 ("Yet, in spite of close-to-parity gender participation rates in the independent workforce over the past decade, men and women have generally emphasized different factors for choosing independent work. In 2017, for example, men were more likely than women to note that they love being their own boss (69 percent vs. 55 percent). While 54 percent of men report they earn more money working on their own than at a traditional job, only 43 percent women said so. Women are significantly more likely to note that flexibility was a more important motivator for independent work than men (74 percent vs. 59 percent). The 2020 female/male attitudinal findings are consistent with prior years, but the share of women independents fell from averaging around 50 percent throughout the study to 42 percent in 2020.").

supplementary contracting work, especially from online platforms.[21] In these ways, the flexibility of independent contracting allows workers to adjust the amount of time worked (and earnings) in response to changes in their life situations, i.e., to optimize their "labor-leisure" tradeoff. Independent contracting also benefits workers with a low preference for fringe benefits (e.g., those who receive benefits through a spouse or life partner or other employment); indeed, a significant body of evidence shows that workers engaged in independent contracting earn higher pecuniary incomes (and have fewer fringe benefits) than employees.[22]

2. Employer Motivations for Independent Contracting

Employers also benefit from independent contracting. First, offering workers who *prefer* to work as independent contractors the opportunity to do so leads to lower overall labor costs because those same workers would demand more in total compensation if they were deprived of the autonomy, flexibility and other job characteristics they value about independent contracting.[23] Second, independent contracting provides flexibility for employers as well as employees. Such flexibility is especially important when firms are faced with the need to adjust output to accommodate short-term fluctuations in demand.[24] From an economic perspective, an employment relationship involves both one-time and continuing fixed costs.[25] One-time costs include, on the front end, the expenses associated with setting up payroll and benefit programs, acquiring the capital needed to support the worker's activities (e.g., logging equipment or a taxicab), providing training, and complying with various Federal, state and local mandates. On the back end, they include the costs of separation, including, typically, severance pay. Continuing costs include the employee's weekly or monthly payroll or salary payments (plus benefits) and employee-related overhead, which typically must be paid whether or not the employee is fully occupied.

When a firm expects stable demand in the future, the fixed costs for a worker expected to work full time or part-time in a single position for an indefinite period may be worth incurring in return for the benefits of the employment relationship, including the assurance that the employee will, barring sickness or other unusual circumstances, always be available, and the ability to task the employee, within reasonable bounds, to perform work at the employer's direction.[26]

In some sectors and some occupations, the benefits of traditional employment are overshadowed by the costs, particularly when demand is unpredictable or sporadic. A courier service, for example,

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[21] Brett Collins *et al, Is Gig Work Replacing Traditional Employment? Evidence from Two Decades of Tax Returns,* IRS SOI Joint Statistical Research Program (March 25 2019) at 17 (available at https://www.irs.gov/pub/irs-soi/19rpgigworkreplacingtraditionalemployment.pdf).

[22] See e.g., MBO Partners, *The State of Independence in America 2019* (2019) at 9 (available at https://www.mbopartners.com/state-of-independence/mbo-partners-state-of-independence-in-america-2019/); Maniyika *et al* (2016) at 15.

[23] The converse is also true – people who prefer traditional employment would demand more in total compensation to work as independent contractors. The point is that both firms and workers benefit when they have the ability to match heterogenous job characteristics to a heterogenous workforce.

[24] See e.g., Alexandre Mas and Amanda Pallais, "Alternative Work Arrangements," *Annual Review of Economics* 12 (2020) 631-658 at 649

[25] Fixed costs are costs which do not vary with output – in this case, costs associated with an individual employee which do not vary with the employee's output.

[26] For a scholarly treatment of the employment relationship from a law and economics perspective, see Scott E. Masten, "A Legal Basis for the Firm," *Journal of Law, Economics & Organization* 4;1 (Spring 1988) 181-198.

would be far less efficient if, rather than being able to call on any one of dozens or hundreds of independent contractors when demand surges or a package needs to be picked up from a particularly remote area, it could only utilize its own employees. Similarly, a construction firm would have higher costs if it were forced to hire specialists (such as tile layers) as traditional employees for which it has only transitory demand.[27]

Another economic rationale for independent contracting relates to the costs of monitoring and incentivizing performance. In a famous 1937 article, Nobel Prize laureate Ronald Coase asked why employers enter into employment relationships in the first instance, rather than simply hiring all of their inputs, labor included, through contracts.[28] Coase's central insight was that employer-employee relationships are most efficient when the costs of using the price mechanism (i.e., of independent contracting) are relatively high – for example, where it is difficult or impossible for the employer to describe in advance the specific activities workers are expected to perform, or to place a value on workers' output.[29] In such situations, employers and employees are more likely to agree on "relational" contracts, that is, contracts in which workers are paid a set wage or salary in return for allowing the employer, within limits, to direct their activities.

Coase's thesis explains why independent contracting is especially commonplace in occupations and industries where output is relatively easily measured and workers can thus be compensated directly for their performance: A trucker may be compensated by the mile, a courier by the package, a brick mason by the number of bricks laid, a logger by the volume of wood harvested, and an insurance agent or financial advisor by the volume of sales or the performance of clients' portfolios.

Finally, some independent contracting relationships have developed in part as a means of coping with sector-specific legal barriers to employment or other forms of government regulation. For example, independent truck drivers can drive under a firm's motor carrier license instead of having to obtain their own motor carrier license.[30] As we discuss in Section III, sector-specific regulation is an important motivator for the use of independent contracting in the financial services sector.

III. Independent Contracting in the Finance and Insurance Industry

Independent contracting plays an essential role in the financial services and insurance industry, especially in customer-facing occupations such as licensed financial advisors, securities sales agents and insurance agents. In the first subsection below, we present data on the extent of independent contracting in financial service occupations which shows that there are roughly half a million workers serving as independent contractors in these sectors. In the second subsection, we examine more closely the specific roles played by independent contractors and show that the use of independent contractors in these roles is driven by economic efficiency considerations on both the supply- and demand-side of the market: (1) Workers choose independent contracting because it provides flexibility, allows them to capture the rewards of entrepreneurship by building their

[27] See e.g., Katharine G. Abraham and Susan K. Taylor, "Firms' Use of Outside Contractors: Theory and Evidence," *Journal of Labor Economics* 14;2 (July 1996) 394-424.

[28] R. H. Coase, "The Nature of the Firm," *Economica* 4;16. (November 1937) 386-405.

[29] Id. at 392.

[30] Department of Transportation Federal Motor Carrier Safety Administration § 382.107 acknowledges the role of independent contractors driving under another firm's license.

own businesses and provides a means of complying with applicable regulatory requirements; and, (2) the public benefits because independent contracting allows firms to efficiently expand their customer-facing workforce, thereby offering more services to more customers than would otherwise be possible.

A. Extent of Independent Contracting in Financial Services and Insurance

To assess the extent of independent contracting in the financial services and insurance sectors, we gathered and analysed data from several sources. We begin by presenting data from the May 2017 CWS, which reports that there were more than 300,000 workers serving as independent contractors in the financial service sector and in financial service occupations in other sectors. As we next explain, other evidence, including industry data, suggests the true figure is much higher.

Our analysis of the CWS data focuses the use of independent contractors in the Finance and Insurance Sector (NAICs 52) (the "financial services sector"), as well as on workers serving in three specific financial service occupational categories – Personal Financial Advisors ("Financial Advisors"), Securities, Commodities and Financial Services Sales Agents ("Securities Agents"), and, Insurance Sales Agents ("Insurance Agents") – in all industry sectors. Table 4 presents the May 2017 CWS estimates data for these categories.

TABLE 4:
INDEPENDENT CONTRACTORS IN FINANCIAL SERVICES (2017)

Industry and Occupation	Total Employed	Independent Contractors	% Independent Contractors
Finance and Insurance Industry			
Financial Advisors	482,657	55,250	11.4%
Securities Agents	233,852	20,759	8.9%
Insurance Agents	572,182	97,657	17.1%
Subtotal, Financial Occupations	**1,288,692**	**173,666**	**13.5%**
Other Occupational Categories	*6,119,764*	*131,568*	*2.1%*
Subtotal Finance and Insurance Industry	**7,408,455**	**305,234**	**4.1%**
Other Industries with Independent Contractors in Financial Occupations			
Financial Advisors	34,425	18,167	52.8%
Securities Agents	2,534	2,534	100.0%
Insurance Agents	4,228	0	0.0%
Subtotal Other Industries	**41,187**	**20,701**	**50.3%**
Total	**7,449,642**	**325,934**	**4.4%**

Source: U.S. Bureau of Labor Statistics, "Current Population Survey: Contingent Worker and Alternative Employment Arrangements May 2017" (available at https://www.census.gov/data/datasets/time-series/demo/cps/cps-supp_cps-repwgt/cps-contingent.html). Note: There are industries that are not listed here with Financial Advisors, Securities Agents, and Insurance Agents who are not independent contractors.

As the table shows, the CWS estimates show a total of 326,025 independent contractors working either in the financial service sector or in financial service occupations at firms classified in other sectors by BLS. Of these, 305,324 people worked in the financial services sector itself, including 55,250 Financial Advisors, 20,759 Securities Agents, 97,657 Insurance Agents and 131,568

people in other occupational categories.[31] In addition, 18,167 independent contractors worked as Financial Advisors in the Professional and Technical Services sector and 2,534 independent contractors worked as Securities Agents in the Real Estate, Rental and Leasing sector.

As the table also shows, independent contractors account for high proportions of the workers in these occupations: For example, 13.5 percent of all financial advisors, securities agents and insurance agents in the financial and insurance industry are independent contractors, nearly double the 6.9 percent of workers in the overall U.S. workforce.

These estimates understate both the extent and economic significance of independent contracting in the financial services sector for at least four reasons. First, as discussed above, the CWS data counts only workers for whom independent contracting is their main source of income. However, many independent contractors in the financial service sector work in financial services as a second job. For example, insurance agents can begin selling products on a schedule they control, which enables them to hold full-time employment while exploring whether a career in the industry is best for them.[32]

Second, by only counting independent contracting during a single week (typically the week prior to the interview of the individuals sampled), the CWS data understate the number of independent contractors active at some point during the sampling year.[33] That is, by design, the CWS survey only estimates how many independent contractors were working in a particular week, not the cumulative number of individuals working as independent contractors annually (or even monthly). For the same reason, the survey results fail to capture seasonality. For example, insurance sales exhibit strong seasonality, with new premium sales peaking in the fourth quarter.[34] It is likely that the use of independent contractors is correlated with demand – i.e., that independent contracting in insurance is highest in the fourth quarter of each year. Because the CWS survey was conducted in May, it would not capture these workers.

Third, respondents to the CWS survey who are independent contractors from a legal perspective may incorrectly identify as employees.[35] This possibility of misreporting is particularly salient in the insurance industry as some insurance producers may be independent contractors under common law rules but classified as statutory employees for certain employment tax purposes.[36]

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[31] Other occupational categories with significant numbers of independent contractors include first line supervisors (31,847), managers (27,299) and chief executives (24,194), who together account for another 27 percent of ICs working in the sector. It is likely these self-reported job categories include individuals working as entrepreneurs or managers while performing functions similar or identical to those of financial advisors, securities agents and insurance agents.

[32] See e.g., Primerica, *Primerica 2020 Annual Report* at 3. The CWS survey estimates that, even among independent contractors who report that financial services work is their main source of income, 17.4 percent report working part-time rather than full-time.

[33] Department of Labor, *Independent Contractor Status under the Fair Labor Standards Act, Final Rule*, RIN No. 1235-AA34 (January 2021) (hereafter Department of Labor, *Independent Contractor Status under the Fair Labor Standards Act, Final Rule*) at 144.

[34] Aflac, *Form 10-K for the Year Ended December 31, 2020* (February 17, 2021) at 6.

[35] Department of Labor, *Independent Contractor Status under the Fair Labor Standards Act, Final Rule* at 145-146.

[36] Internal Revenue Service, "Statutory Employees" (available at https://www.irs.gov/businesses/small-businesses-self-employed/statutory-employees).

Specifically, many insurance firms "primarily or solely employ statutory employees to distribute their life an annuity products" allowing full-time agents "to be treated as employees for employment tax purposes (whereby they and the company they provide services for are subject to FICA tax), while maintain their independent contractor status (reporting their income on a Schedule C)."[37]

Fourth, as we discuss further in Section IV below, independent contractors in the financial sector often operate their own businesses and hire traditional employees. Prohibitions on independent contracting that made it difficult or impossible to continue operating such businesses would thus have effects on their traditional employees, as well as on the independent contractor entrepreneurs who establish and build equity in the businesses they run.

As noted in Section II, the Department of Labor in its 2020 analysis of independent contracting adjusted the CWS estimates of upward by 78 percent.[38] Applying the same adjustment to the financial services sector yields an estimate of 580,163 independent contractors,[39] which is broadly consistent with private sector estimates. For example, the American Council of Life Insurers (ACLI) estimates that there are 704,100 independent agents who sell life insurance products in the U.S.[40] The Financial Services Institute (FSI) estimates that there are over 160,000 independent financial advisers.[41]

To further understand the extent of independent contracting, we also examined publicly available data from the financial reports of selected financial service and insurance firms showing their reliance on independent contractors. Specifically, we gathered and analysed financial reports from 17 major financial services firms which report using independent contracting to assess the extent of their reliance on independent contractors versus traditional employees. The results of our analysis are summarized in Table 5.

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[37] ACLI, *Comments on Proposed Rulemaking on Independent Contractor Status Under the Fair Labor Standards Act,* Department of Labor, Regulatory Information Number 1235-AA34 (October 26, 2020) (hereafter ACLI, *Comments on Proposed Rulemaking*) at 2.

[38] 18.9 million / 10.6 million = 0.783.

[39] 325,934 * 1.783 = 580,325.

[40] ACLI, *Comments on Proposed Rulemaking* at 1, n. 2.

[41] Financial Services Institute, *Comments on Regulatory Information Number 1235-AA34 - Independent Contractor Status Under the Fair Labor Standards Act,* Department of Labor, RIN 1235-AA34 (October 26, 2020) (hereafter FSI, *Comments on Regulatory Information Number 1235-AA34*) at 1.

TABLE 5:
INDEPENDENT CONTRACTORS AT SELECTED FINANCIAL INSTITUTIONS

Firm	Independent Contractors	Total Workforce	% Independent Contractors
Aflac	6,500	11,406	57.0%
Allstate	43,600	85,760	50.8%
American Family	3,000	13,000	23.1%
Ameriprise	7,800	20,100	38.8%
Cetera	3,750	5,250	71.4%
Farmers Insurance	48,000	50,100	95.8%
Guardian	2,500	11,500	21.7%
Horace Mann	1,000	2,490	40.2%
LPL Financial	16,000	20,300	78.8%
MassMutual	7,600	17,574	43.2%
New York Life	12,000	23,000	52.2%
Northwestern Mutual	10,500	17,200	61.0%
Primerica	122,597	125,397	97.8%
Raymond James	5,000	19,800	25.3%
State Farm	19,200	76,700	25.0%
Transamerica	48,032	55,702	86.2%
Western & Southern	84,000	87,800	95.7%
Total	**441,079**	**643,079**	**68.6%**

Source: Company Financial Reports

As the table shows, these 17 firms alone report utilizing a total of 441,079 independent contractors, representing 69 percent of their total workforce. While this data represents only a subset of the industry, it supports our finding that independent contracting plays a very significant economic role in the financial services and insurance sectors, especially for particular firms and particular occupational categories.[42]

B. Economic Efficiency Benefits of Independent Contracting in Financial Services

As the data above show, the primary roles played by independent contractors in the financial services and insurance industries are customer facing: in financial services they serve primarily as securities agents and financial advisors, while in the insurance sector they primarily work as insurance agents. These roles are not mutually exclusive: as individuals may hold multiple certifications and offer a variety of financial and insurance products, including multiple lines of

[42] Because these data are by definition a subset of the overall industry, they understate the number of independent contractors working at financial service firms. On the other hand, as discussed below, some independent contractors may work for multiple firms, meaning that the reported figures may overstate the number of unique individuals working as independent contractors for these firms.

insurance (e.g., life, accident, critical illness, short-term disability, identity protection, homeowners and auto insurance)[43] and a full array of financial advisory services (e.g., financial planning and investment advice, retirement solutions, and wealth management) as well as securities brokerage.[44] Independent contractors in both the financial and insurance sectors are typically paid by commissions and other variable forms of compensation tied directly to performance.[45]

Financial advisors and insurance agents may choose to work with a single firm that offers independent contracting opportunities, employment opportunities, or both. Alternatively, they may choose to create their own firm where they can contract with multiple firms to offer their products. Those choosing to be independent, either with a single firm or multiple firms, each have the opportunity to build and operate their own businesses. Independent financial advisors and insurance agents choosing to work with a single firm benefit by receiving ongoing training and extensive support in terms of business operations and regulatory compliance,[46] which is particularly valuable given the extensive regulatory requirements governing the industry.[47]

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[43] Allstate, *Form 10-K for the Year Ended December 31, 2020* (February 19, 2021) at 3.

[44] LPL Financial Holdings, *Form 10-K for the Year Ended December 31, 2020* (February 23, 2021) at 1-2.

[45] See J. David Cummins & Neil A. Doherty, "The Economics of Insurance Intermediaries," *Journal of Risk and Insurance* 73;3 (2006) 359-396 at 374-375; see also Allstate, *Form 10-K for the Year Ended December 31, 2020* (February 19, 2021) at 3; LPL Financial Holdings, *Form 10-K for the Year Ended December 31, 2020* (February 23, 2021) at 4.

[46] See Securities Industry and Financial Markets Association, *The PRO Act and "ABC" Test Briefing* (Spring 2021) ("Independent financial advisors choose to be independent contractors so that they can own their own business. They determine their hours, buy or rent their office space, employ staff, select and manage vendors, and are typically responsible for their expenses and benefits. This provides great flexibility and can be very rewarding. Notably, independent financial advisors create their own client base and decide the best way to serve them, since they know their clients best. They have branding control and build their own client-service model. Their clients are a valuable asset, and while retention is high, should they choose to affiliate with another broker-dealer, clients often follow."); see also National Association of Insurance and Financial Advisors, *Comments Re: Proposed Rule on Independent Contractor Status Under the Fair Labor Standards Act,* Department of Labor, RIN 1235-AA34 (October 26, 2020) ("For instance, insurance producers – who may opt to operate their own businesses while engaging in substantial contractual relationships with one or more insurance companies – will often work with insurance companies to jointly set forth the terms of their relationship to ensure that the producer can maintain their independence, sell a diverse array of products on behalf of multiple insurance companies, and retain the right to direct or control their work and opportunity for profit or loss. Similarly, NAIFA members who are jointly licensed as insurance producers and broker-dealer representatives and/or independent registered investment advisors may own and operate their own small business, maintain flexibility over their business model and their product offerings, and exert independent control over their business operations."); and, Robert W. Klein, *A Regulator's Introduction to the Insurance Industry,* National Association of Insurance Commissioners (2005) at 26 (hereafter Klein, *A Regulator's Introduction to the Insurance Industry*) (available at https://www.naic.org/documents/prod_serv_marketreg_rii_zb.pdf). Academic evidence indicates that independent status promotes economic efficiency by strengthening the incentives of agents to accurately assess customer risk characteristics. See Laureen Regan and Sharon Tennyson, "Agent Discretion and the Choice of Insurance Marketing System," *Journal of Law and Economics* 39;2 (1996) 637-666 at 645 ("In sum, the independent agent's multiple placement opportunities and ownership of policy expirations reinforce the agent's incentives to obtain risk information about applicants.").

[47] Financial advisors and insurance agents offering securities products are required by law to affiliate with a broker-dealer firm who must supervise them for the protection of investors. Various state insurance laws also require similar supervision when distributing insurance products.

Regardless of whether they represent multiple firms or a single firm, independent contractors in the financial services and insurance industries own and operate their own businesses, including hiring employees, paying expenses, earning profits based on their business success and accumulating equity that can be sold or passed on to heirs. [48] In particular, independent contractors serving as insurance agents and financial advisors and brokers own their client relationships.[49] Independent contractors can also operate their financial or insurance businesses on a part-time basis, sometimes as a second job.

Independent contracting allows firms to engage large numbers of customer-facing sales and service representatives at low cost, with compensation tied directly to effort and commercial success. As a result, it generates significant benefits for both financial service firms and their customers, many of whom would otherwise go unserved. As discussed below, a significant body of evidence suggests that under-consumption of financial advisory services leads to reduced savings and wealth accumulation. In other words, multiple distribution models that include independent contracting results in more job opportunities, products and services for a greater number of individuals.

Those choosing to be independent contractors benefit in multiple ways. First, survey evidence from the CWS, shown in Table 6, indicates that the factors motivating workers to choose independent contracting in the financial sector are similar to those for overall workforce, except that compensation plays a larger role in financial occupations.

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[48] FSI, *Comments on Regulatory Information Number 1235-AA34* at 2 ("As previously discussed, FSI's financial advisor members have an independent contractor relationship with our IBD member firms. As independent contractors, financial advisors own their own business, provide their own start-up capital, experience profit and loss based on their own business success, dictate their own business practices, pay their own operating expenses, have complete flexibility on personnel issues, and report their compensation on Internal Revenue Service (IRS) Form 1099.")

[49] See Klein, *A Regulator's Introduction to the Insurance Industry* at 26 ("Independent agents can represent more than one insurer and 'own' their book of business."); see also Securities Industry and Financial Markets Association, *Comments on Regulatory Information Number 1235-AA34,* Department of Labor, RIN 1235-AA34 (October 26, 2020) at 2 (hereafter SIFMA *Comments on Regulatory Information Number 1235-AA34*) ("Importantly, FAs own the relationship with their clients – the most valuable asset in the securities industry – and an important reason that some individuals choose to operate as an independent contractor. In short, operating as an independent contractor encompasses the flexibility that these entrepreneurs may require to be successful as it provides them the ability to more easily transition their client base when they choose to change the [broker dealer] they affiliate with.").

TABLE 6:
REASONS FOR CHOOSING TO WORK AS AN INDEPENDENT CONTRACTOR, FINANCIAL OCCUPATIONS (2017)

Main Reason	% ICs in Finance Occupations	% ICs in Overall Workforce
Flexibility of schedule	26.1%	26.9%
Enjoys being own boss/independence	24.7%	28.4%
Money is better	21.0%	8.5%
Other personal	5.6%	6.9%
Only type of work could find	5.0%	5.6%
Retired/SS earnings limit	2.3%	1.2%
Other economic	2.3%	4.1%
Other family/personal obligations	2.2%	3.4%
Nature of work/seasonal	0.9%	2.2%
For the money	0.4%	2.6%
All other reasons	0.0%	4.7%
No response	9.5%	5.3%
Total	**100.0%**	**100.0%**

Source: U.S. Bureau of Labor Statistics, "Current Population Survey: Contingent Worker and Alternative Employment Arrangements May 2017" (available at https://www.census.gov/data/datasets/time-series/demo/cps/cps-supp_cps-repwgt/cps-contingent.html). Note: "No Response" includes those that did not respond or did not know.

As the table shows, the top three factors motivating workers to choose independent contracting in financial services jobs are the same as for the workforce overall: flexibility, autonomy and compensation. For financial services, however, compensation plays a much larger role: 21 percent of respondents offer "money is better" as their main reason for choosing independent contracting, compared with just 8.5 percent for the workforce overall. These factors are consistent with the fact, discussed above, that financial sector independent contractors are entrepreneurs who own their own businesses and have an opportunity to both earn profits and build equity.

Moreover, independent contractors operate in a highly competitive market in which financial service firms compete for their business by seeking to offer the most attractive combinations of compensation, benefits and support.

As Aflac explains:

> The Company competes with other insurers and financial institutions primarily on the basis of its products, compensation, support services and financial rating. The Company's sales associates, brokers and other distribution partners are independent contractors and may sell products of its competitors. *If the Company's competitors offer products that are more attractive, or pay higher commissions than the*

Company does, any or all of these distribution partners may concentrate their efforts on selling the Company's competitors' products instead of the Company's.[50]

Similarly, Allstate's 10-K reports that there is "significant competition for producers, such as exclusive and independent agents and their licensed sales professionals."[51]

Another important benefit enjoyed by independent contractors is the ability to lower the costs of complying with substantial regulatory requirements unique to the financial service and insurance industries. Financial advisors, whether employees or independent contractors, must pass a series of exams to be licensed. FINRA-certified financial advisor take the Series 6 or Series 7 exams and the Series 63 exams required by the state in which they expect to work.[52] In addition to being licensed with the FINRA, under the Securities Exchange Act of 1934, independent financial advisors are required to be either a SEC registered broker-dealer or associated with a SEC registered broker-dealer.[53] Working in association with a registered broker-dealer provides an opportunity for independent financial advisors to avoid the expensive and time-consuming undertaking of registering with the SEC. Moreover, the broker-dealer handles the independent financial advisors' licensing and registration with FINRA. Moreover, the affiliated broker-dealer also arranges for the execution and clearing of securities transactions.[54] Therefore, associating with a

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[50] Aflac, *Form 10-K for the Year Ended December 31, 2020* (February 17, 2021) at 20 (emphasis added).

[51] Allstate, *Form 10-K for the Year Ended December 31, 2020* (February 19, 2021) at 25. See also Financial Services Institute, *Comments on Regulatory Information Number 1235-AA34 - Independent Contractor Status Under the Fair Labor Standards Act,* Department of Labor, RIN 1235-AA34 (October 26, 2020) at 4 ("A financial advisor is not captive to their broker-dealer because they can choose to go to another firm at any time. Because there are many IBD firms in a competitive market, independent financial advisors frequently switch broker-dealer affiliations taking their books of business with them. In other words, independent financial advisors do not have to start over when moving firms because it is understood that it is "their business" and "their clients"; the IBD plays a supporting role. This is different from a classic employment relationship where the worker switching employers must start their business anew. Further, the majority of independent financial advisors have aspects of their business that are outside the scope of their relationship with an IBD firm (also called outside business activities or OBAs). Because of the unique relationship between financial advisors and their clients, many clients turn to their financial advisor for additional services such as insurance, accounting, tax preparation, or other financial-related expertise that are outside the scope of the services requiring a financial advisor to hold a securities license and affiliate with a broker-dealer. OBAs provide clients with the convenience of receiving related services from one professional whom they trust and who also has sophisticated knowledge of their entire financial situation. An IBD firm must approve a financial advisor's OBAs, but it does not control them.").

[52] See FINRA, "Qualification Exams," (available at https://www.finra.org/registration-exams-ce/qualification-exams). Investment advisors must also pass the exam. See also, Investopedia, "Series 65," available at https://www.investopedia.com/terms/s/series65.asp).

[53] See U.S. Securities and Exchange Commission, "Guide to Broker-Dealer Registration" (December 12, 2016) (available at https://www.sec.gov/reportspubs/investor-publications/divisionsmarketregbdguidehtm.html). ("We call individuals who work for a registered broker-dealer 'associated persons.' This is the case whether such individuals are employees, independent contractors, or are otherwise working with a broker-dealer. These individuals may also be called "stock brokers" or "registered representatives." Although associated persons usually do not have to register separately with the SEC, they must be properly supervised by a currently registered broker-dealer. They may also have to register with the self-regulatory organizations of which their employer is a member – for example, the Financial Industry Regulatory Authority, Inc. ("FINRA") (f/k/a the National Association of Securities Dealers, Inc. ("NASD")) or a national securities exchange. To the extent that associated persons engage in securities activities outside of the supervision of their broker-dealer, they would have to register separately as broker-dealers." See also, FSI, *Comments on Regulatory Information Number 1235-AA34* at 2.

[54] FSI, *Comments on Regulatory Information Number 1235-AA34* at 2.

broker-dealer facilitates independent financial advisors' business operations by providing an easier route through complex financial regulations and gives them access to the tools they need to develop a client base. Although broker-dealers must, in turn, supervise the securities activities of their associated independent financial advisors, this requirement is imposed on them by federal and state regulations, and not a reflection of employer control.[55] To this point, language was added to the IRC by the 1997 Taxpayer Relief Act to clarify that "supervision for compliance with securities laws cannot be interpreted as control for the purpose of an employment relationship."[56]

The insurance sector is also highly regulated, and companies must conform to complex Federal and state laws.[57] At the Federal level, the Federal Insurance Office and Financial Stability Oversight Council supervise insurance companies.[58] However, insurance companies are primarily overseen by state insurance regulators, creating a network of laws and regulations that national firms must navigate.[59] Moreover, agent licensing requirements are also set at the state level.[60] Due to licensing requirements, all insurance agents – both employees and independent contractors – are subject to an array of state regulations in place to protect consumers. These state regulations require that each insurance company supervise the agents selling its products.[61] As a result, for transactions of products such as variable insurance and variable annuity products, independent insurance agents are restricted to working with a single broker-dealer.[62] As with independent financial advisors, due to federal and state regulations, insurance companies are required to play more of a supervisory role over insurance agents than would be expected with a business-to-business relationship. Despite the regulatory requirements for supervision, in 2019, the Sixth Circuit court decided that insurance sales agents at American Family Insurance were in fact independent contractors, not employees.[63]

In summary, the evidence presented above demonstrates that independent contracting plays an essential role in the finance and insurance sectors by providing an economically efficient mechanism for suppliers to expand their customer-facing workforces while satisfying regulatory requirements, thereby reaching customers who would otherwise not have access to financial services. Further, independent contracting allows hundreds of thousands of people to become entrepreneurs in the financial services industry, sometimes as a means of supplementing their income and in other cases by starting and building successful businesses.

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[55] Id. at 2 and 4.

[56] Id. at 5 (citing Conference Report to Accompany H.R. 2014, Taxpayer Relief Act of 1997, Rpt, 105-220 at 457, 105th Congress (July 30, 1997) available at: https://www.congress.gov/105/crpt/hrpt220/CRPT-105hrpt220.pdf).

[57] Allstate, *Form 10-K for the Year Ended December 31, 2020* (February 19, 2021) at 28.

[58] Id. at 29.

[59] ACLI, *Comments on Proposed Rulemaking* at 2.

[60] Ibid.

[61] Id. at 2-3.

[62] Id. at 3.

[63] *Jammal v. American Family Insurance Co*., No. 17-4125 (6th Cir. 2019)

IV. Economic Effects of Restricting Independent Contracting in the Financial Services Sector

In this section we present our analyses of the economic impact of eliminating or substantially restricting the use of independent contracting in the financial service and insurance sectors. The first subsection focuses on the impact on financial advisors and insurance agents who are able to operate their own businesses as a result of their ability to affiliate as independent contractors with securities firms and insurance companies. As we explain, our analysis indicates that employment and other measures of economic activity in both the financial service and insurance sectors would be substantially reduced. In the second subsection, we estimate the impact of restricting contracting on economic output – i.e., on the actual output of financial advisory and insurance services – and the resulting harm that would be done to consumer welfare, especially low- and moderate-income households who would no longer benefit from these services.

A. Effects on Employment and New Business Formation

As discussed above, independent contracting enables workers in financial and insurance occupations to function as entrepreneurs, growing and operating their own businesses, while still complying with stringent financial and insurance sector regulations. Prohibiting or severely limiting independent contracting would damage or eliminate this business model. Our analysis of the impact of such restrictions focuses on the effects on the thousands of small businesses operated by independent contractor entrepreneurs in the finance and insurance industry and their employees.

To estimate the number of businesses owned by independent contractors in the finance and insurance sector, we utilize the U.S. Census Bureau's County Business Patterns (CBP) data to estimate the number of independent contractors in the Insurance Agencies and Brokerages industry (NAICS 524210) and the Investment Advice industry (NAICS 523930) who own businesses that employ at least one person. Both of these industries are subsets of the Finance and Insurance industry classification (NAICS 52) and are defined as firms performing the types of customer-facing activities associated with the occupational categories we have identified as being most closely associated with independent contracting.[64]

[64] The Insurance Agencies and Brokerage Industry "comprises establishments primarily engaged in acting as agents (i.e., brokers) in selling annuities and insurance policies." See NAICS, "NAICS Code Description – 524210," (available at https://www.naics.com/naics-code-description/?code=524210). The Investment Advice Industry "comprises establishments primarily engaged in providing customized investment advice to clients on a fee basis, but do not have the authority to execute trades. Primary activities performed by establishments in this industry are providing financial planning advice and investment counseling to meet the goals and needs of specific clients." See NAICS, "NAICS Code Description – 523920," (available at https://www.naics.com/naics-code-description/?code=523920.) We chose not to include the Portfolio Management Industry (NAICS 523920) (which "comprises establishments primarily engaged in managing the portfolio assets (i.e., funds) of others on a fee or commission basis… have the authority to make investment decisions, and … derive fees based on the size and/or overall performance of the portfolio") in our analysis as we believe this classification is more likely than the other two sectors to include firms (such as mutual fund managers) that are do not rely on the independent contracting model. To the extent there are independent contractors in this sector, our analysis understates the economic impact of removing independent contracting.

The Census' CBP series maintains annual data currently available through 2019 on the number of firms with at least one employee and the number of establishments (physical locations) associated with these firms for each six-digit NAICS industry. Table 7 presents this information for the Insurance Agencies and Brokerages industry and the Investment Advice industry.

TABLE 7:
FIRMS AND ESTABLISHMENTS IN THE INSURANCE AGENCIES AND BROKERAGES AND INVESTMENT ADVICE INDUSTRIES

Industry	NAICS	Firms	Establishments
Insurance Agencies and Brokerages	524210	122,198	135,077
Investment Advice	523930	20,213	22,246
Total		142,411	157,323

Source: U.S. Census Bureau, County Business Patterns.

As we have explained above, insurance agents in the Insurance Agencies and Brokerages may either be employed directly by insurance companies or be independent contractors selling insurance products on behalf of one or more companies,[65] while financial advisers in the Investment Advice industry are required to be employed by, or independent contractors for, a broker-dealer firm registered with the SEC.[66] Thus, the data presented above include both firms operated by independent contractors and insurance companies and broker-dealers that employ insurance agents and financial advisors as traditional employees. Because we are interested in firms operated by independent contractors, we subtract from the totals above the 5,929 insurance companies identified by Insurance Information Institute and the 3,435 registered broker-dealer firms identified by the Financial Industry Regulatory Authority ("FINRA") as operating in the U.S. in 2020.[67] When these figures are subtracted from the 142,411 firms listed in Table 7, we are left with an estimated 133,047 independent contractor-operated firms in these sectors.[68] As the data suggest, the vast majority of these firms are single establishment firms, reflecting an industry structure that is characterized primarily by small businesses.

To assess the employment impact of restricting independent contracting, we next examine data on employment by these firms, which is also available from the CBP. Table 8 presents the CBP data on firm counts and employment in the Insurance Agencies and Brokerages and the Investment Advice industries, by firm size.

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[65] ACLI, *Comments on Proposed Rulemaking* at 1-2.

[66] SIFMA *Comments on Regulatory Information Number 1235-AA34* at 2; SEC, "Guide to Broker Deal Registration," (available at https://www.sec.gov/reportspubs/investorpublications/divisionsmarketregbdguidehtm.html#II).

[67] See Insurance Information Institute, "Facts + Statistics: Industry Overview" (https://www.iii.org/fact-statistic/facts-statistics-industry-overview#:~:text=In%202020%20there%20were%205%2C929,and%20other%20companies%20(1%2C227). FINRA, 2021 FINRA Industry Snapshot at 11.

[68] 142,411 – 5,929 – 3,434 = 133,047.

TABLE 8:
FIRM COUNTS AND EMPLOYMENT BY FIRM SIZE IN THE INSURANCE AGENCIES AND BROKERAGES AND INVESTMENT ADVICE INDUSTRIES (2019)

	Firms				Employment			
Industry	Insurance Agencies and Brokerages	Investment Advice	Total	Share	Insurance Agencies and Brokerages	Investment Advice	Total	Share
<5 Employees	91,911	17,626	109,537	76.9%	167,732	24,494	192,226	22.7%
<10 Employees	112,330	19,171	131,501	92.3%	295,772	34,249	330,021	39.0%
<20 Employees	118,266	19,658	137,924	96.8%	372,235	40,523	412,758	48.8%
<100 Employees	121,285	19,973	141,258	99.2%	475,985	50,867	526,852	62.3%
≤500 Employees	121,853	20,071	141,924	99.7%	547,670	58,843	606,513	71.7%
All Sizes	122,198	20,213	142,411	100.0%	740,319	105,799	846,118	100.0%

Source: U.S. Census Bureau, County Business Patterns.

As explained above, the data above includes insurance carriers and broker-dealers who employ their own agents and advisors as well as firms owned and operated by independent contractors. Removing the categories, we estimated there were approximately 133,047 independent contractor-operated firms. Examining the data above, we note that this figure corresponds closely to the 131,501 firms in these sectors identified as having fewer than 10 employees, and also that it is likely that independent contractor-operated firms are smaller, on average, than insurance companies and broker-dealers. Accordingly, we base our estimate of the employment effect of restricting independent contracting on this cohort. As the table shows, these firms – which would either be eliminated or significantly disrupted by restrictions on independent contracting – employ approximately 330,021 people and account for 39.0 percent of total employment in these sectors.

We believe this figure represents a conservative estimate of the disruption to employment that would result from restricting independent contract for at least three reasons: (1) this analysis is limited to firms with at least one employee and thus fails to capture independent contractors in the financial service sector who are sole proprietors; (2) our analysis also explicitly excludes over 1,500 independent contractor-operated firms that employ more than 10 people;[69] and, (3) our assumption that insurance carriers and broker-dealers are uniformly larger than the independent contractor-operated firms is inherently conservative.[70]

In addition to accounting for a large share of employment in these industries, independent contractor entrepreneurs also contribute to the dynamism of the U.S. financial sector by forming new businesses and, in the process, creating new jobs. The Census' Business Dynamics Statistics (BDS) program maintains detailed data on new business formation and job creation in the U.S. economy.

To estimate new business formations attributable to independent contractor entrepreneurs in the subset of the finance and insurance sectors defined by the six-digit Insurance Agencies and

[69] 133,047 – 131,501 = 1,546.

[70] The estimates of new business formation, job creation and overall output presented below are also conservative for the same reasons.

Brokerages and Investment Advice industries,[71] we first used BDS data to identify the total number of new establishments attributable to firms with less than ten employees in the four-digit sectors containing these industries (5242 and 5239).[72] We then estimated the number of establishments founded at the six-digit industry level, using the percentage of firms accounted for by each six-digit industry within its respective four-digit industry sector based on Census CBP data. Table 9 presents the number of new business establishments (i.e., discrete locations) founded by independent contractor entrepreneurs in the Insurance Agencies and Brokerages and Investment Advice industries by year from 2015 to 2019.[73]

TABLE 9:
GROWTH IN NEW ESTABLISHMENTS DUE TO INDEPENDENT CONTRACTOR ENTREPRENEURS IN THE INSURANCE AGENCIES AND BROKERAGES AND INVESTMENT ADVICE INDUSTRIES

NAICS Industry	NAICS Code	2015	2016	2017	2018	2019	Total
Insurance Agencies and Brokerages	524210	9,014	8,993	9,028	8,831	8,712	44,578
Investment Advice	523930	1,959	1,955	1,923	1,993	1,956	9,787
Total		10,973	10,948	10,952	10,824	10,669	54,365

Sources: U.S. Census Bureau, Business Dynamics Statistics; U.S. Census Bureau, County Business Patterns.

As shown in Table 9, entrepreneur independent contractors were responsible for founding approximately 9,000 establishments annually in the Insurance Agencies and Brokerages industry and approximately 2,000 establishments in the Investment Advice industry from 2015 to 2019. Over the five-year period, we estimate that entrepreneur independent contractors were responsible for founding 44,578 establishments in the Insurance Agencies and Brokerages industry and 9,787 establishments in the Investment Advice industry, yielding a total of 54,365 new establishments. A prohibition against independent contracting in the financial services sector would have eliminated or substantially reduced this entrepreneurial activity.

Using a similar methodology, we also used BDS data to estimate annual job creation from 2015 to 2019 (the most recent year for which BDS data are available) attributable to independent contractor entrepreneurs in these industries.[74] The results are shown in Table 10.

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[71] As discussed above, the unique registration requirements for insurance agents, brokers, and financial advisors make it possible to quantify economic impacts for NAICS industries 524210 and 523930, in which entrepreneurial activity by independent contractors is particularly salient. However, because independent contractors also participate in other industries within the finance and insurance sector, these estimates understate the broader economic impacts for finance and insurance.

[72] The most granular industry-level data available in the BDS are at the four-digit NAICS code level.

[73] There are two measures of new business formation in the BDS, "firm births" and "establishment births." However, only data on establishment births is available by firm size at the four-digit NAICS level, the necessary level of granularity for the analysis in this section. Establishment births include all establishments created as a result of the founding of new firms as well as expansion to new locations by existing firms. Thus, our analysis of new business formation and expansion based on establishment births captures all start-up activity in the relevant industries.

[74] As with new business formations, we first used BDS data to identify total job creation attributable to firms with less than ten employees in the four-digit sectors containing these industries (5242 and 5239). We then estimated job creation at the six-digit industry level, using the percentage of employment accounted for by each six-digit industry within its respective four-digit industry sector based on Census CBP data.

TABLE 10:
JOB CREATION DUE TO INDEPENDENT CONTRACTOR ENTREPRENEURS IN THE INSURANCE AGENCIES AND BROKERAGES AND INVESTMENT ADVICE INDUSTRIES

NAICS Industry	NAICS Code	2015	2016	2017	2018	2019	Total
Insurance Agencies and Brokerages	524210	31,512	31,152	30,942	31,771	29,284	154,661
Investment Advice	523930	3,749	3,763	3,798	4,086	3,850	19,245
Total		35,261	34,915	34,740	35,856	33,134	173,906

Sources: U.S. Census Bureau, Business Dynamics Statistics; U.S. Census Bureau, County Business Patterns.

As the table shows, independent contractor entrepreneurs were responsible for creating approximately 30,000 jobs annually in the Insurance Agencies and Brokerages industry and 4,000 jobs in the Investment Advice industry from 2015 to 2019. Over the five-year period, we estimate that independent contractor entrepreneurs were responsible for creating 154,661 jobs in the Insurance Agencies and Brokerages industry and 19,245 jobs in the Investment Advice industry, yielding a total of 173,906 jobs. Insurance producer and investment adviser entrepreneur independent contractors have thus served as an engine of job creation in the financial services sector which would be eliminated or substantially reduced if independent contracting were prohibited.

B. Effects on Output and Consumer Welfare

Restricting or prohibiting the use of independent contracting in the financial services and insurance industry would reduce the output of these services in a multitude of ways. Firms, especially those that rely heavily on independent contractors to reach customers, would be forced to dramatically alter their business models resulting in significant cost increases. Individuals who currently choose to work as independent contractors because of the flexibility and wealth-creation opportunities it provides would choose other occupations or reduce their overall work effort. Customers who currently are served by independent contractors, especially low- and moderate-income customers who benefit from the part-time, small-scale nature of many independent contractors, would lose access to the financial advisory and related services these licensed individuals provide.

While the sum total of these costs is difficult to quantify with precision, we can quantify a portion of the economic costs by assessing the amount of output associated with the independent contractor-operated firms identified and analysed in the previous subsection, based on data from the Census Bureau's Economic Census. Table 11 presents Economic Census data on total sales for the Insurance Agencies and Brokerages and the Investment Advice industries by firm size.

TABLE 11:
OUTPUT BY FIRM SIZE FOR THE INSURANCE AGENCIES AND BROKERAGES AND INVESTMENT ADVICE INDUSTRIES ($MILLIONS; 2017)

Industry	Insurance Agencies and Brokerages	Investment Advice	Total	Share
<5 Employees	$23,787	$4,500	$28,286	16.3%
<10 Employees	$40,443	$6,492	$46,934	27.1%
<20 Employees	$52,708	$8,317	$61,025	35.2%
<100 Employees	$75,238	$12,982	$88,221	50.9%
≤250 Employees	$86,578	$16,302	$102,880	59.4%
All Sizes	$134,551	$38,781	$173,332	100.0%

Source: U.S. Census Bureau, Economic Census. Note that the largest firm size category available in the Economic Census data is 250 employees.

As in the previous section, we use firms with less than 10 employees as a conservative proxy for the economic impact of entrepreneur independent contractors in the finance sector. Table 11 shows that the total economic output of entrepreneur independent contractors in the finance sector was at least $46.9 billion as of the most recent Economic Census or 27.1 percent of output in the Insurance Agencies and Brokerages and the Investment Advice industries. At least in the short- to medium-term, all of the output from these firms would be disrupted if independent contracting were prohibited.

The overall harm to consumer welfare associated with this reduction in output is also difficult to quantify with precision. However, economic research continues to find evidence that financial literacy, financial advice and financial education are associated with a range of beneficial financial planning and practices by households that lead to long-term financial well-being. As one authoritative review of the economic literature explains, "it seems clear that there are likely to be important benefits of greater financial knowledge, including savvier saving and investment decisions, better debt management, more retirement planning, higher participation in the stock market, and greater wealth accumulation."[75]

Financial advice goes beyond selecting investments to include "a complex set of interrelated sprocesses" [76] New studies on financial advice focus on improvements across a range of advantageous behaviors, such as portfolio diversification, savings discipline, and disciplined behavior during market volatility, as opposed to focusing only on how advice improves returns. [77] Researchers have long found that when households do invest, their investment portfolios typically do not align with the portfolio theory.[78] Investors frequently under-diversify and under-invest in

[75] See Annamaria Lusardi and Olivia S. Mitchell, "The Economic Importance of Financial Literacy: Theory and Evidence," *Journal of Economic Literature* 52;1 (March 2014) 5-44.

[76] Claude Montmarquette and Nathalie Viennot-Briot, "The Gamma Factors and the Value of Financial Advice," *Annals of Economics and Finance* 20-1 (2019) 387-411 at 388.

[77] Ibid.

[78] Frederick Kibon Changwony, Kevin Campbell, and Isaac T. Tabner, "Savings Goals and Wealth Allocation in Household Financial Portfolios," *Journal of Banking and Finance* 124 (2021) (hereafter Changwony *et al* (2021)) at 1.

stocks, despite the well-established long-term risk premium produced by stock market investments. These errors can be reduced by financial advice. For example, one empirical study found "that advised individuals aged 35-54 years making less than $100K per year had 51% more assets than similar non-advised investors."[79] It adds:

> These are typical middle-class households in the middle of their accumulation years. Moreover, advised individuals are better investors across many key dimensions commonly associated with long term investing success. Specifically, we found that compared with individuals without a financial advisor, advised individuals
>
> - Own more diversified investment portfolios
> - Stay invested in the market by holding less cash and cash equivalents
> - Take fewer premature cash distributions; and
> - Re-balance their portfolios with greater frequency to stay in line with their investment objectives and risk tolerance.[80]

Other empirical studies into household investment conclude that when households seek financial advice, "they are more likely to set goals, develop a plan, invest in equities, and hold diversified portfolios."[81] This effect is the most pronounced for households that start with very limited savings goals.[82] Researchers also found a significant increase in fundamental financial activities, such as saving money, when people learn about goal setting and receive financial education and counselling.[83] From a psychological perspective, with financial advice households also experience a decrease in anxiety related to volatile markets, complex financial products, and economic crises.[84]

Thus, while we are unable to quantify with precision the consumer harm that would result from the reduced availability of financial services and financial advice, the evidence demonstrates it would be substantial.

V. Summary and Conclusions

In this paper we have assessed the evidence on the economic role of independent contracting in the U.S. economy overall and, in particular, in the financial services sector. We find that independent contracting plays an essential economic role in financial services by providing an economically efficient approach to supplying customer-facing services such as financial advice, securities sales and insurance while complying with stringent financial regulatory requirements. Independent contracting also supports a large and thriving entrepreneurial ecosystem which

[79] Oliver Wyman, *The Role of Financial Advisors in the US Retirement Market* (July 10, 2015) at 2.
[80] Ibid.
[81] Changwony *et al* (2021) at 4.
[82] Id. at 19.
[83] See, e.g., F. Carpena, S. Cole, J. Shapiro, and B. Zia, "The ABCs of Financial Education: Experimental Evidence on Attitudes, Behavior, and Cognitive Biases," *Management Science* 65;1 (2019) 346–369.
[84] Changwony *et al* (2021) at 4.

facilitates new business formation, job creation and wealth accumulation. Changes in laws or regulations that substantially limited or prohibited the use of independent contracting in financial services would harm whose who currently work as independent contractors, harm consumers by reducing their financial literacy and thus their ability to accumulate wealth and save for retirement, and harm the economy overall.

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Exhibit C to FSI Comment Letter

Wealth Management Firms Need Advisors as Brand Evangelists to Attract New Talent, J.D. Power Finds

J.D. POWER

Press Release

Wealth Management Firms Need Advisors as Brand Evangelists to Attract New Talent, J.D. Power Finds

Edward Jones, Commonwealth Rank Highest in Satisfaction in Respective Segments

TROY, Mich.: 6 July 2022 — Long before the Great Resignation became a national phenomenon, wealth management firms were struggling to manage attrition among their financial advisors and attract new talent to the profession. According to the J.D. Power 2022 U.S. Financial Advisor Satisfaction Study,[SM] released today, a combination of technological- and pandemic-driven disruption has exacerbated that challenge, with 15% of advisors at wirehouse firms[1] and 7% of independent advisors now categorized as "at risk" of leaving their firms in the next two years.

"With the average age of a financial advisor climbing to 57 this year, wealth management firms that want to continue to grow must do more than just manage advisor attrition rates; they also need to actively create advisor brand evangelists who will attract the next generation of talent," said **Mike Foy, senior director of wealth and lending intelligence at J.D. Power**. "Right now, many firms are missing the mark on developing that level of advisor engagement, but there are some clear drivers that need to be in place for it to happen. Notably, firms that are making the right investments in technology, effective marketing support, competitive products and services and have a strong top-down corporate culture are significantly outperforming the competition when it comes to advisor satisfaction and advocacy."

Following are some key findings of the 2022 study:

- **Advisor loyalty in decline:** Advisor attrition risk increases this year across all categories. Wirehouse firms have the largest proportion of at-risk advisors, with 15% considering leaving their firm in the next one to two years. Among independent advisors, 7% fall into the at-risk category.

- **Tech, competitive products and culture help build advisor advocacy:** Among advisors classified as brand evangelists—those with the highest levels of satisfaction and loyalty to their firms—91% say the technology offered by their firm has improved during the past two years. Likewise, 79% say their firm offers competitive products and services and 74% say their firm's corporate leadership fosters a strong culture.

- **Employee advisor satisfaction declines significantly with length of tenure:** While overall satisfaction among independent advisors is relatively consistent across all advisor tenure levels, it declines significantly among employee advisors based on the length of their industry tenure. Overall satisfaction is 741 (on a 1,000-point scale) among employee advisors in their first 10 years of tenure and falls to 689 among mid-career employee advisors and to 658 among those with a tenure of 20 years or more. This represents a huge risk as experienced advisors obviously have accumulated significant assets that will very often leave the firm if the advisor departs.

- **Advisors want to go back to the office:** A majority (62%) of advisors say their preferred work style is either in the office most of the time (38%) or in the office full-time (24%). Overall satisfaction scores are highest among advisors who are currently working in the office full time (791), followed by those who are working in the office most of the time (778).

[1] Merrill, Morgan Stanley, UBS and Wells Fargo Advisors

Study Rankings

Among employee advisors, **Edward Jones** ranks highest in overall satisfaction with a score of 876. **Stifel** (872) ranks second and **Raymond James & Associates** (863) ranks third.

Among independent advisors, **Commonwealth** ranks highest in overall satisfaction with a score of 918. **Raymond James Financial Services** (842) ranks second and **Ameriprise** (821) ranks third.

The U.S. Financial Advisor Satisfaction Study measures satisfaction among both employee advisors (those who are employed by an investment services firm) and independent advisors (those who are affiliated with a broker-dealer but operate independently) based on six key factors (in alphabetical order): compensation; leadership and culture; operational support; products and marketing; professional development; and technology.

The study is based on responses from 3,039 employee and independent financial advisors and was fielded from January through May 2022.

For more information about the U.S. Financial Advisor Satisfaction Study, visit https://www.jdpower.com/business/resource/us-financial-advisor-satisfaction-study.

See the online press release at http://www.jdpower.com/pr-id/2022075.

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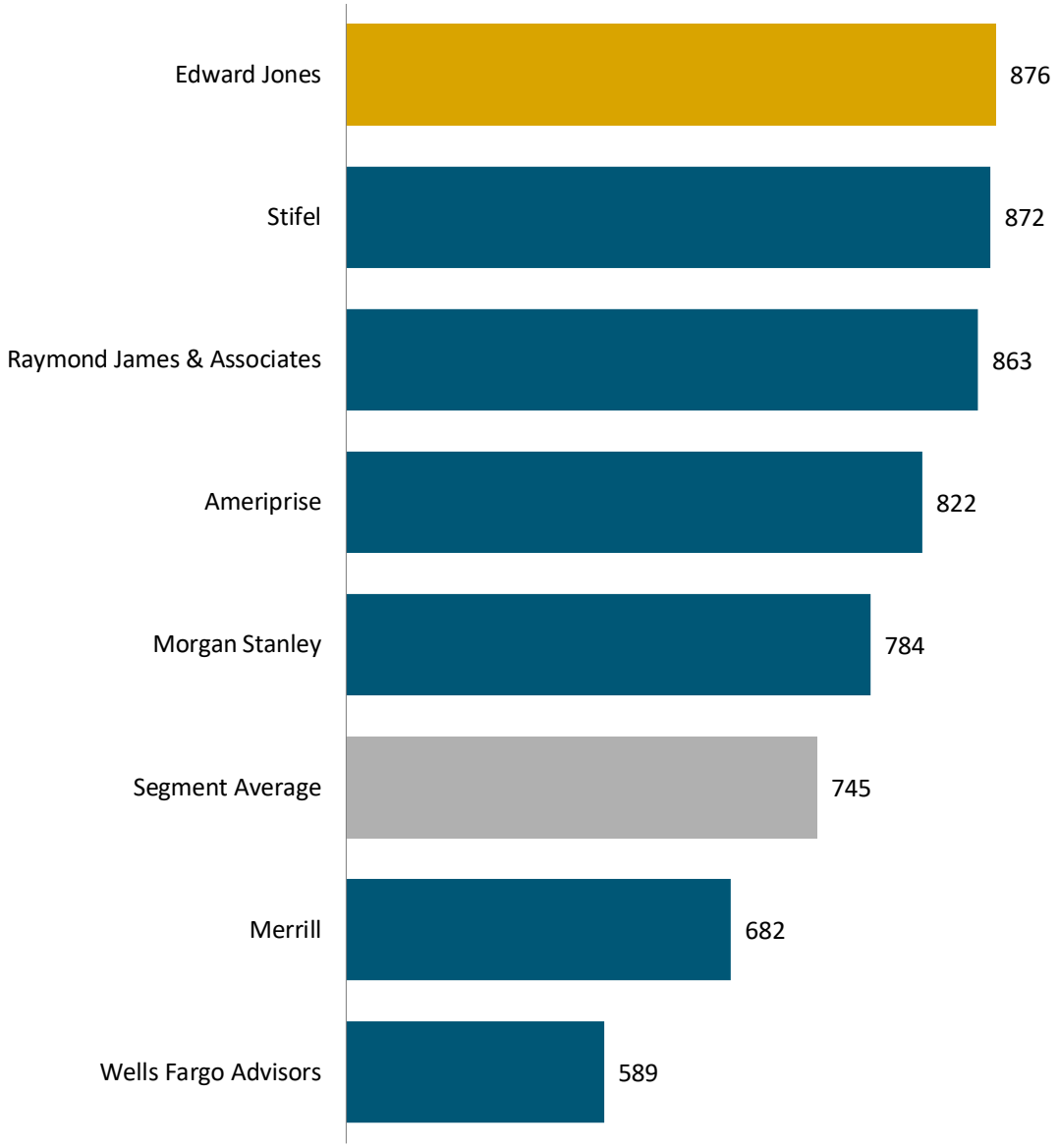
# # #
NOTE: Two charts follow.

J.D. Power
2022 U.S. Financial Advisor Satisfaction Study[SM]

Overall Advisor Satisfaction Index Ranking

(Based on a 1,000-point scale)

Employee Advisors



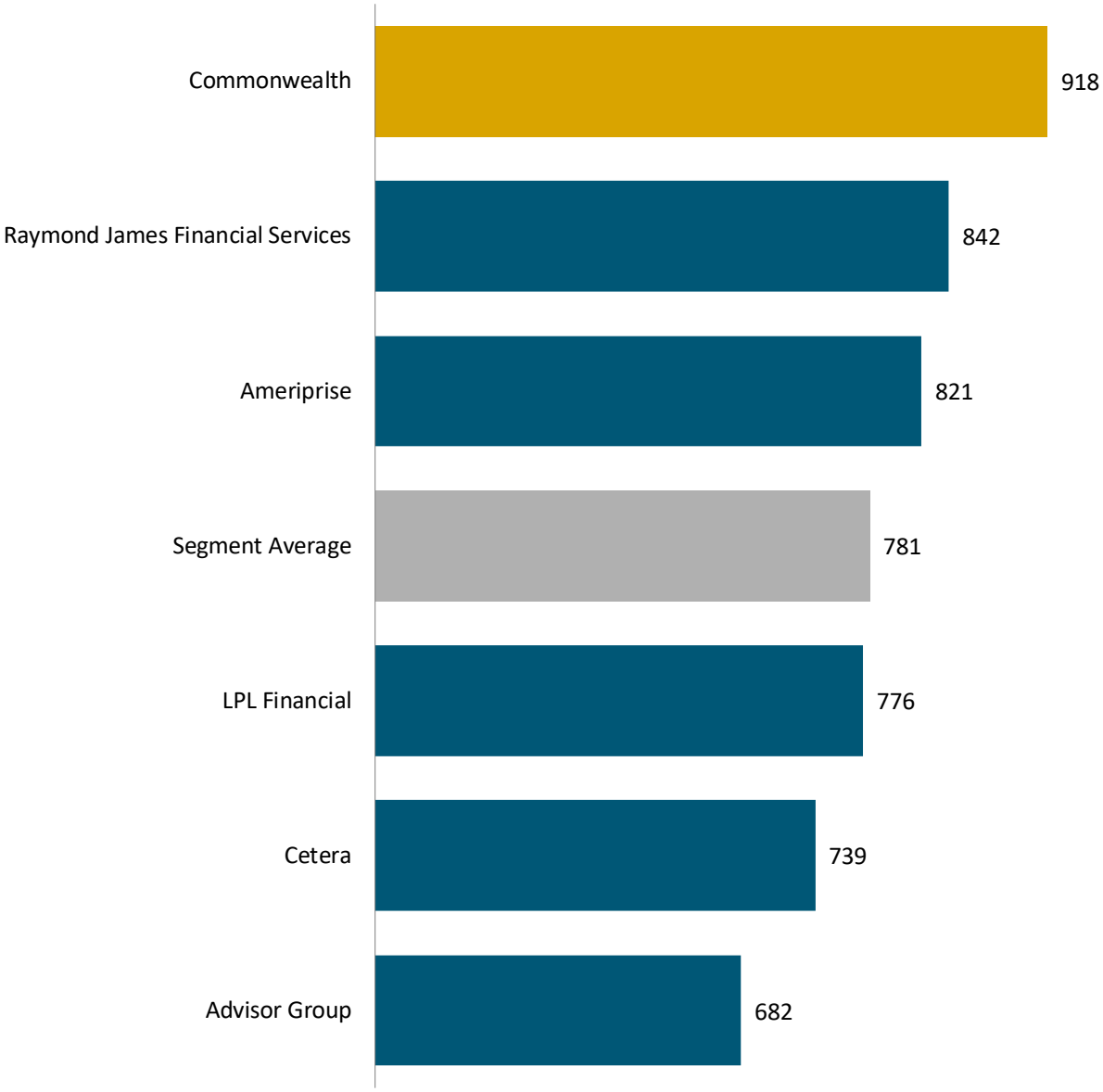
Source: J.D. Power 2022 U.S. Financial Advisor Satisfaction Study[SM]

J.D. Power
2022 U.S. Financial Advisor Satisfaction Study[SM]

Overall Advisor Satisfaction Index Ranking

(Based on a 1,000-point scale)

Independent Advisors



Source: J.D. Power 2022 U.S. Financial Advisor Satisfaction Study[SM]