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Northern Trust



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Via electronic submission: e-ORI@dol.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: RIN 1210-AB32, Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Advice

Dear Sir or Madam:

State Street Bank and Trust Company, The Bank of New York Mellon, and The Northern Trust Company (the “Custody Banks”) appreciate the opportunity to provide comments on the proposed rule (the “Proposed Rule”) issued by the Department of Labor (the “Department”) regarding the definition of “fiduciary” under the Employee Retirement Income Security Act (“ERISA”).¹

As of March 31, 2015, State Street Bank and Trust Company has \$28.5 trillion in assets under custody and administration; The Bank of New York Mellon has \$28.5 trillion in assets under custody and administration; and the Northern Trust Company has \$6.09 trillion in assets under custody. Collectively, the Custody Banks hold over \$63 trillion in assets under custody and administration (approximately 43% of the over \$147 trillion global custody market)², and provide a wide variety of services and products to institutional clients including ERISA Plans.

The Custody Banks believe the Proposed Rule, while intended to address legitimate concerns, captures services which should not be considered “investment advice” for purposes of the final rule. Specifically the Custody Banks are concerned that non-discretionary services, such as the reporting of values for plans or plan asset vehicles, may fall under the proposed new definition of

¹ Definition of the Term “Fiduciary”; Conflict of Interest Rule-Retirement Investment Advice. See 29 CFR Parts 2509 and 2510.

² Based on assets under custody of the top 20 global custodians: BNY Mellon, State Street, JP Morgan, BNP Paribas, Northern Trust, Mitsubishi, BBH, Societe Generale, CACEIS, UBS, Six SIS, Royal Bank of Canada, US Bank, Sumitomo, SEB, Santander, Nordea, National Australia Bank.

fiduciary. Therefore, the Custody Banks are suggesting that the Department adopt clarifying language in the final rule to indicate that these services fall out of scope for purposes of the definition of fiduciary.

The remainder of this letter proceeds in two parts. Part I provides a background on the operational services offered by the Custody Banks, specifically the valuation services provided to plans and plan asset vehicles. Part II discusses the Custody Banks' concerns with the language in the proposed rule, and offers specific recommendations to provide further clarity to the definition of fiduciary.

I. Role and Services Provided by Custody Banks

Custody banks specialize in the provision of safekeeping, settlement, asset administration, and trust and banking services to institutional investor customers. As a custodian or directed trustee, the Custody Banks frequently report valuations to plans and plan asset vehicles. Under this service, the Custody Banks receive pricing feeds from various third-party vendors and use those prices to prepare reports for clients and assist in the calculation of the aggregate portfolio values. In some cases, Custody Banks also gather pricing and expense information in order to strike a Net Asset Value ("NAV") for a particular plan asset vehicle or plan investment option, and provide general analytics to assist plans in connection with evaluating their risk and portfolio management.

In providing these services, the Custody Banks do not make independent judgments or otherwise apply discretion regarding the calculation of aggregate portfolio values, the prices of the underlying assets, or the striking of NAVs. The clients do not retain the Custody Banks to exercise subjective judgment as to the valuations provided by the vendors or any advice with regard to the purchase, retention or sale of the securities or other assets.

The Custody Banks rely on third-party pricing vendors in order to determine the value of a particular asset. When the assets are publicly traded, the Custody Banks often make use of pricing services that are offered by these outside vendors whose job is to organize and gather the market price for a particular asset. The Custody Banks will then use the market price when providing services (such as reporting) to the plan or plan asset vehicle. When providing these services for assets that are not publicly traded, the Custody Banks will normally look to the asset manager to obtain the relevant pricing information. In the absence of an asset manager, the Custody Banks may look to the plan sponsor or the general partner of a partnership to obtain the relevant price.

The custody agreement or related documentation between the Custody Bank and the plan or plan asset vehicle will spell out the list of third-party vendors or sources that the bank plans to use when providing its reporting or NAV services. These sources are presented as the "default" choices used by the Custody Banks; however the Custody Bank will also offer alternative sources, which the plan or plan asset vehicle may direct the Custody Bank to use. The plan or plan asset vehicle is free to select alternative pricing vendors, rather than the standard list of pricing vendors used by the Custody Bank.

With respect to risk evaluation or portfolio management analytics services provided by the Custody Banks, asset values are sourced in the same manner as for the reporting described above. These analytics services take prices from specified sources and provide plans tools through which they can evaluate the impact of various risk scenarios on plan assets. Such tools are commonly used as part of a prudent risk management process, but the analytic tools offered by the Custody Banks are not commissioned for purposes of evaluating individual transactions, and should not be considered “investment advice” for purposes of the final rule.

In each of the foregoing situations, the Custody Banks are merely utilizing and reporting values as to which they have not exercised any subjective judgment. The pricing vendors used under this service are established pricing vendors and are disclosed to (or selected by) the underlying plans in the custody agreement or related documentation.

II. Custody Bank Concerns and Recommendations

The Custody Banks believe that the Department did not intend to capture the services described above under the definition of “investment advice” in the Proposed Rule (“Covered Advice”). Nevertheless, the Custody Banks believe that the Department’s final rule would benefit from additional clarity defining the scope of current advice as it applies to the activities of the Custody Banks. The following commentary provides detail on the specific sections of the Proposed Rule that are of concern, and includes recommendations to help to remove any ambiguity regarding the services that the Custody Banks provide.

1. Create new Definition of Appraisal:

The Custody Banks strongly support the decision by the Department to limit the definition of Covered Advice in the second Proposed Rule with respect to valuations to an “appraisal, fairness opinion, or similar statement...if provided in connection with a specific transaction or transactions involving the acquisition, disposition or exchange” of securities. This revised approach to valuations appropriately focuses on statements of value a plan may rely on as advice, rather than the routine, non-discretionary reporting of values provided by the Custody Banks.

Nevertheless, we believe the new definition needs further clarification.

Specifically, we are concerned that values reported to plans or plan asset vehicles in the ordinary course of providing custodial services may, under the proposal, be considered an “appraisal, fairness opinion, or similar statement” creating the possibility that these non-discretionary services may be deemed to be Covered Advice should they in any way be used by the plan or plan asset vehicle in connection with transactions. For example, a plan or plan asset vehicle considering the sale of a given security at a given price may well look to the values reported by its custodian to help plan the sale. In such a case, the custodian is simply reporting values in a nondiscretionary fashion, and is in no way providing advice to the plan or plan asset vehicle.

The Custody Banks are also concerned that this scenario may also extend to the use of NAVs by plan participants in defined-contribution plans with respect to their asset allocations and investment activities. As in the case described above, the custodian is responsible for providing the NAV, but is in no way providing advice. Nevertheless, we are concerned that such a fact pattern may create the risk of a custodian being deemed a fiduciary with respect to the transaction.

Similarly, a plan may request a statement of value of plan assets as the plan considers a merger or spin-off, which the Custody Banks would provide as requested. While such reporting could well be considered “in connection with a specific transaction...,” the Custody Banks are simply reporting values based on non-discretionary sources as described in Section I of this letter, and are in no way providing advice with respect to the contemplated plan actions.

In order to better define what constitutes an “appraisal, fairness of opinion, or similar statement”, the Custody Banks urge the Department to clarify that valuation reporting and NAV striking services provided by the Custody Banks do not fall under this definition.

This clarification could be accomplished by modifying the Proposed Rules to add an additional definition to §2510.3-21(b)(f) to read:

(9) “Appraisal, fairness opinion, or similar statement of value” means a subjective determination or assessment of the value of securities or other property commissioned by a plan fiduciary for a specific purpose.

In order to ensure consistency with this new definition, the Custody Banks urge the Department to update §2510.3-21(a)(1)(iii) to read:

*“An appraisal, fairness opinion, or similar statement **of value** whether verbal or written concerning the value of securities or other property if provided in connection with a specific transaction or transactions involving the acquisition, disposition, or exchange, of such securities or other property by a plan or IRA;”*

And update §2510.3-21(b)(5) to read:

*“The person provides an appraisal, fairness opinion or **similar** statement of value to – “*

The Custody Banks believe this additional definition and corresponding changes would appropriately clarify that activities such as striking a NAV or reporting asset values are not considered Covered Advice under the Proposed Rule.

2. Adding Periodic Reporting to the Carve-out

The Custody Banks support the proposed “carve-out” for reporting of values in connection with reporting and disclosure provisions under Federal or state law or

regulation, or self-regulatory organization rule or regulation. We believe such a straightforward “carve-out” will greatly simplify compliance with the Department’s new rule for many activities conducted by the Custody Banks.

We are concerned, however, that the carve-out is too narrow, and will exclude many periodic reports the Custody Banks provide to plans and plan asset vehicles which are clearly not within the intended definition of Covered Advice. Such reporting is essential to the prudent management of a plan or plan asset vehicle, but may not be specifically mandated by law, rule, or regulation.

As a result, the Custody Banks also urge the Department to revise the reporting carve-out in §2510.3-21(b)(5)(iii) to read:

“A plan, a plan asset vehicle under 29 CFR2510.3-101, a plan fiduciary, a plan participant or beneficiary, an IRA or IRA owner ~~solely~~ for purposes of periodic reporting or calculation of net asset values, or for compliance with the reporting and disclosure provisions under the Act, the Code, and the regulations, forms and disclosure provisions under the Act, the Code, and the regulations, forms and schedules issued thereunder, or any applicable reporting or disclosure requirement under Federal or state law, rule or regulation or self-regulatory organization rule or regulation.”

This revision will help remove ambiguity regarding certain periodic reporting that is not related to a specific transaction.

3. Modification of “carve out” for collective investment vehicles

The Custody Banks support the proposed “carve out” for statement of value to a collective investment fund holding plan assets. We are concerned, however, by the proposed limitation of the “carve out” to such funds which hold investments of more than one unaffiliated plan. While many collective investment funds do hold assets of multiple unaffiliated plans, there are numerous circumstances where a fund may only have a single investor. For example, during a fund start-up or wind-down, a fund may have a single investor as a transitional matter, or a fund may have been created at the request of a plan sponsor as an investment option in a participant directed plan. The reporting of valuations and related services by the Custody Banks for these funds, however, is identical regardless of the number of investors, and there is no reason that such reporting should be considered advice for funds with single investors and not considered advice for those with multiple investors.

As a result, we suggest the following change to the proposed “carve-out”:

(ii) An investment fund, such as a collective investment fund or pooled separate account, ~~in which more than one unaffiliated plan has an investment, or which holds plan assets of more than one unaffiliated plan~~ the underlying assets of which constitute plan assets under 29 CFR2510.3–101.

4. Clarification of the interaction between the definition and the “carve outs”

The Custody Banks support the changes narrowing the scope of the definition of fiduciary to appraisals that are “...provided in connection with a specific transaction or transactions involving the acquisition, disposition or exchange, of such securities or other property by the plan or IRA;” in order to fall within the definition. We also support the proposed “carve-outs” related to reporting valuations to commingled funds and for purposes of regulatory reporting. With the changes described above, we believe the revised approach to valuations will appropriately define valuation services that may constitute advice for purposes of the rule.

As we read the Proposed Rule, we expect that the definition of fiduciary and the “carve outs” should be read in parallel, and thus the ability of parties to avail themselves of the “carve outs” exists independently of the status of a given activity under the definition. We are concerned, however, that an alternative reading may suggest that the “carve out” is only available to activities which have been deemed to fall into the definition of fiduciary. Such a reading would have several negative impacts, including incurring additional costs required to establish an activities status under the definition, only to be then excluded as part of the “carve out,” and creating the inference that all activities that meet the requirements of the “carve out” are per se within the scope of the definition.

We suggest the Department provide additional guidance in the preamble to the final rule, clarifying that parties may determine whether activities are in scope as Covered Advice by evaluation under either the definition or the “carve outs.” In addition, we suggest the Department clarify that qualification under one of the “carve outs” does not create an inference that the activity being evaluated is within the scope of the definition.

Conclusion

We believe that the Department did not intend to capture the services described above under the definition of investment advice in the Proposed Rule, and therefore strongly urge the Department to clarify that these services do not fall under the definition, as described above.

Please do not hesitate to contact the undersigned with any questions:

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Respectfully submitted,

  

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