



Derek B. Dorn  
Managing Director,  
Regulatory Affairs & Policy |  
Associate General Counsel

T 212 913 1038  
F 212 916 6121  
derek.dorn@tiaa.org

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Attention: Fiduciary Rule Examination,  
Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, DC 20210  
By email to [EBSA.FiduciaryRuleExamination@dol.gov](mailto:EBSA.FiduciaryRuleExamination@dol.gov)

**Re: Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice; Best Interest Contract Exemption (Prohibited Transaction Exemption 2016-01); Class Exemption for Principal Transactions in Certain Assets Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (Prohibited Transaction Exemption 2016-02)**

Ladies and Gentlemen:

Teachers Insurance and Annuity Association of America (“TIAA”) is pleased to share our perspectives on questions of law and policy concerning the final rule (the “Rule”) defining who is a fiduciary under section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (“ERISA”) as a result of giving investment advice, as well as the associated new class exemptions.

TIAA was founded in 1918 on the core belief that those who serve others should retire with financial security – and we have continued to deliver on that promise for nearly 100 years. As a mission-driven organization, TIAA is proud of its longstanding engagement in the policymaking process. Consistent with that commitment, we are grateful for opportunities during the multiyear rulemaking to offer comments to the Department.<sup>1</sup>

“Put the customer first” has always been a core TIAA value – and we believe this should be the industry standard. Consequently, TIAA has been *directionally* supportive of a clear and

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<sup>1</sup> TIAA’s comment on the proposed rule, dated July 20, 2015, is available on the Department’s website at: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/00540.pdf> September 24. Our supplemental comment letter, dated September 24, 2015, is available on the Department’s website at: <https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/03033.pdf>. Additionally, TIAA offered testimony at the Department’s hearing on August 12, 2015; the written testimony is available on the Department’s website at: <https://www.dol.gov/agencies/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB32-2/written-testimony-11.pdf>.

enforceable best-interest standard that applies to retirement advice, including distribution advice. But while articulating this directional support, we have also noted our concerns that operational and technical aspects not become impractical, overly complex, or unnecessary to accomplish the Rule's purposes.

The final Rule addressed some – but not all – of the issues TIAA highlighted during the rulemaking process. In preparing for the Rule's applicability, we continue to have concerns about these unaddressed issues. Meanwhile, our preparations have newly exposed for us aspects of the Rule that, if unaddressed, could unnecessarily burden TIAA's ability to help our participants achieve financial well-being and a secure retirement.

Given these continued and newly understood concerns, TIAA is grateful for this further opportunity to share our perspective with the Department. In its release, the Department has invited comments on “questions raised in the Presidential Memorandum, and generally on questions of law and policy concerning the [Rule] and PTEs.” Consistent with the spirit of our earlier submissions to the Department, we focus on specific aspects of the Rule where narrowing and simplification will further the Rule's policy objectives.

### **About TIAA.**

TIAA was formed by the Carnegie Foundation for the Advancement of Teaching in 1918, is incorporated as a stock life insurance company in the State of New York, and operates on a nonprofit basis. The College Retirement Equities Fund (“CREF”) – the world's first variable annuity – was created in 1952 to give retirement savers the ability to invest in equities and reduce their exposure to inflation risk.

Throughout our history, TIAA has helped millions of Americans at academic, medical, research and cultural organizations retire achieve financial security. Today, TIAA is a Fortune 100 company with more than 13,000 employees and 163 offices nationwide. We are the leading provider of financial services in the not-for-profit market, serving 5 million individuals and over 16,000 institutions.

As TIAA works to fulfill its mission in the 21st century, we have grown our asset-management capabilities. TIAA's investment-management arm, Nuveen, is a five-time winner of the Lipper Award for Best Overall Large Fund Company, the world's largest agricultural investor, and the world's third-largest commercial real estate investment manager. While we expand our business, our core focus and mission remain unchanged: helping the people we serve achieve a financially secure retirement. We believe this focus, along with our nonprofit heritage and unique mission, set us apart in the financial services industry.

TIAA's unique corporate structure allows us to focus our efforts on our clients' long-term financial needs. TIAA has no outside shareholders, other than the TIAA Board of Overseers, which is a not-for-profit entity. Importantly, under TIAA's corporate charter, TIAA functions without profit to the corporation or its shareholders. As a result, our corporate interests are aligned with those of our clients – both at the plan and individual investor level. This structure

makes TIAA particularly sensitive to the potential for additional costs, which ultimately will fall to our participants through additional fees or lower investment returns.

Today TIAA offers to both plan sponsors and IRA investors a diversified array of ten annuities, proprietary mutual funds advised by an affiliate, and non-proprietary mutual funds from scores of different fund families. The TIAA employees who market and sell these products to the plans we recordkeep and to our plan participant and IRA clients are not paid commissions.

Our clients largely use defined contribution plans as their primary retirement vehicles, and understand the value of lifetime income vehicles and our TIAA and CREF annuities. TIAA drives results – in 2016, we paid \$4.8 billion to retired clients, including more than 30,000 annuitants over the age of 90.

**TIAA is committed to a best-interest standard.**

As noted above, TIAA has always had a core value of putting the customer first. In fact, one way we measure our success in aligning our interests with participants is through a short “Put Your Interests First” survey question that we present to every individual participant after an advice session discussing plan accounts or IRAs. The survey question asks: “How strongly do you agree or disagree that [Name of TIAA Employee] puts your interests first?”

From 2012 through May 2015, between 95% and 98% of respondents either agreed or strongly agreed that their TIAA employee consultant “put their interests first.” We are proud of this record and strive to maintain it. In fact, our business processes include having a director-level supervisor call clients who have scored us less favorably to understand why and be sure their needs have been met.

And, as also noted, we believe that putting the client first should not just be TIAA’s standard, it should also be the standard across the industry. Accordingly, we view the Department’s rationale in promulgating the Rule as consistent with TIAA’s values, how we historically have run our business, and how we value the participants in the plans and the IRA Owners we serve.

At the same time, however, we believe modifications to the Rule are needed to ensure retirement-plan participants and retail investors continue to have access to the advice and educational resources that enable them to effectively plan for retirement. As the Department reconsiders the Rule, we would encourage particular attention to the issues outlined below. We especially urge the Department to consider modifications that will guard against (i) adding costs to plan sponsors and retirement investors without commensurate benefits and (ii) inhibiting effective plan design in a retirement system that relies on voluntary employer and employee participation.

## **Definition of “investment advice”.**

### **1. Consistent with the Rule’s Preamble and a plain reading of the Rule text, the “hire-me” exclusion should cover the promotion of a single service.**

During the rulemaking process, TIAA and other commenters urged the Department to clarify that recommending one’s own (or affiliated) investment management or advisory services is not a fiduciary recommendation. We appreciate that, in finalizing the Rule, the Department recognized the strong rationale to create such a “hire-me” exclusion. The Rule’s Preamble<sup>2</sup> and text<sup>3</sup> clarify that one does not become a fiduciary merely by marketing oneself (or an affiliate) as a potential advice fiduciary, *unless* the marketing comes with an investment recommendation of the type covered by the Rule (*e.g.*, a rollover recommendation).

Given the clarity of the Rule’s Preamble and text, we were puzzled that sub-regulatory guidance released in January appears to narrow the hire-me exclusion by distinguishing between situations when a Financial Institution promotes a *range* of available fiduciary services as opposed to a *particular* fiduciary service. This sub-regulatory guidance suggests that the hire-me exclusion is available only in the context of a range of services.<sup>4</sup>

The Department should clarify the scope of the hire-me exclusion to conform with the Rule’s Preamble and text, to ensure that a provider can market its full suite of services, including any one service in particular. If the underlying fiduciary services are themselves provided under applicable ERISA standards, a Financial Institution should be able to sell its own services in a non-fiduciary manner *regardless* of whether the Financial Institution is promoting its fiduciary services in general or selling a particular fiduciary service. The Department’s suggestion in the sub-regulatory guidance that selling a particular fiduciary service would require exemptive relief separate from the relief available for the underlying service itself is neither warranted under the Rule nor necessary from a consumer-protection standpoint.

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<sup>2</sup> “It was not the intent of the Department ... that one could become a fiduciary merely by engaging in the normal activity of marketing oneself or an affiliate as a potential fiduciary to be selected by a plan fiduciary or IRA owner, without making an investment recommendation covered by (a)(1)(i) or (ii). Thus, the final rule was revised to state, as an example of a covered recommendation on investment management, a recommendation on the selection of ‘other persons’ to provide investment advice or investment management services. Accordingly, a person or firm can tout the quality of his, her, or its own advisory or investment management services or those of any other person known by the investor to be, or fairly identified by the adviser as, an affiliate, without triggering fiduciary obligations.” 81 Fed. Reg. 20,946, 20,968 (Apr. 8, 2016).

<sup>3</sup> “A recommendation as to the management of securities or other investment property, including, among other things, recommendations on investment policies or strategies, portfolio composition, selection of *other persons* to provide investment advice or investment management services, selection of investment account arrangements (*e.g.*, brokerage versus advisory); or recommendations with respect to rollovers, transfers, or distributions from a plan or IRA, including whether, in what amount, in what form, and to what destination such a rollover, transfer, or distribution should be made....” 29 C.F.R. § 2510.3–21(a)(1)(ii) (emphasis added).

<sup>4</sup> See U.S. Department of Labor, Employee Benefits Security Administration, Conflict of Interest FAQs, Part II – Rule, No. 19 (Jan. 2017) (concluding that while a “description of the range of services that the financial institution can provide does not constitute a recommendation of any particular account type as appropriate for the prospective customer merely because the financial institution represented that it provides high-quality services for competitive fees ... [if] the financial institution actually recommends a particular account type or service, that would be a fiduciary investment advice recommendation under the Rule.”).

**2. Recommending a third-party consultant to a plan-sponsor fiduciary should not itself be a fiduciary act.**

In the retirement-plan context, a plan-sponsor fiduciary will commonly engage one or more third parties to provide fiduciary services to a plan. Such an engagement will enable the plan-sponsor fiduciary to satisfy its own fiduciary duties of seeking an expert where it is prudent to do so. To recommend an appropriate third-party consultant, the plan-sponsor fiduciary will commonly turn to its recordkeeper(s) for guidance and assistance.

But in such contexts, the Rule would be unduly restrictive, as it includes within the scope of “investment advice” a recommendation to a plan fiduciary of another person to provide investment advice or investment management services. When the recommendation is provided as an accommodation to help plan-sponsor fiduciaries manage their own fiduciary responsibilities, and when the Financial Institution is not receiving direct compensation for making the recommendation, this type of recommendation should not be considered investment advice. Recommendations to hire independent fiduciaries, just like recommendations to hire non-fiduciary service providers, are important, but present no particular conflicts or consumer-protection concerns that would warrant subjecting them to the Rule. Requiring the Financial Institution to assume fiduciary responsibility for recommending other fiduciaries would discourage such recommendations – to the detriment of plan sponsors.

**Exceptions and exclusions from “investment advice”.**

**3. The exclusion for an independent fiduciary with “financial expertise” should be available to *any* plan fiduciary.**

Excluded from the definition of “investment advice” are “investment-related communications” between a Financial Institution and “independent fiduciaries with financial expertise.”<sup>5</sup> To make use of this exception, the Rule places the burden on the Financial Institution to know whether (or reasonably believe that) the independent fiduciary has the requisite expertise. Under the Rule, an independent fiduciary has the requisite expertise if it (i) is a certain type of financial entity (*e.g.*, registered investment advisor), or holds, or has under management or control, total assets of at least \$50 million, and (ii) is capable of evaluating investment risks independently (both generally and regarding particular transactions and investment strategies).<sup>6</sup>

By imposing this \$50 million threshold, the Department takes the position that only fiduciaries of larger plans are capable of distinguishing between situations when a Financial Institution is selling a product or service, and those when the Financial Institution is providing investment advice. But ERISA provides no basis for such a financial threshold. In fact, the Rule’s creation of such a financial threshold contravenes the fundamental premise that a plan fiduciary must act in accordance with ERISA’s fiduciary-duty provisions *regardless of* the amount of assets the

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<sup>5</sup> 29 C.F.R. § 2510.3-21(c)(1). The exclusion is conditioned on certain disclosures being made and no direct fee being received by the Financial Institution.

<sup>6</sup> *Id.* § 2510.3-21(c)(1)(i), (ii).

fiduciary manages. ERISA holds no plan fiduciary to a lesser standard merely because the fiduciary manages fewer assets. Rather, if the plan fiduciary lacks expertise to perform its duties, the fiduciary should engage a professional with the appropriate expertise to help the fiduciary meet its duties under ERISA.

As to the requirement's second prong, the Rule inappropriately delegates to the Financial Institution a duty to gauge the independent fiduciary's financial acumen. Again, ERISA already tasks a plan fiduciary with responsibility to evaluate investment risks; if the plan fiduciary lacks the requisite expertise, the plan-sponsor fiduciary should hire professionals to help the fiduciary meet its ERISA duties.

Accordingly, we urge the Department to extend the exclusion to investment-related communications with *any* plan fiduciary, regardless of the amount of assets it manages and its perceived investment acumen.

#### **4. Ordinary course Financial-Institution-to-Financial-Institution interactions should not be fiduciary advice.**

In the Rule's Preamble, the Department states that "use of the term 'plan fiduciary' in the proposed rule was not intended to suggest that ordinary business activities among Financial Institutions and licensed financial professionals should become fiduciary investment advice relationships merely because the institution or professional was acting on behalf of an ERISA plan or IRA."<sup>7</sup> We agree with the Department's intended outcome. Unfortunately, both the Rule's definition of the term "fiduciary" and the Rule's independent-fiduciary exception contain several confusing elements – which could trigger unnecessary market dislocations and inefficiencies, ultimately to the detriment of retirement savers.

As a threshold matter, if communications from a Financial Institution that manufactures a product are neither individualized nor specifically directed to an identified end-user plan or IRA, the manufacturer should be presumed *not* to be an investment advice fiduciary. To hold otherwise will likely have a chilling effect on the flow of information and ideas among financial professionals – ultimately to the detriment of plan and IRA end-users.

In the same context, the independent-fiduciary exception (and associated sub-regulatory guidance) introduces "presumptions" that are overly restrictive and misplaced. Most fundamentally, it is unreasonable that to interact with a distribution intermediary, a product manufacturer must essentially become a guardian of the intermediary's compliance with the Rule. If the intermediary Financial Institution is itself acting as a fiduciary, there is no need for additional protections from product manufacturers. And even where the intermediary Financial Institution is not a fiduciary, the manufacturer should be regarded as one step removed from any fiduciary status – particularly where the manufacturer neither has privity with an end-user nor knowingly designs a product for an identified end-user.

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81 Fed. Reg. at 20,982.

The Rule’s presumptions in this regard are even more challenging given the lack of specificity as to who is (and is not) “independent” for purposes of the independent fiduciary exception.<sup>8</sup> The Department suggests that a product manufacturer can reasonably conclude that the intermediary has the independence required under the independent fiduciary exception only if the intermediary offers its products to plans under the Best Interest Contract (BIC) exemption. But such a limitation seems misplaced; as the Department has already acknowledged, intermediaries may have several exemptions available to them besides the BIC Exemption (and the ability to avoid fiduciary status altogether). Whatever the case, product manufacturers should not take on potential liability by being required to police their distribution intermediaries’ compliance with the Rule. On the independence prong, we believe traditional and well-settled norms of corporate control are sufficient.<sup>9</sup>

Additionally, while we appreciate the Department’s attempt to clarify treatment of model portfolios that one Financial Institution constructs at the request of another Financial Institution, we would respectfully offer a simpler solution: The model provider should not be a fiduciary if it does not know the end-user’s identity, has no privity with the end-user, and does not knowingly design the model for a specifically identified end-user. Further, in the interest of transparency, we would urge that disclosure by Financial Institutions of a model provider’s fees be encouraged, rather than discouraged. Finally, where the intermediary institution is itself acting as a fiduciary – as often occurs under model-portfolio advisory programs – plans and IRAs are already protected.

Accordingly, we urge the Department to broaden and simplify the exemptions for interactions and arrangements between independent financially sophisticated institutions.

##### **5. Recommendations concerning subsequent investment or use of Required Minimum Distributions (“RMD”) payments should not be fiduciary advice.**

In sub-regulatory guidance, the Department indicated that a financial representative would not be deemed to have recommended a distribution from a plan or IRA “simply by explaining the tax requirements and telling the plan participant that the law requires those distributions”.<sup>10</sup> But the Department then stated that if a recommendation is made as to the application of the RMD payments (for example, a life insurance agent recommending a life policy and receiving an associated sales commission), then fiduciary advice has been rendered. We respectfully find this statement to be overreaching. Clearly, selling life insurance outside of a plan is not investment advice under the Rule. And, as the Department acknowledges, RMD payments are required by law – and thus are not, by their very nature, a recommendation to take a distribution from a plan or IRA. However, the sub-regulatory guidance would deem a mere suggestion related to using

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<sup>8</sup> See U.S. Department of Labor, Employee Benefits Security Administration, Conflict of Interest FAQs, Part II – Rule, *supra* note 4, No. 28 (explaining that the “Rule does not specifically define ‘independent’” but offering specificity only in the context of interactions between a broker-dealer and a retirement plan.)

<sup>9</sup> If the intermediary is a fiduciary, it will already have a duty to assure independence of the manufacturer by avoiding situations that may affect its best interest as a fiduciary under 29 CFR § 2550.408(b)-2(e).

<sup>10</sup> See U.S. Department of Labor, Employee Benefits Security Administration, Conflict of Interest FAQs, Part II – Rule, *supra* note 4, No. 4.

such payments – such as purchasing a life insurance with the proceeds as noted above, or even opening a bank account – to be fiduciary advice. We urge the Department to reconsider this position, so that it is not fiduciary investment advice to recommend how an individual might direct proceeds of RMD payments.

**6. The education exclusion should be expanded to include a service provider’s recommendations about enrolling in or contributing to a plan.**

Under the Rule, “investment education” is expressly excluded from being treated as “investment advice.” Among other categories, “investment education” includes “plan information,” or information that informs a plan fiduciary or plan participant about the benefits of a plan and increasing contributions. Given the longstanding public-policy objective of encouraging saving for retirement, many industry participants had reasonably assumed that the Department would view a discussion about the benefits of enrolling, or increasing contributions to, a plan as educational – even if the discussion is coupled with a non-investment recommendation or “call to action” (such as to enroll or increase contributions). But in sub-regulatory guidance, the Department distinguishes between a plan sponsor and a Financial Institution making such recommendations.<sup>11</sup> The treatment of a plan sponsor’s recommendation as educational is premised on the plan sponsor receiving no fee or other compensation as a result of the recommendation. The implication is that such a recommendation from a Financial Institution *would* be fiduciary since the Financial Institution may receive additional compensation as a result of recordkeeping additional assets.

This implication contravenes the longstanding public-policy objective – evidenced in both congressional action and the Department’s own policies – of encouraging employees to participate in workplace savings plans and to make salary deferrals.<sup>12</sup> The possibility that a Financial Institution might experience incidental benefits as a result of promoting plan-design improvements, plan enrollment, or increased contributions does not warrant imposing fiduciary obligations on the Financial Institution. We are concerned that by deeming such communications fiduciary advice, Financial Institutions will be inhibited from discussing with plan sponsors important plan-design provisions (*e.g.*, auto enrollment or auto escalation) and from delivering key messages to participants about saving for retirement. Accordingly, and akin to the hire-me exclusion’s guardrails, we urge the Department to deem these types of communications to be non-fiduciary advice *unless* coupled with a specific investment-related recommendation (*e.g.*, recommendation of an investment alternative or distribution option).

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<sup>11</sup> See U.S. Department of Labor, Employee Benefits Security Administration, Conflict of Interest FAQs, Part II – Rule, *supra* note 4, No. 10.

<sup>12</sup> The automatic enrollment provisions of the Pension Protection Act and the Department’s “QDIA” regulations are just two examples of those initiatives.

**7. Absent a “call to action,” interactive investment materials and asset-allocation models should be permitted to reference specific investments and distribution options offered through the Financial Institution without triggering fiduciary status.**

In the context of interactive investment materials and asset-allocation models, the Rule significantly narrows the definition of “education,” to exclude communications that reference specific investment or distribution options under a plan or IRA (unless the specific investment or distribution option is specified by a plan participant or IRA owner, or a specific investment is a designated investment alternative in an ERISA plan). In essence, the Rule presumes that, absent one of these limited carve-outs, merely referencing specific investments or distribution options available under a plan or IRA in the asset-allocation models or interactive materials is tantamount to a call to action – and thus fiduciary advice. Such a narrowing would severely limit a Financial Institution’s ability to educate retirement investors about important features, benefits, and risks of particular investments and distribution options offered through the Financial Institution – some of which will have unique attributes that cannot be adequately explained without *specific* reference in interactive investment materials or asset-allocation models.

We are particularly concerned by the negative consequences this limitation will have for annuities. As the only investment vehicle that can guarantee retirees will not outlive their savings, lifetime annuities are central to TIAA’s mission. And as the nation’s largest nongovernmental provider of annuity income, TIAA understands that considerable explanation and illustration are often required for annuities – particularly as compared to other investments available in the marketplace. For example, the features of a particular annuity will turn not only on its type (deferred *vs.* immediate and fixed *vs.* variable) but also across providers and within product sets available through a single provider. Variations can occur across multiple axes – actuarial assumptions and calculations, fees and costs, liquidity restrictions, guaranteed rates, and the availability and limitations of various riders and other benefits. Each variation can affect the decision-making process of a retirement investor in determining the appropriateness of a specific investment product or distribution option.

The Rule suggests that a Financial Institution is unable, absent a limited carve-out, to illustrate an *actual* product within interactive investment materials or asset-allocation models without becoming a fiduciary. If this is the case, retirement investors will have diminished ability to determine actual annuity payouts and other key features, benefits, and risks. We urge that as long as there is no “call to action” and it is clear the illustration is presented solely as an example, illustrations of projected annuity payouts based on specific investments or distribution options should be considered non-fiduciary education. (For instance, educational tools that allow a retirement investor to understand a lifetime-income stream that takes into account specific annuity products available through the Financial Institution, based on input that that the retirement investor is considering a lifetime-income stream, should be educational.)

Similarly, in the mutual-fund context, it is unclear under the Rule whether simple illustrative calculators and tools that help a retirement investor narrow a range of investments would qualify as educational interactive investment material. For example, tools that calculate the specific target-date fund closest to the retirement investor’s anticipated retirement date based on an arithmetic formula and the retirement investor’s data inputs, or that present pre-screened or

sortable lists of mutual funds based on objective and disclosed criteria (*e.g.*, asset class, Morningstar rating, fees and expenses or product manufacturer), should be *per se* educational. These kinds of tools foster financial literacy and help retirement investors effectively navigate available investment options.

The Department notes in the Preamble that it is open to continuing a dialog on possible approaches for additional guidance in this area. We urge the Department to consider expanding the education exclusion in the context of asset-allocation models and interactive materials. Doing so would provide retirement investors with continued access to important educational tools and materials about specific investment products and distribution options that, without a “call to action,” can meaningfully aid the investor’s decision-making.

**8. To accommodate plans with multiple recordkeepers, the Department should revisit the requirement that a recordkeeper identify *all* similar “designed investment alternatives” in asset-allocation models and interactive investment materials.**

The Rule provides that asset-allocation models and interactive investment materials for plan participants can be populated with specific funds and still qualify as non-fiduciary education, but only if the identified investments are the plan’s “designated investment alternatives.” When that condition is satisfied, the Department deems plan participants’ interests to be protected by fiduciary oversight and monitoring of the designated investment alternatives, as required under ERISA. But in those instances, the Rule also requires the models and materials to identify *all* designated investment alternatives with similar risk and return characteristics.

This particular requirement presents unique challenges in the multivendor context, which is common across plans in the higher-education and not-for-profit sectors. When it is not the sole recordkeeper, the Financial Institution generating the models and materials will be constrained in satisfying this requirement. Requiring a recordkeeper to present investment options available only through another recordkeeper would necessitate a web of intricate arrangements between or among each Financial Institution and the plan fiduciary – creating administrative burdens and driving up costs. As a consequence, participants in plans with multiple recordkeepers will likely lose access to the valuable resources that participants in sole recordkept plans will enjoy.

Accordingly, we urge the Department to revisit this requirement. One potential solution would be to require the Financial Institution generating the models and materials to identify similar designated investments on its recordkeeping platform and, consistent with principles under Interpretive Bulletin 96-1,<sup>13</sup> also to disclose that other similar designated investments may be available and identify potential sources for further information (such as the employer’s benefits office or its website, the other service provider, or participant disclosures under ERISA section 404a-5).

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<sup>13</sup> 29 C.F.R. § 2509.96-1.

## **Best Interest Contract (BIC) Exemption.**

### **9. The BIC Exemption should be available for recommendations to *any* plan fiduciary.**

In our prior submissions to the Department, we urged that the BIC Exemption be made available to fiduciaries of *all* plans – and not just non-participant-directed plans under a certain size. The Department responded in part to this request, by extending the BIC Exemption to transactions with a plan fiduciary that meets certain criteria (*i.e.*, being ineligible for the exception available to independent fiduciaries with financial expertise). In the Preamble to the BIC Exemption, the Department explains that the BIC Exemption is not available to transactions with independent fiduciaries with financial expertise because a Financial Institution can instead access the exclusion for communications with these fiduciaries.<sup>14</sup>

But that exclusion does not obviate the importance of exemptive relief should a service provider seek to provide fiduciary investment advice to a plan, with an undertaking to do so in the plan’s best interest and in compliance with many other safeguards required under the BIC Exemption. Rather than *per se* denying availability of the BIC Exemption in those contexts, we urge that the BIC Exemption be modified to enable a Financial Institution to determine for itself when it seeks to provide investment advice and assume fiduciary status in doing so.

### **10. The BIC Exemption should be available for robo-advice even if the Financial Institution is unable to charge level fees.**

The BIC Exemption is available for “robo-advice,”<sup>15</sup> but only if the robo-advice provider is a Level Fee Fiduciary.<sup>16</sup> This limitation effectively prevents Financial Institutions unable to use level fees – because, for instance, their robo-advice platforms include products that the Financial Institution manufactures – from providing rollover and distribution advice through robo-advice models.

We urge the Department to make the BIC Exemption available to robo-advice provided by such Financial Institutions. Of course, this should be conditioned on the advice complying with the BIC Exemption’s requirements. Such an extension would follow the Department’s stated purpose for creating the BIC Exemption – to facilitate various types of common fee arrangements when subject to an enforceable best-interest standard.<sup>17</sup> Failing to make this

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<sup>14</sup> Best Interest Contract Exemption, 81 Fed. Reg. 21,002, 21,013 (Apr. 8, 2016).

<sup>15</sup> *I.e.*, investment advice provided through an interactive website powered by computer software-based models/applications, using personal information the investor supplies through the website/application to provide the advice, and with no personal interaction or advice from an individual Adviser.

<sup>16</sup> A fiduciary is a Level Fee Fiduciary if the only fee or compensation received by the Financial Institution providing the advice, its Advisors, and any Affiliates in connection with the advice provided is a fixed, asset-based fee or set fee that does not vary based on the investment selected. Best Interest Contract Exemption, § VIII(h).

<sup>17</sup> In the preamble to the BIC Exemption, the Department notes: “Certain types of fees and compensation common in the retail market, such as brokerage or insurance communications, 12b-1 fees and revenue sharing payments, may fall within these prohibitions when received by fiduciaries as a result of transactions

accommodation to all Financial Institutions creates an uneven and restricted playing field in favor of robo-advisers that are independent from product manufacturers.

**11. A signature by an IRA Owner should not be required for the advice provided under the BIC Exemption.**

The contract requirements under the BIC Exemption should be changed to permit an agreement binding the Financial Institution to the Impartial Conduct Standards without requiring a signature from the IRA investor. This modification would enable Financial Institutions and their Advisers to provide real-time advice that is sensitive to market conditions (without the delay associated with obtaining a client signature on a paper agreement or via electronic means) while also providing the IRA investor with the meaningful protections envisioned under the BIC Exemption. While we appreciate the Department's flexibility by tying the contracting requirements to the execution of the recommended transaction in the Rule, this still does not fully achieve the goal of facilitating prompt delivery of advice, given that orders received are subject to industry and legal standards governing prompt execution.

**12. Instead of the Rule's burdensome and complex multi-layered disclosure approach, the Department should leverage the existing disclosure regime under ERISA sections 404a-5 and 408(b)(2).**

We urge that the web disclosure requirements be eliminated from the BIC Exemption. These web disclosures are neither warranted from a business standpoint as they are costly and burdensome, nor from a consumer-protection standpoint as they are highly unlikely to be used by individual retirement investors.

Furthermore, the BIC disclosures should be limited to, and mirror, the relevant investment-related fee and expense disclosures under the Department's 404a-5 participant disclosure regulations and, upon request, the Department's 408(b)(2) regulation. Tailoring disclosures to individuals in IRAs and other non-ERISA-covered plans will create additional resource burdens. Instead of imposing new burdens, persons acting on behalf of IRAs and participants in non-ERISA plans should be enabled to leverage information already contained in the 404a-5 disclosures.

**13. The definition of "Best Interest" should mirror ERISA's "prudent man standard of care" under ERISA section 404(a) for all retirement investors.**

As we note above, TIAA supports the extension of an enforceable best-interest standard. But we continue to believe that the standard should be phrased so it is identical to the duties of prudence and loyalty under section 404(a) of ERISA, as further developed by regulations and case-law. By

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involving advice to the plan, plan participants and beneficiaries and IRA owners. To facilitate continued provision of advice to such retail investors under conditions designed to safeguard the interests of these investors, the exemption allows investment advice fiduciaries, including investment advisers registered under the Investment Advisers Act of 1940 or state law, broker-dealers, and insurance companies and their agents and representatives, to receive various forms of compensation that, in the absence of an exemption, would not be permitted under ERISA or the Code." 81 Fed. Reg. at 21,002.

crafting a different definition in the BIC Exemption, the Department risks creating a new fiduciary standard applicable solely to investment advice. At the least, a new standard will trigger considerable uncertainty and confusion; at worst, it will establish an even broader and potentially unachievable standard than exists today. The consequent potential for increased litigation to discern the meaning of the new standard will impose costs that, for a service provider like TIAA, will be directly borne by participants. As is widely appreciated, ERISA's is already the highest fiduciary standard under law. There is no discernible need for enhancement of that standard in the BIC context.

**14. The BIC Exemption should be expanded to accommodate advice to participants of the advice provider's own employer sponsored plans.**

In earlier submissions to the Department, we noted concerns that TIAA will not be able to make available our own investment products and services, including advising on our lifetime annuity distribution options, to employees and former employees who participate in TIAA's ERISA-covered plans.<sup>18</sup> Since the Rule did not scale back this exclusion, we continue to have these concerns. By way of example, the decision to take a lifetime annuity is a complex decision and participants and beneficiaries of TIAA's plans benefit significantly from guidance we should be able to provide under the Impartial Conduct Standards.

The Department explained its unchanged position in the Rule's Preamble by referring to a concern about abuse where a participant or beneficiary receives advice from his/her own employer "upon whom he or she depends for a job." The Department believes that, to protect employees from abuse, "employers generally should not be in a position to use their employees' retirement benefits as a potential revenue or profit source, without stringent safeguards." But this explanation falls short of clarifying why the BIC Exemption – with all of its stringent conditions designed to mitigate the harmful impact of conflicts of interest – does not provide an adequate safeguard. As the Department itself has recognized on multiple occasions, the employer's decision to hire or retain an employee is a business decision completely separate from a fiduciary act of providing investment advice, including any resulting indirect benefit. In fact, any perceived abuse related to performing these two separate functions would be addressed by the ability of a fiduciary, who is delivering an investment advice, to mitigate conflicts by complying with the stringent safeguards of the BIC Exemption.

Accordingly, we urge the Department to make exemptive relief available to Advisers, Financial Institutions, and any affiliates that make their own products and services available to employees and former employees participating in their employer-sponsored plans.

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<sup>18</sup> This concern stems from the fact that the BIC Exemption does not apply if "[t]he Plan is covered by Title I of ERISA, and . . . the Adviser, Financial Institution or any Affiliate is the employer of employees covered by the Plan . . . ." 81 Fed. Reg. at 21,076.

## **Principal Transaction Exemption.**

### **15. The Rule and associated Principal Transaction Prohibited Transaction Exemption should accommodate the purchase of securities in closed-end fund initial public offerings.**

The Principal Transaction Prohibited Transaction Exemption (PTE) establishes very narrow exemptions for ERISA plans and IRAs to purchase securities offered in a principal transaction. But the exemptive relief does not extend to closed-end fund<sup>19</sup> (CEF) initial public offerings (IPOs). Because of how these funds are offered, restricting purchases in IPOs will hurt retirement investors – and all other investors and the capital markets – in ways that cannot be remedied simply by allowing plans and IRAs to purchase these funds in the secondary market.

Because CEFs are often designed and managed to offer strong income and cash flow, they are an important investment option for long-term investors in IRAs and tax-deferred accounts. In fact, of the total \$177 billion in assets held in CEFs composed of taxable bond or equity funds, about 25% (\$44 billion) is in IRAs and tax-deferred accounts.<sup>20</sup> But unlike continuously offered funds, CEFs generally have a limited opportunity to raise investment capital through a brief IPO offering period – typically around 20 business days.

While we do not believe the Department meant to adversely impact the investment product, excluding 25% of the CEF universe's investor base from an initial offering would significantly reduce the scale of future CEFs. Such an exclusion would create disadvantages for *all* fund shareholders, including IRA investors who purchase shares after the IPO,<sup>21</sup> through reduced

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<sup>19</sup> CEFs are one of three general types of investment companies identified in the Investment Company Act of 1940 ('40 Act); the other two are open-end funds (OEFs) and unit investment trusts. Exchange-traded funds are a newer investment company structure, which some describe as a hybrid of an OEF and a CEF. There are many similarities across these investment company types. Each is a pooled investment vehicle that offers shares almost exclusively through a public offering registered under the Securities Act of 1933, with all applicable fees, expenses, and offering costs fully disclosed in an initial prospectus. But CEFs differ in that they are generally not offered continuously (unlike open-end mutual funds) and typically have a fixed number of shares issued during the IPO. Notably, CEFs generally do not issue redeemable shares; after the IPO investors buy and sell shares on a national stock exchange at prices established through market trading. The exchange and market participants provide investors with price transparency and liquidity throughout the trading day. The non-redeemable nature of CEF shares allows full investment of all capital (rather than reserving significant amounts of cash to meet redemptions), especially in funds with less liquid investments.

<sup>20</sup> As of December 31, 2016, the Investment Company Institute (ICI) states that the CEF universe included 530 funds with \$262 billion in assets, of which \$175 billion represent taxable bond funds or equity funds (municipal bond funds comprise the remainder). *See* Investment Company Institute, 4th Quarter Closed-End Fund Statistics (2016). The ICI does not publish the proportion of assets held in tax-deferred retirement savings plans. However, financial intermediaries that offer CEFs suggest IRAs or other tax-deferred retirement plans hold approximately 25% of the taxable bond and equity CEF universe, which translates into roughly \$44 billion of CEF assets held in retirement accounts.

<sup>21</sup> For example, assume that today there is public interest of \$250 million in a particular new CEF IPO and its asset class and investment strategy. Under the Rule, because of the IPO exclusion, the fund will be 25% smaller. That means higher fund expense ratios, reduced efficiency and investment choice in managing a fund's portfolio which may lead to less diversification, reduced or absent CEF analyst coverage (CEF analysts generally do not evaluate or publish information about smaller funds), and lower secondary market volume, leading to potentially

income and return potential.<sup>22</sup> Correspondingly, the exclusion of 25% of the potential investor base from the CEF IPO process will impair the ability to raise capital for important areas of the economy – including issuers from infrastructure, technology, energy, and communications sectors.<sup>23</sup> By removing capital from the marketplace, these issuers will face challenges in efficiently funding essential projects through capital markets.

At a more micro level, we note that CEFs offer important investment features to retirement investors. In particular, retail investors choose CEFs for access to less liquid and more institutional-like asset classes – such as real assets, energy master limited partnerships, senior loans, preferred securities, Build America Bonds, and even investments in the Public-Private Investment Program under the Trouble Asset Relief Program. All these strategies have allowed CEF investors – including those investing for retirement in IRAs – to diversify their income portfolios away from more traditional sources while enjoying diversified, professionally managed investment portfolios.

Against this backdrop, we appreciate the Department’s concerns about the risk of underwriters “dumping” shares on investors during the IPO process. But given differences in the IPO process for CEFs as compared to operating companies, those concerns are not present here. Consider the distinctions. In a typical operating company equity IPO, the issuer consults with its underwriters and sets a specific capital target the offering must raise at a valuation determined by a negotiation between the issuer and the underwriters. That capital goal is prominently featured on the front of the offering’s preliminary prospectus. In contrast, the assets raised in a CEF IPO depend solely upon investor demand discerned during the initial offering period, not a pre-determined capital goal. In addition, no valuation concerns are present as the CEF holds only cash proceeds immediately following the offering that are then promptly invested in a pool of securities in accordance with the fund’s investment mandate. For the CEF IPO, the underwriting syndicate members are committing only to the shares needed to fill their clients’ indications of interest – rather than issuer and syndicate goals. Beyond that, the underwriters hold little or no additional inventory. And for CEF IPOs pricing is known at the outset and high transparency and liquidity opportunities continue after launch. Additionally, we highlight a further protection of the CEF IPO process: Syndicate members track aftermarket activity and will impose a claw-back of the sales concession in the event an Adviser engages in “flipping” shares purchased during the

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wider bid/ask spreads. These diseconomies of scale affect current and future shareholders, taxable and retirement alike, as well as the capital markets being served by that asset class.

<sup>22</sup> Since the IPO is the only time a CEF investor can buy a known quantity of fund shares at a certain known price, forcing interested IRA investors into purchasing shares on the secondary market introduces price and quantity execution risk to those investors. But under the Rule, the share price set in the secondary market is quite likely to be higher once the retirement investor enters, given increased demand is chasing smaller supply. This is unlike the result of the restriction on an equity IPO; after the syndicate breaks, a retirement investor can still buy the very same investment product (the share of the company), and he or she pays either more or less for the privilege than he would have paid in the IPO. CEF IPOs are different.

<sup>23</sup> Consider, for example, the Build America Bond funds that were launched by several fund companies, including Nuveen, as part of the American Reinvestment and Recovery Act in 2009. If those funds were brought to market with the Rule in effect, the amount of CEF capital available to finance such infrastructure spending through CEFs would have been reduced by 25%, the diversification of the bond portfolio likely would be reduced, fund expenses would be higher, and the retirement investor, who could have purchased this fund only in the secondary market, would have a less attractive and less advantageous product to buy.

offering. This fact can remove financial incentives for an Adviser to dump the shares after the pricing of the CEF offering.<sup>24</sup>

In summary, the PTE's failure to accommodate IPOs in the CEF setting will harm the product for *all* investors, including retirement investors, while adversely affecting the overall market by impeding capital. We urge the Department to modify the PTE so IRA owners and other tax-deferred retirement savers can have the opportunity to participate in CEF IPOs.

### **Conclusion.**

As the Department reviews the Rule and the associated PTEs, TIAA appreciates the opportunity to share our perspective and concerns. We hope that our comments can help the Department develop a more refined means of implementing a best-interest standard for retirement advice that will help participants and IRA Owners achieve more successful retirement outcomes without causing unnecessary burdens on service providers such as TIAA and its affiliates. We would be pleased to discuss the foregoing comments with representatives of the Department.

Sincerely yours,



Derek B. Dorn

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<sup>24</sup> While there had been concerns in the 1970s over CEF liquidity, the CEF market has matured considerably – such that those concerns are no longer dominant. Listed CEFs, which do not issue redeemable shares, obtain investor liquidity through exchange listing and trading. But the more appropriate focus is on *secondary-market* liquidity for CEF shares. The primary driver of CEF secondary-market liquidity is, perhaps obviously, fund size. Larger funds offer greater secondary market liquidity. In addition, CEF IPOs traditionally have been broadly syndicated, which means shares are sold to many investors across many different underwriting firms. Given (a) this highly fragmented investor base, (b) the average CEF share position relative to the average CEF average daily trading volume, and (c) insights from CEF designated market makers (DMMs) and other professional market participants, we believe that today, unlike 1977, it is highly likely the average CEF shareholder enjoys abundant liquidity in the markets. Our conclusion is that the average shareholder could sell all his or her shares at once, or buy up to six times the average share position, without affecting share prices significantly or perhaps at all.