



July 21, 2015

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Office of Exemption Determinations  
Employee Benefits Security Administration  
Suite 400  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, DC 20210

Re: Best Interest Contract Exemption [D-11712, ZRIN 1210-ZA25]

Ladies and Gentlemen:

AARP appreciates the opportunity to respond to the Department of Labor's (the Department) request for comments on the proposed Best Interest Contract Exemption. The proposed exemption would provide conditional relief for financial entities that are fiduciaries by reason of the provision of investment advice to receive compensation when participants and beneficiaries, IRA owners, and small plans purchase, hold or sell investment products in accordance with the fiduciaries' advice. The Department proposed this exemption in connection with the publication of its proposed regulation under ERISA section 3(21)(A)(ii), which defines who is a fiduciary of an employee benefit plan as a result of the provision of investment advice to a plan or its participants or beneficiaries.

AARP is the largest nonprofit, nonpartisan organization representing the interests of Americans age 50 and older and their families. Nearly half of our members are employed full or part-time, with many of their employers providing retirement plans. A major priority for AARP is to assist Americans in accumulating and effectively managing adequate retirement assets to supplement Social Security. The shift from defined benefit plans to defined contribution plans has transferred significant responsibility to individuals for investment decisions that will directly impact the adequacy of the assets available to fund future retirement needs.

**I. AARP SUPPORTS THE BEST INTEREST CONTRACT EXEMPTION'S CONDITIONAL RELIEF FOR THE PROVISION OF INVESTMENT ADVICE AND RECEIPT OF COMPENSATION.**

AARP supports the Department's decision to propose broad conditional relief for the provision of investment advice and the receipt of compensation by investment advice fiduciaries in connection with the purchase, holding or sale of certain investment products by individual account plan participants and beneficiaries, IRA owners and small plans (Retirement investors). AARP shares the goal of increasing access to qualified investment advice for such Retirement investors within a framework designed to provide such advice based on sound investment principles and free from conflicts of interest.

Most Americans with retirement savings are now solely responsible for investing the plan assets in their individual accounts or IRAs. Moreover, since 1975, the variety and complexity of investments has dramatically changed. This constantly evolving investment marketplace, along with the evolution of the retirement landscape, demonstrates a strong need for a broad exemption that facilitates the provision of advice to such retail investors who shoulder greater responsibility for the investment of their individual plan accounts and IRAs. AARP believes that any final exemption must be conditioned upon a disclosure regimen that would enable the Retirement investor to fully and timely understand the costs and risks associated with various investment recommendations coupled with safeguards that are clear, prominent, and understandable to the Adviser and Retirement investor.

The potential negative impact of biased advice on the growth of retirement assets both during the accumulation phase and post retirement justifies the standards imposed on investment advice fiduciaries under the Department's proposed exemption. In the absence of an administrative exemption, ERISA generally prohibits a fiduciary from receiving payments from third parties and from engaging in conflicts of interest. AARP believes that the structure of the proposed exemption provides the flexibility necessary to accommodate a wide range of current business practices within a framework designed to minimize conflicts of interest and to preclude advisers from avoiding responsibility under ERISA for imprudent or biased advice. In this regard, the Department may not grant an exemption unless it makes findings that the exemption is administratively

feasible, in the interests of the plan and its participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan.

AARP submits the following specific comments on the proposed exemption:

**II. THE WRITTEN CONTRACT REQUIREMENT BENEFITS BOTH THE ADVISER AND THE RETIREMENT INVESTOR BY CLEARLY STATING THE RIGHTS AND OBLIGATIONS OF BOTH PARTIES.**

AARP believes that there are substantial added benefits of a written contract between the advice provider and the retirement investor, under which the adviser acknowledges fiduciary status, commits to adhere to basic standards of impartial conduct and warrants that it has adopted policies and procedures reasonably designed to mitigate harmful conflicts of interest. A contract document protects both sides, making clear the rights and obligations of both parties to an arrangement or transaction. The contract should be a separate document to better ensure that the investor sees and understands the terms and conditions of the advice reasonably in advance of any purchase or sale. Contracts between advisers and employers should only be binding on the signatories, and any employer signed agreement to provide advice to employees (participants) should require that employees separately be notified of the terms of the advice contract.

Currently, IRA owners do not have a statutory right to bring suit against fiduciaries for violations of the Internal Revenue Code's (the Code) prohibited transaction rules and any losses suffered as a result of the fiduciary's misconduct. The proposed exemption would give IRA owners the right to enforce these new contractual rights. By so doing, the contract provides protections for assets that were originally accumulated under ERISA's protective system. Given the increasing influx of employer-sponsored retirement plan monies into IRAs, ensuring some ongoing protections for those tax-subsidized retirement savings is imperative and consistent with the national priority to ensure individuals' retirement security.

Moreover, AARP believes that the proposal's requirement for a written contract with an IRA owner should assist in emphasizing that an IRA is an account designed to accumulate retirement assets over the long term and not just another "retail"

investment account. This is also consistent with the tax incentives designed to encourage the participation in retirement plans and IRAs--important and successful components of our nation's efforts to achieve the goal of improved retirement security.

The Department has broad authority under section 408(a) of ERISA and section 4975(c)(2) of the Code to grant conditional or unconditional exemptions from all or part of the prohibited transaction restrictions, subject to the findings that the Department must make with respect to each granted exemption. AARP believes that the Department's requirement that the Adviser and Financial Institution contractually comply with the Impartial Conduct Standards under the proposal is an appropriate exercise of the Department's exemption authority under ERISA and the Code. In the absence of the requirement for a written contract with the IRA owner, AARP believes that it may be difficult for the Department to make the necessary findings for broad fee relief from the fiduciary prohibitions of ERISA section 406(b) for investment advice fiduciaries where neither the Department nor the IRA owner has any recourse against the Adviser for providing biased advice that resulted in losses to the IRA.

### **III. DESIGNATION OF COMPLIANCE OFFICERS WILL HELP TO ADDRESS CONFLICT OF INTERESTS AND ADHERENCE TO THE IMPARTIAL CONDUCT STANDARDS.**

The Department noted in the preamble to the proposed exemption that a Financial Institution may want to consider designating an individual or group responsible for addressing material conflict of interest issues and an internal compliance officer or committee to monitor adherence to the Impartial Conduct Standards. According to the Department, that individual or group could also develop procedures for reporting material conflicts of interest and for handling complaints.

The Department has requested comment on all aspects of the policies and procedures. AARP favors the inclusion in the final exemption of a specific requirement that the Financial Institution designate a person or persons to be responsible for addressing material conflicts of interest and for monitoring adherence to the Impartial Conduct Standards. AARP further believes that, in the interest of transparency, such person(s) should be identified in the written

contract by name, title or function. AARP is aware that most financial institutions have a designated compliance officer or compliance department that is responsible for assuring that the institution complies with applicable securities or banking rules and regulations.

#### **IV. COURT ACCESS IS IMPERATIVE TO PROTECT THE RIGHTS OF RETIREMENT INVESTORS.**

Section II(f) of the proposed exemption prohibits the written contract from containing a provision under which the Retirement investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution. The preamble to the proposed exemption clarifies that this prohibition would not affect the ability of the Adviser and Financial Institution and a Retirement investor from entering into a pre-dispute binding arbitration agreement relating to individual contract claims.

AARP has significant concerns about the Department's decision not to exclude pre-dispute binding arbitration provisions from the written contract with the Retirement investor. AARP believes that these arbitration provisions deny the Retirement investor the opportunity to seek redress through the courts for losses incurred. We believe that binding arbitration provisions in contracts with Advisers often reflect a lack of negotiating power on the part of the Retirement investor rather than a conscious decision on his or her part to avoid the court system.

Conversely, AARP supports the exclusion of contract provisions which require the Retirement investor to waive or qualify its right to bring or participate in class actions. Retirement investors should not be precluded from bringing or participating in a class action where the Adviser or Financial Institution has engaged in an illegal pattern or practice affecting a large number of Retirement investors. Scandals in the financial services industry involving the manipulation of LIBOR interest rates and foreign currency markets underscore the importance of Retirement investors having the right to bring or participate in class actions.

AARP does not believe that imposition of this provision will have a major impact on the number of class actions filed or the manner in which Financial Institutions conduct their daily operations. In order to even consider bringing a class action,

putative members first must have knowledge of the pattern and practice of the conduct of the Adviser causing them harm. Moreover, merely because putative class members request a court to certify a class does not mean that the court necessarily will do so. A court must determine that the class members have common legal claims and the class members must provide rigorous proof of that commonality. In *Wal-Mart Stores, Inc. v. Dukes*, 134 S.Ct. 2541 (2011), the Supreme Court concluded that class members' "claims must depend upon a common contention of such a nature that it is capable of classwide resolution" "which means that determination of its truth or falsity will resolve an issue that is central to the validity of each one of the claims in one stroke." In short, class action certification is an onerous process. Consequently, the Adviser and Financial Institution will be insulated from frivolous lawsuits.

**V. POINT OF SALE DISCLOSURES SHOULD BE DELIVERED IN ADVANCE OF THE SALE, BE SIMPLE AND UNDERSTANDABLE, AND PROVIDE THE OPPORTUNITY FOR ADDITIONAL INFORMATION.**

The Department has requested comments on the proposed point of sale disclosures. AARP believes that it is essential that such disclosures be provided to the Retirement investor reasonably in advance of the execution of the investment transaction in order to enable the Retirement investor to have sufficient time to assess the impact of the total costs of the recommended investment and any limitations on the advice provided. Because the summary chart is designed to concisely provide cost information to the Retirement investor in a clear and useful fashion, AARP recommends the inclusion of two additional disclosures that AARP believes would assist the Retirement investor in evaluating the investment. First, AARP believes that it would be helpful if the summary chart specifically defined the "total cost" of investing in an asset in order to put the chart in perspective for the Retirement investor. Lastly, AARP believes that the chart would be improved if it contained a cross-reference (internet hyper-link) to the specific place on the Financial Institution's public web page where more detailed cost information could be found.

The written contract disclosure should contain the key terms of the contract, inform the investor of their right to obtain complete information about fees, and provide copies of or electronic links to all of the fee information. As the Department knows, fee disclosures usually are in multiple documents and in

varying formats. Some documents are automatically provided and others only available upon request. As much as practicable, the Department should make sure all fees are disclosed reasonably in advance of the contract and in a single prominent and understandable place and format.

All disclosures should clearly and prominently disclose the charges for investment advice separately from the charges for buying or selling shares, investment management or any other service charges, to the extent practicable. To the extent that the fees for investment advice cannot be broken out from the commissions paid to the insurance agent or broker, AARP suggests a prominent and timely disclosure that states that a portion of the commissions payable to the agent or broker represent compensation for the fiduciary advice provided. If investment advice charges are combined with any other charges, such as fund level investment management fees, this must be clearly, prominently and timely disclosed to the participant or investor. Also, if some costs are paid by the sponsor or plan, the disclosure should be clear which and how much of the costs are being paid by the sponsor or plan versus the participant or investor. Given the wide variance of compliance with the Department's section 408(b)(2) fee disclosures, the Department should monitor that disclosures are provided and understandable to investors.

**VI. A LIMITED RANGE OF INVESTMENT OPTIONS SUCH AS ONLY PROPRIETARY FIRM ASSETS IS PERMITTED AS LONG AS THESE LIMITATIONS ARE PROMINENTLY DISCLOSED TO THE RETIREMENT INVESTOR.**

The Department would permit advisers to offer advice and recommend investments even if the adviser offers limited assets or an insufficiently broad range of assets to meet the investor's needs, provided the limitations are disclosed. There are two types of limited menus – limited in the types of assets and limited as to the seller of the asset. With respect to the former, one of the main tenets of modern investment portfolio is diversification. The Department should consider requiring advisers to clearly and prominently notify or explain the key role that diversification plays in a successful retirement portfolio.

The Department also would permit an adviser to limit advice to proprietary firm assets, which is the reality in much of the financial service industry. We support the Department's requirement that the adviser clearly and prominently disclose this limitation to the investor in advance of the contract and to affirmatively determine that the adviser is providing advice that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor. *Proposed Best Interest Contract Exemption*, 80 Fed. Reg. 21960, 21984-88 (proposed Apr. 20, 2015) (Application No. D-11712). It would be useful if the Department could clarify examples for advice on proprietary products. We also agree with the Department that advisers should not be permitted to use unclear terms such as "may" to confuse investors as to whether or not their advice is limited.

**VII. THE DEPARTMENT SHOULD CLARIFY THE RULES BY WHICH ELECTRONIC DISCLOSURES OF POINT OF SALE AND ANNUAL DISCLOSURES ARE MADE TO THE RETIREMENT INVESTOR.**

AARP urges the Department to clarify its views in the final rule on the electronic provision of point of sales disclosures and annual disclosures to the Retirement investor. How will such documents be provided? What procedural steps must the Adviser or Financial Institution take to assure itself that the Retirement investor is in receipt of the disclosures mandated by the class exemption?

The Department should provide guidance for each of the three types of transactions – internet, telephone, and in-person. For transactions that are completely via the internet, at what point and what documents must be presented to the investor? Much like making a consumer purchase on the internet, there should be notice in advance and a final opportunity to review and confirm the purchase or sale. At the end of the transaction, a copy of all agreed to documents and terms and conditions should be transmitted via email to the investor. For telephone transactions, the adviser should mail or email all documents, as the investor requests, and the transaction be completed only after return of the documents. Finally, for in person transactions, all documents should be provided on paper unless the parties agree that the investor accepts receipt of some or all documents electronically. The adviser should document the form of delivery and transmission of all required documents. AARP has previously conducted surveys and submitted such to the Department on participants' use

and preference for paper disclosures. The Department should require and assume advisers must provide paper delivery of documents whenever individuals do not affirmatively request or agree to electronic delivery.

**VIII. THE DEPARTMENT SHOULD CLARIFY WHETHER INVESTMENT ADVICE INCLUDES ALL THE THREE PARTS OF A RECOMMENDATION TO TAKE A DISTRIBUTION--THE DISTRIBUTION ITSELF, THE ROLL OVER AND PLACEMENT OF THESE ASSETS.**

Under the proposed investment advice rule, investment advice includes a recommendation to take a distribution of benefits or the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA and a recommendation as to the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA. AARP suggests that the Department clarify in the final exemption whether the exemption would apply to investment transactions that occur in connection with advice provided to a participant regarding taking a distribution from a plan or rolling over his or her assets to an IRA. For example, the advice to roll over plan assets may be coupled with specific recommendations as to the investment of the rolled over assets. In other instances, the recommendation to take a distribution may be separated in time from the advice provided at a later date on the investment of the rolled over assets. In either instance, the adviser should clearly explain to the participant or investor the scope of their offer of advice, and then comply with the best interest contract exemption.

**IX. AARP SUPPORTS THE CHANGES TO PTE 84-24 AS IT APPLIES TO IRA TRANSACTIONS INCLUDING VARIABLE ANNUITY CONTRACTS AND MUTUAL FUND SHARES.**

AARP supports the Department's proposed revocation of PTE 84-24 as it applies to IRA transactions involving annuity contracts that are securities (including variable annuity contracts) and mutual fund shares. As proposed, PTE 84-24 would remain available for investment advice fiduciaries to receive commissions for IRA purchases of insurance and annuity contracts that are not securities. The Department has requested comment on whether the types of information required in the section III (a) and (b) disclosures are applicable and available to insurance and annuity contracts that are not securities.

In this regard, PTE 84-24 currently permits an investment advice fiduciary to receive commissions on insurance and annuity contracts and mutual fund shares that are purchased by plans and IRAs, subject to a number of conditions. The conditions include disclosure of the commissions to be received by the investment advice fiduciary and a description of any charges, fees, discounts, penalties, or adjustments that may be imposed under the recommended contract or securities in connection with the purchase, holding, exchange, termination or sale of such contract or securities. AARP believes that the fee disclosures mandated by PTE 84-24 are substantively similar to the proposed section III(a) and (b) disclosures and that the necessary information is currently available. AARP notes that variable annuity contracts and mutual fund shares are similar to many of the investment products included within the definition of "Assets" under the proposed exemption, which often fluctuate in value on a daily basis. This is in contrast to fixed annuity contracts, which offer the Retirement investor the security of fixed payments for the life of the contract.

**X. THE DEPARTMENT SHOULD CLARIFY STATUTORY OR ADMINISTRATIVE RELIEF MAY BE AVAILABLE FOR CERTAIN COVERED TRANSACTIONS.**

Section I(b) of the proposed exemption provides relief for Advisers, Financial Institutions, and their affiliates to receive compensation in connection with a purchase, sale or holding of an Asset by a Retirement investor as a result of the Adviser's and Financial Institution's advice. Section VI provides relief from ERISA section 406(a)(1)(A) and (D) for the purchase of an Asset that is an insurance or annuity contract. No similar relief is provided for the purchase or sale of other Assets described in section VIII(c). AARP recommends that the Department clarify in the final exemption the statutory or administrative relief that may be available from the prohibitions of ERISA section 406(a)(1)(A) (and/or the parallel provisions of Code section 4975) for purchase or sale transactions with parties in interest (disqualified persons) to the plan or IRA. We believe that, in the preamble to the final rule, the Department should include examples that clarify the interaction of the proposed exemption with the relief available under other statutory or administrative exemptions for the purchase or sale of an asset from a party in interest or disqualified person.

**XI. THE EXEMPTION SHOULD COVER ONLY THOSE FINANCIAL INSTITUTIONS AND ADVISERS THAT ARE SUBJECT TO REGULATORY OVERSIGHT AND SUPERVISION BY A STATE OR FEDERAL AGENCY.**

Section VIII(e) of the proposed exemption defines the term “Financial Institution” to mean the entity that employs the Adviser or otherwise retains such individual as an independent contractor, agent or registered representative and that is a registered investment adviser, a bank or similar financial institution, an insurance company qualified to do business under the laws of a state, and a registered broker or dealer. AARP supports the Department’s decision to limit relief under the proposal to Financial Institutions and Advisers that are subject to regulatory oversight and supervision by a state or federal agency. AARP believes that the presence of federal or state oversight of the Financial Institutions that intend to take advantage of the proposed exemption offers an additional layer of protections for the Retirement investor. In this regard, AARP suggests that the Department clarify how the proposed exemption would operate under circumstances where an affiliate or entity related to the Financial Institution is not subject to state or federal oversight.

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AARP appreciates this opportunity to provide its views on the proposed Best Interest Contract exemption. We have submitted separate comments on the definition of advice, and have separately submitted our request to testify. If you have any questions, please feel free to me or contact Michele Varnhagen on our Government Affairs staff at 202-434-3829.

Sincerely,



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