



July 20, 2015

VIA E-MAIL: e-ORI@dol.gov and e-OED@dol.gov

Office of Regulations and Interpretations and  
Office of Exemption Determinations  
Employee Benefits Security Administration  
Attn: Conflict of Interest Rule and related exemption package  
Room N-5655 and Suite 400  
U.S. Department of Labor  
200 Constitution Avenue NW  
Washington, DC 20210

Re: RIN 1210-AB32, Conflict of Interest Rule  
ZRIN 1210-ZA25, Best Interest Contract Exemption (D-11712)

Dear Sir or Madam:

As someone who has spent more than three decades working to build America's workplace savings system, I welcome this chance to share Putnam Investments' comments and concerns about the recent rule proposals from the Employee Benefits Security Administration (EBSA) of the Department of Labor (DOL). These rules, to be issued under the Employee Retirement Income Security Act of 1974 (ERISA), touch on fiduciary responsibility and potential conflicts of interest in the provision of retirement investment advice.

Putnam Investments is one of the pioneers of America's mutual fund industry, with approximately \$160 billion under management today on behalf of over 100 institutional and 5 million individual customers. We proudly strive to embrace our own fiduciary responsibilities. Indeed, Putnam's highest value is to "always put the client first." And that ethical heritage traces its roots back to the Prudent Man rule articulated in 1830 by Judge Samuel Putnam, whose great-grandson founded our company.

Putnam's investment products for the Defined Contribution (DC) market are almost wholly distributed through financial intermediaries. We work with firms that employ a variety of business models, from traditional broker-dealers, to independents, to bank channels and registered investment advisers. Some partners are fiduciaries today under ERISA or Securities and Exchange Commission (SEC) rules, and some are not. But all are already subject to regulation based on their business models: regulation that does – or where it doesn't yet, should – focus on ensuring that financial firms put the customer first.

So we wholeheartedly agree with the expressed intention of the DOL's proposed rules. The best interests of retirement savers should always come first. Any potential conflicts between the interests of those savers and the intermediaries who advise them or offer them guidance should be fully disclosed and guarded against carefully.

The question, in our view, is not whether a customer's best interest should be the standard for advice-giving. Of course, it should. The real question is how best to achieve that goal through a set of clear, certain, well-coordinated and effective rules that can be implemented cost-effectively. In our view, the DOL's draft rule would not achieve that.

To the contrary, if implemented as drafted, these rules would raise costs and confusion across the entire workplace savings system – ultimately at the expense of retirement savers. Access to meaningful investment information, guidance and education that retirement savers need to make decisions would, at best, be seriously inhibited and, in many cases, eliminated. Litigation risk could explode. So could the perverse result of increased inequality – as lower-income clients lose access to advice that highly-affluent customers will surely continue to pay for and benefit from.

At least two other key public policy goals would be set back by the proposed rule.

- First, the expansion of workplace savings coverage to the tens of millions of Americans who lack such plans on the job today would likely be stymied by rising costs, compliance and litigation risk. This would aggravate the “access gap”, the single most serious failing in U.S. workplace retirement policy today.
- Secondly, the provision of more lifetime income options, whether annuities or insured draw-down options within workplace plans or at the point where participants “roll-over” assets to Individual Retirement Accounts (IRAs), would face similar cost and litigation-risk headwinds. Innovation in that arena could slow or stall. Tens of millions of retirement savers would have to sign Best Interest Contracts before providers could offer any meaningful information about these – or any other – investment options.

As discussed in more detail below, what retirement savers need is a simpler, more tailored rule that focuses on the critical issues at hand, without raising the specter of dramatic unintended consequences.

### Comments and Concerns

First, we offer a few points about the rule and Putnam. Like other asset managers, we want to make sure that the rule's technicalities properly apply to investment product manufacturers like ourselves – the firms that build the investment offerings that financial intermediaries use to work with clients toward their retirement goals. We highlight a few of these issues below.

A level playing field for different investment products is critical to a balanced and effective rule. The investment funds and other products that succeed today are different from those of just a few years ago. Market change stops for no one. So it is vitally important to keep this in mind as the rules are revised. The DOL should not take any steps that would reduce choice or prevent the free flow of ideas and innovations which, in a fiercely competitive marketplace like the U.S. retirement system, will ultimately work to consumers' benefit.

In particular, focusing solely on fees – directly, through a proposed low cost fund exemption, or indirectly, through an overly complicated, fee-focused BIC exemption, as discussed below – risks reducing savers' choices by artificially pushing financial advisors in the direction of passive products. We will not recite here the age-old debate between active and passive management. That debate – which is really as simple as the reality of net-of-fee returns – plays out in the long term performance that retirement savers experience over time.

Likewise, the rule shouldn't limit the possibility of an advisor working with affiliated products. Provided that there is clear, full, plain-English disclosure around potential conflicts of interest, those products may be the right choice for a particular plan or IRA holder.

In the end, a variety of strategies and investment approaches – and a wealth of considerations beyond just fees, including volatility, risk, liability-matching, diversification, etc. – play into appropriate savings and investment decisions. In our market-based economy, the DOL should not inadvertently stymie ongoing debate and competition with a regulatory fiat.

We believe retirement plan sponsors and intermediaries understand that sales discussions aren't fiduciary advice, and the rule should exempt these discussions accordingly. We need to be able to educate intermediaries and plans about our

investment offerings – and to promote our investing acumen without being trapped in red tape – in situations where it’s clear we are selling only our own services and products, not acting as a trusted plan advisor that recommends investments from the market as a whole.

The rule should be revised to make it clear that sales talk won’t be considered “advice” in situations where a reasonable retirement investor would understand the non-fiduciary, promotional nature of the information being provided.

The counterparty or seller’s exemption should also be clarified, both to apply to services as well as products (including direct promotion of a fund firm’s own mutual funds) and to apply to smaller participant-directed plans. If a small plan sponsor can be asked to comply with ERISA and the tax code, with all their complexities, that same sponsor should be treated like other employers for purposes of the rule.

Basic information and education should not be subject to ERISA’s prohibited transaction rules. Retirement investors need information in order to make decisions. Under the proposed rule, many types of baseline investment information that we and other firms make available to the public and to prospective clients, including general educational pieces and market discussions, could potentially be characterized as “fiduciary” advice. Likewise, some of the most basic of interactions between our call center employees and our fund investors could trigger a web of technical ERISA rules.

Finally, in other contexts, such as consultant questionnaires and RFP responses, asset managers could arguably be considered fiduciaries under this draft rule even when they do not know they are providing information to a retirement plan! The rule should be amended, through careful reworking or elimination of the “specifically directed to” clause of the definition, to make it clear that these situations are not fiduciary interactions.

The rule’s applicability to IRA rollovers should be carefully reconsidered. Financial firms must be allowed to continue to provide participants with information about the important decision to roll assets to a new plan or IRA or withdraw them. Without a workable path for financial firms to assist customers at this critical juncture, we may see an increase in assets leaving the retirement system – to the detriment, most importantly, of working families.

Instead of subjecting most rollover conversations to fiduciary status, the DOL should seek to define more clearly (and broadly) the boundaries of what may be said and done by a financial firm in this context without triggering fiduciary status. The analysis should come down to the facts and circumstances – against the policy

background of our shared desire to encourage savings and prevent loss of assets from the retirement system.

The rule should be amended so that “advice” to a fiduciary party who isn’t the decision maker for the plan, such as a plan’s broker-dealer, doesn’t trigger fiduciary status. Under the current wording, advice to any “fiduciary” – which could now include a large number of advisors – may be fiduciary advice. Asset managers need to be able to educate intermediaries about our products without tripping into the highly technical area of ERISA prohibited transactions.

The DOL should also look more broadly at any other collateral consequences in situations where an asset manager works with an intermediary, and not directly with a plan, to ensure that the rule focuses appropriately on the intermediary as the party which has a direct relationship with the retirement investor. Otherwise, general investment information, investment models, and fund information provided to educate financial advisors – often without knowledge of the advisor’s underlying client base or their specific needs – could potentially create fiduciary status for a fund provider.

The rule should make it clear that valuation of fund assets and routine reporting is not a fiduciary activity. This is basic information which retirement investors need to monitor their investments and make good decisions, and which isn’t tied to a specific proposed transaction, but to ongoing, basic account maintenance. The exemption should also apply even when reporting isn’t required by law, but by good, transparent commercial practice.

Fund providers routinely provide a net asset value for their funds. Although this activity may, from time to time, include valuing hard-to-assess assets, that activity takes place in the context of a fund’s operations, not a specific plan investor’s circumstances, and should not be subject to fiduciary status, particularly where the fund vehicle itself is not a plan assets vehicle.

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Additional details on many of these points, as well as on the risks the proposed rules pose to the workplace savings system – and ideas on ways to improve the rules – can be found in the comment letters being submitted by our affiliated firms, Empower Retirement and Great-West Financial. And even though these rules have limited direct impact on Putnam Investments as an asset manager, we wholly concur with Empower and Great-West’s respective points.

## The Value of Advice

Our prime concern is not with the rule's impacts on Putnam and its asset manager peers. After all, mutual fund sponsors are, by definition, SEC-registered investment advisers that are already subject to a robust, well-developed fiduciary standard with decades of law to back it. We are not the direct focus of this proposed rulemaking. But we are deeply concerned with the indirect impacts of the proposed rule which would fall not only on us and our financial intermediary partners, but on the market for retirement services, and on American savers and retirees.

As a company that distributes investment funds through intermediaries, we are disturbed by the underlying assumptions and data cited by the DOL as rationale for proposing these rules. As the Investment Company Institute, the U.S. Chamber of Commerce and many others have noted, the baseline study done by the Council of Economic Advisors – and cited by EBSA to justify this rule-making – was deeply flawed. Its estimates of the alleged “costs” of “conflicted advice” were not well-validated by the studies it cited, and the report totally failed to assess any benefits that investors may have received from the advice and guidance they paid for. It was, in short, a highly debatable all-cost/no benefit “analysis”.

While some advisors do, indeed, abuse clients' trust and put their own interests first, we believe that behavior can – and should be – dealt with by stricter enforcement of existing law. To curb these abuses, we would strongly support increased funding for the enforcement units of relevant financial regulators. But policy should not be based on the misdeeds of the few. It should, instead, be guided by evidence and data on the behavior of the advisor community as a whole.

Our decades of experience suggest that the overwhelming majority of financial advisors are honest servants of their clients. They earn their livings by delivering real value. Their personal success and that of their clients are well-aligned. Advisors who overcharge or abuse their clients generally do not succeed over time. Those who deliver value do. This common sense view is not merely “anecdotal” – it is amply supported by objective data from studies of how access to professional advice, on the whole, favorably impacts actual investors' outcomes.

A study done by the Investment Funds Institute of Canada (IFIC) in 2012, for example, analyzed a full spectrum of households across ages, wealth and income levels – then compared those who enjoyed professional advice with those who didn't.<sup>1</sup> The results were dramatic. After as little as six years, it found that advised households had built up 58% more assets than those without advice. After fifteen

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<sup>1</sup> The Investment Funds Institute of Canada and CIRANO (Center for Interuniversity Research and Analysis on Organizations), *New Evidence on the Value of Financial Advice*, Dr. Jon Cockerillne, 2012.

years, advised household held 2.7 times as much in assets as comparable families without advice. These are net results, after taxes and accounting for the costs of the advice given, and they reflect the real value investment advisors can provide.

Similarly, the annual Lifetime Income Surveys done by Putnam Investments and the Putnam Institute from 2010 to 2014 (and since carried on by the Empower Institute)<sup>2</sup> have consistently shown that investors who have access to professional financial advice are much further along toward the goal of replacing their work-life incomes in retirement than comparable savers who lack professional advice.

These surveys assess a comprehensive range of assets, including Social Security, workplace and personal savings, home equity, and even the value of businesses that people own. Analyzing this data allows us to estimate what level of income replacement – or Lifetime Income Score (LIS<sup>SM</sup>) – various savers are achieving – and what variables account for greater success.

The single most powerful variable is access to any form of workplace savings plan. Those who lack such access are on track – at the median – to replace just 42% of working income. Simply having any form of payroll deduction plan raises the median LIS score to 74%. This vastly better outcome is worth noting, since we believe the added costs, complexity and legal risks posed by the DOL’s proposed rule could inhibit the formation of new work-based savings plans.

Another very powerful variable the survey discloses is the impact of access to professional financial advice. At the median, households that do not receive advice are on track to replace 56% of their working income. Those who do draw on professional financial advice, by contrast, are headed at the median towards replacing 82% of their working incomes. This is a massive step closer to what most of us would consider to be retirement success.

A recent study by Oliver Wyman<sup>3</sup> also indicates that individuals with access to professional guidance exhibit the behaviors commonly associated with long-term investment success. Specifically, the report found, among other things, that when compared to individuals without access to professional guidance, those with access:

- Own more diversified investment portfolios;
- Stay invested in the market by holding less cash and cash equivalents;
- Take fewer premature cash distributions; and

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<sup>2</sup> Empower Institute is the research and education arm of Empower Retirement’s parent company, Great-West Lifeco U.S., Inc.

<sup>3</sup> Oliver Wyman, “The role of financial advisors in the US retirement market,” July 10, 2015.

- Re-balance their portfolios with greater frequency to stay in line with their investment objectives and risk tolerances.

These studies underscore how seriously the Council of Economic Advisors report – which the DOL cites as its rationale for these rules – ignored the economic value that financial advisors deliver. What is worse – and again this would be due to cost, complexity and litigation risk – the real-world impact of the proposed DOL rules would likely be to curtail the availability of financial advice to lower-income and lower balance savers. Since the best available data shows that advice delivers measurable value, and since wealthy savers will likely continue to pay for that value, the probable cut-back of investment advice to less-well-off savers would, perversely, further exacerbate wealth and income inequality. Surely that is a consequence that no one intends.

### The BIC Exemption

Because we believe in the value of advice, we think the rule and its related prohibited transaction exemptions should allow for continued market competition and evolution. DOL should, indeed, uphold the principle of a best interest standard – but without an overlay of burdensome requirements that would make the provision of advice potentially unworkable. Unfortunately, in our view, the proposed Best Interest Contract (BIC) exemption, which would apply to a wide swath of the financial advisor community, misses the mark.

### The BIC's individual contract requirements and other provisions are unprecedented and impractical in a number of respects. Among other things:

- Inclusion of individual advisors as parties is unprecedented – and unnecessary, given financial firms' existing legal responsibility for their employees' actions.
- The required timing of the contract essentially creates a “Catch 22” that could stymie even basic information-gathering or comparison-shopping by investors, as financial firms become reluctant or unable to assist in any meaningful way without a formal relationship being in place. Any contract requirement should apply at the point of a transaction's completion or the actual commencement of services, not before.
- The prospect of amending and repapering millions of contracts is daunting and must be avoided. It is critical that, for existing customers, a fully informed, negative consent process be available to bridge the gap between today's practices and the new requirement.



- The liability and warranty provisions may lead many providers to decide that providing advice to customers with smaller accounts is simply not economically viable. Advisors should be liable for violating the best interest standard – beyond that, blanket warranties covering all existing state and federal law are not required in other U.S. legal contexts and, given the outsized impact of even minor non-compliance in the context of ERISA’s strict regime for prohibited transactions, should be stripped from the final rule.
- The BIC exemption is overloaded with new disclosure requirements that diverge widely from EBSA’s own, more carefully-crafted rules under Sections 404(a) and 408(b)(2) of ERISA. While we vigorously support clear, understandable disclosure, the proposed website, point of sale, and ongoing annual disclosures are impractical both in timing and content. They would be of limited value, and deviate, without explanation, from the blueprint that already exists in the DOL’s own rules. Any disclosure requirements in the IRA space should track those existing provisions closely –and where the existing provisions already apply for plan investors and participants, there should be no duplication.
- We fully agree that financial firms should maintain robust procedures to mitigate potential conflicts of interest. But the proposed policies, particularly around compensation (with their unclear “would tend” standard), are too broad. The requirements would appear to foreclose existing compensation practices – contrary to the DOL’s stated intention to craft the BIC as a path to preserve those structures. We believe the DOL should be careful to remain principles-based in its imposition of this new requirement, and should be appropriately deferential to existing SEC and FINRA guidance around firms’ internal policies and approaches to conflicts of interest.

As a result of these and other issues, while the BIC exemption is intended to permit continued receipt of 12b-1 fees and other common forms of compensation for intermediaries’ services, in practice, the exemption is not business-model neutral, because its requirements are simply not workable. Traditional broker-dealer models, in which the advisor is paid for advice through means other than an advisory fee charged directly to the client, may simply become untenable in the retirement market.

The impact may be most dramatic in the IRA market – a critical lynchpin in keeping assets productively at work toward retirement saving needs and preventing system leakage. The rule, combined with the absence of a practical, helpful exemption, will indirectly push savers toward a single model – fee-based advice from an ERISA fiduciary. Some retirement investors already obtain advice in exactly this way – but, in a diverse market including investors with differing needs, investment approaches, and account sizes, the model is not for everyone. We fear that many smaller IRA investors and plans will simply no longer be able to obtain the help they need.

Likewise, we are concerned that the BIC exemption would not, in practice, be product-neutral across investment choices. Faced with the complexity of the exemption, especially its requirement for internal policies, firms that do seek to rely on the BIC may find themselves be pushed toward low-fee products to minimize litigation risk – even in situations where a different fund might be the better choice for a particular retirement investor.

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We do strongly support EBSA’s policy goals: ensuring that investment providers to retirement investors act in the best interests of their clients. But we believe that the rule, as currently proposed, would likely have the unintended consequence of damaging the America retirement system as a whole.

We are encouraged by the DOL’s reported openness to engage with commentators on possible revisions. We urge the DOL to consider carefully the comments it receives and move forward with a rule that recognizes that advice can be valuable, seeks to remain neutral across legitimate advisor business models and investment product choices, and focuses on the core issues at hand, while avoiding unnecessary complexity and cost.

Sincerely,

A handwritten signature in black ink, appearing to read "Robert L. Reynolds", with a long horizontal flourish extending to the right.

Robert L. Reynolds

President and CEO, Putnam Investments