

VIA ELECTRONIC MAIL

July 21, 2015

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

RE: RIN 1210-AB32
Regulatory Definition of the Term “Fiduciary” as it Relates to Investment Advice

To Whom It May Concern:

In its notice of proposed rulemaking dated April 20, 2015, the Department of Labor (“Department”) published its proposed regulation regarding the definition of a “fiduciary” of an employee benefit plan¹ under the Employee Retirement Income Security Act of 1974 (“ERISA”) and proposed updated prohibited transaction exemptions (collectively, the “Proposal”). The Department’s Proposal also applies the definition of a “fiduciary” of a plan (including an individual retirement account [“IRA”]) under section 4975 of the Internal Revenue Code of 1986 (“Code”) to persons who provide investment advice to a plan, its participants or beneficiaries, or an IRA owner.

The Proposal’s expanded definition of a “fiduciary” would result in a monumental change for the financial services industry and fundamentally alter how millions of investors receive guidance about their retirement savings.

Commonwealth Financial Network[®] (“Commonwealth”) is an independent broker/dealer and an SEC-registered investment adviser with home office locations in Waltham, Massachusetts, and San Diego, California, and more than 1,600 registered representatives (“RRs”) and investment adviser representatives (“IARs”) who are independent contractors conducting business in all 50 states (collectively, “Advisors”). Virtually all of Commonwealth’s Advisors work with qualified retirement plans or IRAs and will be affected by the Proposal.

Commonwealth appreciates the opportunity to comment on the proposal. Although we support the Department’s intention to clarify the definition of a “fiduciary,” we have concerns about the details of the Proposal, and the included “prohibited transaction” exemptions, and we believe that if the regulations were adopted as proposed, the result would be a major disruption to the financial industry, ultimately increasing costs to investors and decreasing participation in retirement savings plans by consumers.

¹ 80 FR 21928 et seq.

Executive Summary

Commonwealth recognizes that the current 5-part test² to determine whether a person is acting as a “fiduciary” with respect to an ERISA plan has its shortcomings. Commonwealth supports a well-thought-out and uniform fiduciary standard of care applicable to persons who provide individualized investment advice to plan sponsors, plan participants and beneficiaries, and IRA owners. Advisors who are fiduciaries to a retirement plan (including IRAs) have a duty to avoid material conflicts of interest and to disclose conflicts of interest that cannot be avoided to plan sponsors and participants. The Department must create meaningful and practical “prohibited transaction” exemptions that allow advisers³ to continue to work with participants and investors so long as the advisers disclose material conflicts of interest. To that end, the Department should craft “rules of the road” for retirement plan advisers that are simple, easy to follow, and not so expensive that they drive up compliance costs, which will ultimately be borne by investors.

The Proposal’s extension of the applicability of the definition of “fiduciary” to IRAs is a profound change to the current retirement savings landscape. The change is concerning because of the strict nature of the category of “prohibited transaction” rules involving conflicts of interest related to variable compensation received by “fiduciaries.”⁴ Absent an exemption from the “prohibited transaction” rules, a “fiduciary” that engages in a transaction with an IRA investor and receives any compensation is subject to steep excise taxes and other liability. The Department’s proposed solution, the Best Interest Contract Exemption (“BICE”), is too complex and burdensome to be an effective solution and should therefore be revised before the Department finalizes the regulations.

Another troubling issue is the change to the Department’s Interpretive Bulletin 96-1 (“IB 96-1”), which provides a safe harbor for advisers who want to limit their services to investment education and not trigger fiduciary status. The Proposal removes the ability for advisers to identify specific investments as part of hypothetical asset allocation models used to educate participants. This change will only serve to confuse plan participants and provide them with less information about their investment options. The Department should leave the safe harbor created by IB 96-1 unchanged.

As drafted, the BICE “prohibited transaction” exemption would require firms relying on the exemption to disclose potential conflicts of interest at an unprecedented level of detail. Financial firms would need to build entirely new systems to provide the initial and ongoing disclosures. The costs to create these systems would totally outweigh any benefit such detailed disclosures would provide. Instead, BICE should require only general disclosures about conflicts of interest and the fees and expenses associated with an IRA, with links or other sources to more detailed information upon request. In addition, the condition that contracts pursuant to BICE include language that would require disputes to be litigated in state courts under the vagaries of state law would create an uncertain and chaotic dispute-resolution landscape. The current dispute-resolution system is well

² 29 CFR 2510.3-21(c)

³ “Adviser,” as the Department uses the term in the Proposal, is not limited to investment advisers registered under the Investment Advisers Act of 1940 or similar state law. As used herein, adviser refers to an individual or entity who can be, among other things, a representative of a registered investment adviser, a bank or similar financial institution, an insurance company, or a broker/dealer. See 80 FR 21928, footnote 1.

⁴ Code §4975(c)(1)(E)-(F)

equipped to handle investor complaints, including those related to alleged breaches of fiduciary duties by advisers.

Commonwealth questions the data and assumptions in the Regulatory Impact Analysis. The Department has grossly overstated the “harm” to investors that would occur without the Proposal and grossly underestimated the costs of complying with the disclosure and reporting requirements of BICE.

The Proposal does not sufficiently address existing relationships with plans and IRA clients. If, under the final regulation, firms will need to execute agreements to continue servicing existing clients, then firms should be allowed to obtain negative consent to avail themselves of BICE. Otherwise, the process of obtaining BICE via positive consent will be impractical, and the costs associated with “repapering” existing client accounts will be astronomical, leaving enormous numbers of existing clients without the personalized financial advice they are accustomed to receiving and desperately need.

The Department must continue working with the Financial Industry Regulatory Authority (“FINRA”) and the Securities and Exchange Commission (“SEC”) to ensure that a uniform standard of care applies across industries. In addition, the Department must choose a realistic effective date for the new regulations, giving time to firms to implement major policy and procedure changes and systems upgrades.

I. Commonwealth supports a uniform fiduciary standard of care

Commonwealth acknowledges the need to update the 40-year-old test used to determine whether a person is acting as a fiduciary to a plan. Rather than change the entire definition with a completely new—and somewhat confusing—test, the Department should simply broaden the test by removing two of the elements and including language that applies to plan participants. Concurrently, the Department should work with FINRA and the SEC to create a uniform fiduciary duty and standard of care applicable to the financial services industry that is based on long-standing common-law principles. These simple changes will go a long way to address the Department’s concerns about advisers who are acting as fiduciaries or providing fiduciary advice to retirement plans or plan participants, or offering conflicted advice that is in the adviser’s best interest, not the best interest of the client.

Commonwealth proposes the following test to determine whether an adviser is acting as a fiduciary to a plan:

A person will be deemed a fiduciary if, for a direct or indirect fee, the person:

- i. Renders advice as to the value of securities or other property or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property
- ii. Pursuant to a mutual agreement, arrangement, or understanding, written or otherwise, with the plan, a plan fiduciary, or a plan participant that

- iii. Is individualized based on the particular needs of the plan or a plan participant.

These simple changes would expand the scope of activities by advisers deemed “fiduciary” in nature and address the Department’s concerns that advisers may take advantage of the narrowness of the existing 5-part test to offer conflicted advice without being held to a fiduciary standard. At the same time, the language above is not so specific as to create additional loopholes. Furthermore, by using three of the existing elements of the 5-part test, the above-referenced 3-part test is founded on well-established concepts and will be easily adopted by the financial services industry.

II. Applying the fiduciary standard to IRAs

Applying the definition of “fiduciary” to IRAs will create a uniform fiduciary duty applicable to advisers who service retirement plan participants and IRA investors whether the adviser is an RR or an IAR. The problem is that the Proposal would adversely impact how RRs can be compensated for working with IRA clients. Currently, RRs who provide investment advice to IRA clients are exempt from registering as investment advisers under the Investment Advisers Act of 1940, as amended, if the advice is solely incidental to the conduct of business as a broker/dealer.⁵ These RRs are not currently deemed fiduciaries and therefore may receive variable compensation depending on the investment product the IRA investor purchases.

These variable compensation structures offer IRA clients, especially clients with smaller account balances, meaningful choices on how to pay for the essential services RRs provide. These variable compensation structures could, however, create a conflict of interest for RRs to recommend products that pay higher compensation. Without practical exemptive relief, these conflicts of interest would create a “prohibited transaction” under the Code.

The Proposal’s solution, BICE, would require a huge investment in technology to administer the disclosure requirements. In many cases, RRs will be forced to cease working with IRA clients with modest account balances (e.g., less than \$50,000) because it would no longer be worth the expense of complying with BICE. The result is an unfair bias against RRs to the detriment of investors.

The Department must be careful not to discount the essential function RRs serve in the retirement savings marketplace, providing professional guidance and investment services to millions of Americans. RRs encourage working individuals to save for retirement and assist investors, once retired, in finding suitable investments designed to meet investors’ investment objectives and goals. The Department must make sure the final regulation is not so onerous that it favors IARs over RRs or limits their ability to perform their crucial role in the retirement savings marketplace.

III. Investment education safe harbor

Since ERISA was enacted in 1974, the retirement marketplace has shifted from plan sponsor-directed defined-benefit plans to participant-directed defined-contribution plans. It has never been more important for participants to have access to investment education so they can make informed

⁵ See Investment Advisers Act of 1940, section 202 (a)(11)(C).

decisions about plan participation and retirement savings. The safe harbor created by the Department's IB 96-1 exempts investment education from the definition of "investment advice" under ERISA, thereby allowing advisers to provide investment-related information to participants without becoming fiduciaries. This safe harbor gives plan sponsors the flexibility and choice to work with RRs to whom the plan sponsor might not otherwise have access.

The four general categories of information within the safe harbor are:

1. *Plan information.* The benefits of plan participation, the effects of contributions and withdrawals on retirement income, eligibility, and other information about the operation of the plan.
2. *General Financial or Investment Information.* General concepts such as risk and return, diversification, dollar cost averaging, compounding return, tax-deferred investing, historical rates of return for different asset classes, the effects of inflation, estimating retirement income needs, determining time horizons, and assessing risk tolerance.
3. *Asset Allocation Models.* Hypothetical models of individuals with different time horizons and risk profiles (including specific investment alternatives in model asset allocations).
4. *Interactive Investment Materials.* Questionnaires, worksheets, software, and related materials to help participants estimate future retirement income needs and assess the impact of different asset allocation models on retirement income.

This safe harbor is essential for many small plans to receive professional investment services. In this context, the adviser is providing investment education and may receive variable, commission-based compensation. There is no expectation that the RR is providing individualized investment advice to any particular client.

Notably, the safe harbor allows RRs to identify specific investment alternatives within asset allocation models. The ability to name which specific investments within a retirement plan fit into a particular asset allocation model is essential investment education participants desperately need. The current regime under IB 96-1 works well and should remain unchanged.

Amazingly, the Proposal would remove an adviser's ability to discuss particular investments and remain within the investment education safe harbor. This change is unwarranted and will only serve to provide participants with less information. It makes no sense for an adviser to create hypothetical asset allocation models without being able to indicate which investments in a plan's fund lineup correspond to the asset classes in the models.

IV. Best Interest Contract Exemption

If the Department is intent on expanding the scope of the "fiduciary" definition, it is critical that the Proposal includes a practical exemption that allows advisers to receive variable direct and indirect compensation for their services. BICE, in its current form, is far from practical.

Commonwealth supports the goal of disclosing material conflicts of interest to retirement investors. The Proposal, however, is entirely impractical in the level of detail and specificity required to comply with BICE. The administrative and operational burdens, and the hard dollar costs required

to develop the necessary systems to comply with BICE, far outweigh the incremental benefit to investors over a more generalized disclosure.

The Proposal would require financial institutions to create systems to calculate the 1-, 5-, and 10-year total costs for the point-of-sale disclosure and create a year-end report duplicating much of the same information.⁶ In addition, financial institutions would need to create and maintain a public website detailing the costs to investors, compensation to the firm, and compensation to the adviser of all investments sold in the last 365 days or currently available.⁷ The Department does not appear to appreciate the scope of financial products offered to investors and completely underestimates the operational and administrative burdens of maintaining all of the required information, not to mention the exorbitant costs for information systems upgrades.

The Department should instead create a model BICE disclosure form that provides general disclosures based on general product types. The model disclosure should be concise and include a brief description of the different types of advisers (i.e., RRs, IARs, and insurance agents), a brief description of available product types, and a general description of how advisers are compensated, with links to sources such as prospectuses and revenue sharing disclosure websites where retirement investors can find more detailed information if they are so inclined.

The Proposal also narrowly defines “Assets” that may be sold to a retirement investor under BICE. Curiously, the definition of “Assets” in the Proposal excludes nontraded real estate investment trusts (“NTRs”) and business development companies (“BDCs”), two products on which high-net-worth investors rely to diversify their retirement portfolios. Apparently, the Department’s opinion is that these alternative investments are too risky for unsophisticated investors and therefore should not even be an option. Rather than ban products in a paternalistic overreach of authority, the Department should recognize that FINRA, and many state securities regulators, have established strict suitability rules with regard to liquidity and net-worth requirements for investors in alternative investments such as NTRs and BDCs. Many states also limit the total amount of these alternative investments in a portfolio to 10% of an investor’s liquid net worth. These suitability rules are designed to ensure that only those investors with the appropriate risk tolerance and financial status purchase these alternative investments. The Proposal should be revised to allow investors access to a broad range of “Assets,” including NTRs and BDCs.

The Proposal would create a private right of action for breach-of-contract claims without defining what remedies should be available. The Proposal would subject advisers to state court contract enforcement cases without providing state courts any guidance on appropriate remedies. The private right of action in the Proposal would displace FINRA and SEC authority over customer disputes and subject financial institutions to a variety of state laws. FINRA arbitration is a well-established dispute-resolution process, and FINRA arbitrators are competent to apply the fiduciary standard of care to customer claims in FINRA arbitration. The addition of the private right of action requirement in BICE is merely the Department’s roundabout solution to its lack of statutory authority to enforce ERISA’s fiduciary duties with respect to IRAs. Instead of inserting a bad procedure, the Department should remove the private right of action requirement from BICE.

⁶ 80 FR 21960 et seq.

⁷ Id.

V. Regulatory Impact Analysis is based on flawed assumption

The Department's economic analyses are based on studies that are questionable at best. The data was criticized by Brian Reid, chief economist of the Investment Company Institute, at a hearing before the United States House of Representatives Committee on Education and the Workforce.⁸ The Department's assertion that mutual funds that pay a commission "underperform" other funds in the same asset class is unfounded. In fact, according to Reid, investors who purchased funds with front-end loads actually outperformed the average return for their fund category.⁹ The Department's analysis implies that advisers are simply out to fleece investors and provide no value to investors whatsoever. The Department fails to recognize the critical role advisers play in assisting their clients to financially prepare for retirement and grossly underestimates the valuable services advisers provide to investors that encourage retirement savings participation and help investors create diversified portfolios that match investors' goals and investment objectives.

VI. Grandfathering existing accounts

If the ultimate solution addressing conflicts of interest in commission-based IRAs is BICE, firms should be able to utilize a negative consent process for obtaining BICE relief. Obtaining affirmative consent would be a prohibitive, costly, and time-consuming process, and firms would never achieve 100% compliance. The result will be that countless investors will be suddenly left without access to the financial guidance that they have come to expect and desperately need from their trusted advisers. Commonwealth suggests that the Department allow firms to satisfy the BICE disclosure requirements for existing commission-based IRAs via negative consent. This would allow firms to satisfy their disclosure requirements without undue expense and without disrupting the services provided to existing IRA investors.

VII. Department should work more closely with FINRA and the SEC when it revises the Proposal

With the Proposal's application to IRAs, the Department is moving into an area already heavily regulated by FINRA and the SEC. Based on FINRA's comment letter to the Proposal,¹⁰ it is clear the Department and FINRA are not on the same page. The Department must rely on the expertise of the SEC and FINRA to create a uniform fiduciary standard applied across all retirement vehicles. It is imperative that the rules do not create an uneven playing field or a bias toward certain products or compensation structures.

Conclusion

It is important that the Department does not inadvertently limit investor access to professional guidance by creating regulations that are too restrictive or that serve to stifle investor choice. The Proposal, as currently drafted, would create numerous unintended consequences that would limit

⁸ See e.g., Oral Testimony of Brian Reid, Chief Economist, Investment Company Institute, Subcommittee on Health, Employment, Labor and Pensions, Committee on Education and the Workforce, United States House of Representatives, June 17, 2015, https://www.ici.org/govaffairs/testimony/15_house_fiduciary_oral.

⁹ Id.

¹⁰ See http://www.finra.org/sites/default/files/FINRACommentLetter_DOL_07-17-15.pdf.

investor access to the investment advice they currently receive from their advisers, which is vital to helping them meet their retirement savings goals. The Proposal should be revised to define a simpler test to determine whether a person is acting as a fiduciary and a revised BICE narrowly tailored to address material conflicts of interest. These changes would address the Department's concerns about conflicted advice without confusing investors or limiting investors with modest account balances from accessing quality professional guidance. In addition, the effective date of the new regulations must give firms enough time to update policies and procedures and make technological updates. Firms should have at least two years to comply once the regulations are finalized.

Thank you for the opportunity to comment on the Proposal. If you have any questions regarding our comments or concerns, please call me at 781.736.0700.

Sincerely,
Commonwealth Financial Network

/s/ Brendan Daly
Legal and Compliance Counsel