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February 4, 2011

VIA ELECTRONIC MAIL - e-ORI@dol.gov
Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Definition of Fiduciary Proposed Rule
U.S. Department of Labor
200 Constitution Avenue, N.W., Room N-5655
Washington, DC 20210

Re: **Definition of Fiduciary Proposed Rule**

Dear Sir or Madam:

We are writing to you to provide comments on the Definition of Fiduciary Proposed Rule published at 75 Fed. Reg. 65263 on October 22, 2010 (the "Proposed Rule"). Our comments relate to issues affecting broker-dealers, who service individual retirement accounts (IRAs) invested in individual brokerage accounts and who service small plans.

First, we believe the Proposed Rule should be modified to address the services provided by numerous broker-dealers to holders of individual retirement accounts invested in individual brokerage accounts. According to an October 2010 report on The U.S. Retirement Market, Second Quarter 2010, published by the Investment Company Institute, over $1.4 trillion IRA assets are invested in individual brokerage accounts. This number excludes mutual fund holdings and represents 36% of total IRA assets across the country. (If we assume that these IRAs – holding 36% of the assets – also constitute 36% of the total number of IRAs, that means that over 16,500,000 households have IRAs that are invested in individual brokerage accounts.) And yet, many individual IRA holders investing in these brokerage accounts may not have extensive investment experience and the detailed knowledge needed to invest his or her assets without professional help. Many, and perhaps most, investors in IRAs need assistance in allocating their accounts among asset classes, in diversifying their accounts, and in selecting and removing specific investments. As the number of such accounts, the complexity of investments, and the need for guidance has increased in recent decades, it has become common practice in the industry for broker-dealers to provide assistance to such investors. It is common for the IRA holder to retain discretion to decide how to invest the IRA assets and for a broker-dealer to provide suitable investment recommendations. In many instances, the broker-dealers are compensated from commissions generated by the IRAs' investments. In this way, individuals are provided a cost-effective means of obtaining needed investment assistance while retaining control over investment decisions.

The Proposed Rule's expansion of the definition of investment advice appears to include broker-dealers even if they provide IRA holders with research reports, investment information, and suitable recommendations. (Note that investment recommendations by broker-dealers are subject to a suitability standard under the Federal securities laws.) If broker-dealers are investment advice fiduciaries, then their compensation arrangements will typically run afoul of the prohibited transaction rules of Internal Revenue Code section 4975. Section 4975(c)(1)(E) and (F) prohibit any direct or indirect:

> (E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or
>
> (F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

To the extent a broker-dealer is considered a fiduciary and receives variable compensation in the form of commissions from the IRA investments, the broker-dealer will have violated these provisions. This would be the case even if the broker-dealer fully discloses the compensation and the IRA holder makes the ultimate investment decisions. And, as explained above, this would apply to 36% of the total IRA assets, amounting to over $1.4 trillion.

If broker-dealers cannot provide IRA holders with investment recommendations beyond investment education, without becoming a fiduciary (and, consequently violating the prohibited transaction rules), broker-dealers may stop providing their IRA clients with needed investment assistance. However, the average IRA holder invested in an individual brokerage account may not be sophisticated enough about investments to do it all on his or her own. Yet, if the Proposed Rule is finalized as currently drafted, the combined impact of the new fiduciary definition and the prohibited transaction rules will mandate that result for millions of IRA holders. As a result, we recommend that either the Proposed Rule be modified or a prohibited transaction exemption be issued to address this issue.

We understand the Department is concerned with conflicts of interest and how they affect an individual's retirement assets. Thus, we suggest that whether relief is issued in the form of an exception to the definition of fiduciary or a prohibited transaction exemption, that it be contingent on certain disclosures being made to the IRA holder. For example, consider the following conditions:

(1) The broker-dealer meet disclosure requirements identical to those under ERISA Regulation § 2550.408b-2;

(2) The IRA owner is notified in writing that the individual brokerage account includes investments that provide compensation to the broker-dealer and that the compensation varies from investment to investment and/or based on other factors; and

(3) The IRA owner is notified in writing that the broker-dealer's ability to affect its own compensation is a potential conflict of interest and, as a result, the advice may not be impartial and the interests of the broker-dealer may be adverse and therefore the IRA owner should carefully monitor his or her own account activity.

Alternatively, we recommend that the Department amend Prohibited Transaction Class Exemption 86-128. At this time, PTCE 86-128 provides an exemption for IRAs that satisfy the conditions of 29 CFR 2510.3-2(d) for "a fee for effecting or executing securities transactions . . . as an agent for the plan." At least two changes to the exemption are required. First, "fee" should be replaced with a broader concept that covers commissions, non-monetary compensation, etc. We recommend that the Department use the concept of "compensation" as defined in the regulation under ERISA section 408(b)(2). Secondly, we recommend that the exemption extend to "securities and other property" to properly reflect the range of investments in retirement plans.

Second, a similar issue exists in the context of small plans. A majority of the defined contribution plans in this county are small plans – for example, plans with less than $5 million in assets. In our experience, it is uncommon to see registered investment advisers (RIAs) providing investment advice for plans of that size. Instead, these small plans have commonly and cost-effectively used the broker-dealer model for investment decisions. As with IRAs discussed above, it is typical for the fiduciaries of these plans to make their decisions with the help of investment recommendations provided by broker-dealers. These broker-dealers are usually compensated in the form of commissions paid on the plans' investments.

While the plan fiduciaries typically receive investment information and guidance from broker-dealers, the investment information is not "based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategies, overall portfolio compensation or diversification of plan investments." *See* ERISA Regulation §2510.3-2(c)(ii)(B). Based on this language in the current regulations, these broker-dealers likely do not provide individualized advice to the small plans and, therefore, are not fiduciaries. However, the Proposed Rule deletes this language, which increases the likelihood that an investment recommendation will be considered to be investment advice. To the extent broker-dealers are treated as fiduciaries under the Proposed Rule, they are subject to the prohibitions of ERISA Sections 406(b)(1) and (3). Similar to the situations described above for IRAs, if a broker-dealer is a fiduciary who receives variable compensation based on a plan's investments, the broker-dealer will likely have engaged in a prohibited transaction. This may cause some broker-dealers to cease providing the fiduciaries of small plans with the assistance they need to make informed investment decisions and will disrupt the current arrangements for small plans across the country. Further, it is not clear how these fiduciaries will obtain the necessary assistance without incurring additional costs to the detriment of plan participants.

In order to allow a these small plan arrangements to continue to function, we suggest that there be an exception to the definition of fiduciary or a prohibited transaction exemption for these broker-dealer services. As with our proposal in the IRA context, in order to address conflict of interest issues, we think there should be conditions imposed whether relief is provided in the form of an exception or an exemption. As broker-dealers will already be required to make the required disclosures under ERISA Regulation § 2550.408b-2, the following additional conditions could be imposed:

(1) The responsible plan fiduciary is notified in writing that the plan's assets include investments that provide compensation to the broker-dealer or an affiliate and that the compensation varies from investment to investment and/or based on other factors; and

(2) The responsible plan fiduciary is notified in writing that the broker-dealer's ability to affect its own compensation is a potential conflict of interest and, as a result, the advice may not be impartial and the interests of the broker-dealer may be adverse and therefore the responsible plan fiduciary should carefully monitor the plan's investment activity.

We believe that without providing an exception or exemption with respect to these broker-dealer arrangements, both individual IRA holders and small plans will no longer receive important investment information without incurring significant additional costs.

Very truly yours,

Fred Reish

C. FREDERICK REISH

CFR/SXC:csk/shm