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April 12, 2011

Filed Electronically

Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave, NW
Washington DC 20210

RE: Public Hearing on Definition of Fiduciary

During the hearing on March 1 and 2, Department officials explored with several witnesses whether existing class exemptions, such as PTEs 75-1, 86-126 and 84-24, address witnesses concerns that the Department's proposal effectively would prohibit commission-based compensation. Although the issue did not arise on the panel on which the Institute testified, we would like to provide our views. We also would like to provide our views on an issue of importance to the retirement industry that received little time or attention at the hearing – proposed exceptions for providers of investment platforms.

We continue to believe, as we testified, that the Department's first objective should be to write a rule that clearly and correctly draws the line between true advisory relationships and incidental market interactions in which plans, participants and IRA savers obtain input for their decision making process. That is, the rule should require individualized advice and a mutual agreement that a relationship of trust and confidence exists. The Department should not try to cure the lack of clarity in the proposal by pointing to exemptions that might provide some relief if the rule sweeps too far. For those situations where a true advisory relationship of trust and confidence exists, the Department indeed should review whether the existing exemptions will operate to provide the kinds of relief the Department officials asked about at the hearing. Nevertheless, we have reviewed the existing exemptions with the assistance of outside ERISA counsel and conclude that in light of restrictive interpretations by the Department of the possible exemptions, existing exemptions simply do not provide the clarity needed to address commenter concerns about commission-based compensation.

1. The existence of class exemptions does not relieve the Department from ensuring its regulation captures only true fiduciary relationships.

The Department has proposed to redefine what activities make a person a fiduciary under ERISA by providing investment advice. Our comment letter and testimony focused on how the

Department should revise the proposal to draw the right line between real advisory relationships where both sides understand the adviser is in a position of trust and confidence, on one hand, and ordinary business interactions like selling a product and providing general investment education, on the other.

Section 406(b) of ERISA prohibits a fiduciary from dealing with the assets of a plan for his own account, acting in a transaction involving a plan on behalf of a party whose interests are adverse to the plan, and receiving any consideration for his personal account from a party dealing with a plan. ERISA includes exemptions from these prohibitions and empowers the Department to grant additional administratively feasible exemptions that are in the interests and protective of plans and participants.

It is unreasonable for the Department to say that service providers should be unconcerned about being swept into fiduciary status when no position of trust and confidence exists – or even when it is *unclear* if fiduciary status applies – simply because there may be a statutory or administrative exemption available. Rather, the Department should focus on drafting appropriate revisions to ensure the rule draws a clear line between fiduciary and non-fiduciary activities. Because fiduciary status underpins the entire ERISA compliance structure, the Department has a responsibility to keep the lines of demarcation clear, and should repropose the rule with appropriate revisions and seek an additional round of comments before finalizing any amended rule.

2. The Department should not assume that commonplace compensation arrangements for IRAs can continue under existing class exemptions.

The ability to maintain common compensation arrangements is critical in the IRA market, a market the Department did not analyze in its cost-benefit assessment. The Department cannot extend automatically its analysis of ERISA-governed plans to IRAs because the IRA market operates somewhat differently than the employer-based plan market. Specifically, while it is uncommon for front-end commissions to be charged in 401(k) plans, they are used routinely in retail accounts including IRAs. We have urged the Department to complete a full IRA market analysis.

In analyzing the cost of the proposal on true advisory relationships in the IRA market, the Department should not assume that most brokers and other financial professionals will be able to accept fiduciary status and continue their current compensation structure by using a class exemption. The current class exemptions, in light of the Department's restrictive interpretations of them, do not provide sufficiently clear relief.

Since 1975, the Department has sought to provide exemptive relief for transactions involving the sale of mutual funds to plans and IRAs but the scope of these exemptions has not been entirely clear. Concerns about the application of the existing exemptions to mutual fund transactions arise in two respects. First, many of the existing class exemptions do not provide sufficient guidance on how they apply to mutual fund transactions. For many years, ICI has asked the Department to address

mutual fund transactions specifically by carving them out separately in regulations and advisory opinions or, if necessary, through more tailored prohibited transaction relief.¹

Second, even where exemptions purport to cover mutual fund transactions, there is a great deal of uncertainty on how the exemptions apply, often because of subsequent guidance from the Department restricting the reach of these exemptions, or limits on what is covered by the exemption in the first place. Below we describe the relevant exemptions and the questions they raise.

We emphasize that while the parameters of the relevant exemptions and the Department's current commitment to them may be unclear, the class exemptions as promulgated were intended and expected to provide relief for a wide range of services and transactions. Any action the Department might take now with respect to the exemptions should make them more, not less, usable. The Department should not clarify or revise these exemptions to provide *fewer* opportunities for firms to provide investment advice, particularly as the Department is considering expanding the definition of investment advice for fiduciary purposes.

PTE 84-24: PTE 84-24 was intended to provide relief where a broker provides investment recommendations and advice, and specifically covers the receipt of sales commissions by the principal underwriter.² Although the exemption *defines* principal underwriter to include affiliates, Department officials have at times suggested that the exemption might not cover the receipt of a commission by a broker affiliated with the principal underwriter.³

It is also unclear how Part III(c) of the exemption, which provides conditional relief for the "effecting" of a plan's purchase of mutual fund shares by the principal underwriter, is satisfied. We read the purpose of the exemption to allow a mutual fund firm to sell its own funds, and assure the firm that various ways the firm might allocate its revenue (investment advisory fees, shareholder servicing, and sub-transfer agent fees) will not trip into a prohibited transaction. In a footnote in a 2000 advisory opinion addressing a different issue, however, the Department cast doubt on the exemption:

It is the Department's view that PTE 84-24 would not provide relief for any prohibited transaction that may arise in connection with any fees or other compensation separate and apart from the commission paid to a principal underwriter upon a plan's purchase of recommended securities. Thus, PTE 84-24 does not exempt any prohibited transaction arising out of transactions involving fees paid to a fiduciary service provider with respect to an advice

¹ See Institute Letter from Kathy Ireland to Ivan Strasfeld (Feb. 11, 1993); Institute Letter from Kathy Ireland to Robert Doyle (Feb. 11, 1993); Institute Letter from John Canary to Ivan Strasfeld (May 11, 1995); Institute Letter from Russell Galer to Ivan Strasfeld (Sept. 19, 1995); Institute Letter from Kathy Ireland to Office of Exemption Determinations (June 14, 2004).

² See 47 Fed. Reg. at 14810 (Preamble to PTE 84-24); 42 Fed. Reg. at 32395, 32396 n. 2 (Preamble to PTE 77-9); DOL Info. Ltr. to W. Chadwick (Aug. 8, 1980).

³ See Institute Letter from John Canary to Ivan Strasfeld (May 11, 1995).

program which provides specific/individualized asset allocation recommendations to participants based on their responses to questionnaires.⁴

The footnote seems inconsistent with the exemption (whose terms provide relief from section 406(b)), and it has caused a great deal of uncertainty about the scope of exemption. For example, it could be read to mean the exemption does not cover investment management fees because the fee paid by a mutual fund to its investment management is “separate and apart” from the commission paid to a principal underwriter. The payment of an investment management fee, however, is always the result of the “effecting” of a sale of a mutual fund, and notwithstanding this footnote, PTE 84-24 should be read to provide the relief it purports to give.⁵ In addition, we see no public policy reason why the relief would be limited to principal underwriters receiving commissions but not to other advice programs that are functionally equivalent.

PTE 75-1: PTE 75-1, Part II was established to provide section 406(a) relief for purchases and sales of securities in “principal transactions” between a broker-dealer and a plan and includes a mutual fund exemption with relief from section 406(b) for “the purchase and sale by the plan of securities issued by an open-end investment company.”⁶ The exemption from the outset created confusion in the industry because its original structure suggested that it only applied to principal transactions, but most mutual fund sales exhibit the characteristics of agency transactions. In 2006, the Department revised Part II of PTE 75-1 and repositioned the exemption for mutual funds into its own free standing exemption. While this served to alleviate some confusion as to whether the sale must be a principal transaction, the Department’s explanation does not address the issue.

Other uncertainties also remain surrounding the use of PTE 75-1. First, in proposing revisions to the mutual fund portion of the exemption, the Department questioned whether the exemption had any utility, and stated in finalizing the revisions the Department would continue to review the issue.⁷ These statements chill usage of the exemption. Second, much like PTE 84-24, the scope of fees covered by PTE 75-1 is not entirely clear. While the exemption covers the purchase transaction itself and the

⁴ Advisory Opinion 2000-15A n.4 (Nov. 15, 2000). Footnote 4 states that the requestor did not ask for an opinion about PTE 84-24’s applicability to “formal advice programs.”

⁵ It would be an odd result if the exemption provided relief for a commission for distributing a mutual fund but not to the investment management fee itself. After all, ERISA section 3(21)(B) protects advisers of mutual funds from concern that the purchase of fund shares by an ERISA plan might by itself trigger a prohibited transaction.

⁶ In the Institute’s original comment letter, we expressed the view that prohibited transaction relief was not necessary at all when a broker-dealer sells mutual fund shares to a plan and the only compensation received is a commission. See Institute Comment Letter from David Silver to Commissioner of Internal Revenue Service and Office of Employee Benefits Security (Aug. 29, 1975). We continue to believe that many transactions involving the sale of mutual funds simply do not require relief from section 406(a) or (b).

⁷ See 69 Fed. Reg. at 23218 (Apr. 28, 2004); 71 Fed. Reg. at 5885 (Feb. 3, 2006) (stating the exemption for mutual fund transactions “remains in effect *pending further action* by the Department”) (emphasis added).

receipt of sales commissions,⁸ there is uncertainty whether it extends to other types of fee payments to brokers in mutual fund transactions, such as shareholder servicing, sub-transfer agent, and revenue sharing fees.

PTE 86-128: PTE 86-128 § II(a) exempts a “plan fiduciary’s using its authority to cause a plan to pay a fee for effecting or executing securities transactions to that person as agent for the plan.” This exemption clearly provides relief from section 406(b) for the receipt of commissions by brokers that are plan fiduciaries for agency transactions. One uncertainty arises because the exemption refers to a plan fiduciary “causing” the plan to pay a fee, an ambiguous term that possibly could be read to mean that only discretionary investment management, and not investment advice, is covered. There is nothing in the text of PTE 86-128 nor any other guidance we are aware of that suggests PTE 86-128 is not available for non-discretionary investment advice.⁹ Nevertheless, because much of the discussion regarding PTE 79-1, the predecessor exemption to PTE 86-128, related to investment management, the question is not free from doubt.

Much like PTEs 84-24 and 75-1, there is uncertainty also about the fees covered in connection with mutual fund transactions. In particular, PTE 86-128 could be read not to cover a fiduciary’s receipt of fees paid from the mutual fund or its agent rather than directly from the plan because the exemption covers a plan fiduciary who is “using its authority to cause *a plan* to pay a fee.” (emphasis added).¹⁰

ERISA Section 408(b)(14): The Pension Protection Act added a statutory exemption for investment advice because existing rules and exemptions were not providing sufficient opportunities for participants and IRA savers to obtain quality investment advice. Unfortunately, more than four years later, the Department still has not issued final guidance.

In early 2009, the Department issued a final rule (now withdrawn) for a class exemption with respect to advice to IRAs.¹¹ The class exemption addressed a number of uncertainties regarding the PPA’s statutory language, including the reference to “off-model” advice and the application to IRAs offering access to a wide range of investments and would have provided a clear path for firms to provide quality investment advice under strict conditions.

⁸ See 41 Fed. Reg. 56760, 56761 (Dec. 29, 1976) (preamble to proposed PTE 77-9).

⁹ The Department often has taken the position that investment advice fiduciaries “cause” plans and participants to take actions and can therefore be liable for the result.

¹⁰ Indeed, one court rejected arguments that PTE 86-128 could cover a fiduciary’s receipt of fees from a third party in connection with a plan’s investment transactions. *Chao v. Linder*, 421 F. Supp. 2d 1129, 1138 (N.D. Ill. 2006) (“In looking at the plain language of the exemption it is clear that a covered transaction is one in which a plan itself pays the fees of the fiduciary. Defendants neither pointed to nor could we find any indication in the exemption itself, or in the explanation and history of the exemption, that PTE 86-128 was intended to cover commissions paid by a third party to the fiduciary.”)

¹¹ See 74 Fed. Reg. 3822 (Jan. 21, 2009).

The Department's latest, and very controversial, proposal eliminates the class exemption and would include a new condition that suggests that computer models cannot consider historical performance in distinguishing among investment options in an asset class.¹² The Department also suggested it might embark on a process to determine or define the generally accepted investment theories under which plan assets should be invested. An exercise to define generally accepted investment theories would have implications far beyond computer models under the PPA exemption.¹³ The uncertainty about the scope of section 408(b)(14) makes it very difficult for firms to develop advisory programs for ERISA plans or IRAs and this frustrates Congress' goal of increasing access to investment advice to retirement savers.

3. The Department should assure that the exceptions for information related to platform investments work.

The proposal includes two exceptions related to platforms of investments offered by recordkeepers. While our hearing testimony urged the Department to retain these platform exceptions, most of the discussion at the hearing focused on other issues, including the seller's exception, which we urged the Department to retain and clarify. We want to reiterate here the importance also of maintaining and clarifying the platform exceptions to ensure that recordkeepers can continue to offer a range of services – not involving impartial investment advice – that assist fiduciaries in making decisions regarding plan menus.

In our comment letter we provided examples of this assistance, none of which involve a recordkeeper undertaking to provide individualized recommendations about what decisions plan fiduciaries should make. For example, in responding to a plan's Request for Proposals, a 401(k) recordkeeper may provide a sample plan line-up to give plan fiduciaries a sense of the overall cost of a recordkeeping arrangement and a sense of the funds available on the recordkeeper's platform. Recordkeepers also may work with plans they serve to develop objective screens that the recordkeeper can run for the plan to help the plan narrow the universe of available funds for initial selection and monitor over time the funds fiduciaries select for the menu. They also may provide a sample investment policy statement or discuss with a plan how its existing investment policy statement would work in the context of the recordkeeper's available investments. Finally, when plan fiduciaries decide to replace a fund on the menu they will often ask the recordkeeper to suggest funds that are reasonably similar to the one being removed.

We believe the Department's exemptions for investment platforms are intended to cover these types of routine information and assistance that recordkeepers provide. Our members are concerned,

¹² See 75 Fed. Reg. 9360 (March 2, 2010).

¹³ See Institute Comment Letter from Mary Podesta on 2010 Investment Advice Proposed Rule (May 4, 2010), available at <http://www.dol.gov/ebsa/pdf/1210-AB35-029.pdf>.

however, that the language is somewhat vague and believe it important the Department either confirm that this information and assistance is covered or clarify the language to assure that it is.

* * * *

The lack of adequate relief provided by existing exemptions bears on the full IRA market analysis Department will need to undertake and publish before finalizing any changes to its fiduciary definition. In its economic analysis for this new proposal, the Department states that the effect of the regulation largely will be that service providers will “modify their business practices to ensure that they act solely in the interests of their employee benefit plan clients and the plans’ participants and beneficiaries as required by section 404 of ERISA.”¹⁴ The Department concludes that costs associated with these modified business practices are less than benefits from “improvement in service value,” although the Department admits it cannot quantify these benefits.

We disagree with the Department’s conclusions on how service providers to plans and IRAs would react to the proposal if finalized in its proposed form. Many firms decide from the outset whether a service will be offered as a fiduciary service, and if it is not, the firm designs the service (and the information and assistance provided with it) so that the firm can be sure it does not cross into fiduciary status. These firms will react by scaling back their services. While other firms may opt to maintain services the rule recharacterizes as fiduciary and to operate under the revised new rule, the foregoing discussion makes plain that firms cannot simply “modify their business practices” because existing class exemptions contain too much uncertainty to allow clear opportunities to offer fiduciary investment advice. The Department needs to revise its analysis to consider the cost to 401(k) and IRA savers who will lose access to the information and assistance they receive now to help them make investment decisions.

The Department’s first goal in making appropriate revisions to the rule should be to clearly and properly draw a line between commonplace financial market interactions (which do not trigger fiduciary burdens) and advisory relationships (which do). The possible availability of exemptions does not relieve the Department of the obligation to make any changes to this long-standing rule clear and workable.

Our comment letter details the ways the Department should modify the proposal to ensure it captures only true advisory relationships. This includes applying the proposal only to individualized advice pursuant to a mutual agreement, removing the triggering “status” conditions for those who happen to meet the definition of investment adviser under the Advisers Act or are a fiduciary for other purposes, clarifying the exceptions for sellers and platform providers, and applying the exceptions for 401(k) plans to IRAs. Taken together, these issues and others raised at the hearing will require significant changes to the text of the proposed regulation. Because of the importance of getting this project right, the Department should seek another round of comments through a reproposal.

¹⁴ 75 Fed. Reg. at 65273.

Thank you for the opportunity to supplement the hearing record. Please feel free to contact the undersigned at 202.326.5826 (podesta@ici.org) or Michael Hadley at 202.326.5810 (mhadley@ici.org) with any questions.

Sincerely,

A handwritten signature in black ink that reads "Mary P. Podesta". The signature is written in a cursive style with a large initial "M".

Mary Podesta
Senior Counsel – Pension Regulation