DrinkerBiddle&Reath LLP

C. Frederick Reish
Partner
310-203-4047 Direct
310-229-1285 Fax
fred.reish@dbr.com

Law Offices

1800 Century Park East
Suite 1400
Los Angeles, CA
90067-1517

(310) 203-4000 phone
(310) 229-1285 fax
www.drinkerbiddle.com

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<u>Via Electronic Mail - e-ORI@dol.gov</u>
Office of Regulation 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, D.C. 20210

Re: Proposed Regulation on Fiduciary Investment Advice

Dear Sir/Madam:

I am writing to provide additional comments on the proposed amendment to the regulation defining fiduciary investment advice, §2510.3-21(c), and to request additional clarification of the application of the proposed regulation, if adopted, with regard to the "platform" exception. In that regard, I support the comments filed by the American Benefits Council ("ABC") and, in this letter, augment those comments. The specific comments referenced in this letter are found in the section of the ABC correspondence to the Department entitled <u>Plan Menu of Investment Options</u>.

The ABC comments were particularly insightful with regard to the practical operations of the provider marketplace.

The ABC comments and my commentary are as follows:

- *The service provider may provide the plan fiduciary with objective factors that others commonly use in selecting plan menus, such as fund ratings, past performance (measured against competitive funds), risk measurements, fees, and manager tenure.*

  <u>COMMENTARY</u>: Small plan sponsors, who are often unsophisticated in financial matters, would find value in the observations and experiences of others, including common investment industry experiences and criteria, practices of other plan sponsors, and observations of providers. In order for small plan sponsors to be able to make decisions about "individualizing" the investment line-up for their participants (for example, fewer and more traditional investments for a less educated workforce), they would benefit greatly from an understanding of what other plan sponsors or knowledgeable investment industry practitioners are doing, as well as from data and information from providers (*e.g.*, recordkeepers) based on their experiences and on commonly accepted industry criteria. This

information is, virtually by definition, generic and not individualized to the plan. Therefore, providing this information should not be considered to be individualized, that is, to be fiduciary investment advice.

While that conclusion may be fairly obvious to ERISA experts, the lack of specific guidance in the area is disconcerting to providers and, in fact, some courts may have difficulty, without DOL guidance, in understanding the subtle distinctions between general information and individualized recommendations. It is easy to forget that many of our concepts and theories are not easily understood by others, including judges in the court system and arbiters in arbitration settings. Therefore, I urge the DOL to provide additional, explicit guidance in this area, perhaps in the form of comments in the preamble to the final regulation, if adopted.

- *The service provider may screen funds based on objective criteria that are provided by the plan fiduciary or that are commonly used in the industry. For example, if the plan fiduciary establishes criteria based on fund ratings, past performance (measured against competitive funds), fees, risk, and manager tenure, the service provider may screen the available funds based on such criteria and provide the plan fiduciary with fund options that meet the plan fiduciary's criteria. Within each investment category, there would generally be multiple funds for the plan fiduciary to choose from, but in some circumstances, there could be a single fund.*

COMMENTARY: While general information about investment criteria and performance may be helpful to unsophisticated plan sponsors, there is a need to apply those criteria to the investments available on a platform in order to reach a limited and reasonable list of investment alternatives to be offered by a plan. That involves two decisions: First, which asset classes should be offered (in order, for example, to satisfy the broad range condition of the 404(c) regulation); and second, the selection of mutual funds or other investments to populate each of those asset classes. That process is somewhat complex and certainly time-consuming . . . unless it is computerized. To assist plan sponsors, providers should also be able to define and explain the criteria (for example, which criteria may produce the lowest cost mutual fund lineup). Focusing on the selection of the investments, plan providers should be able to offer, without fear of fiduciary status (and the resulting 406(b) prohibited transactions), the tools to assist plan sponsors in applying general investment criteria to the available investments. So long as the criteria are not biased, and so long as the plan sponsor has the right to include or exclude criteria, there is little, if any, opportunity for abuse. And, the value to the plan sponsor is substantial.

Key issues are: Are the criteria generally accepted by the investment community (and is there a representation to that effect); is the system such that the plan sponsor can exert sufficient control to minimize the possibility of bias (in other words, does a plan sponsor have adequate opportunity to use multiple selection criteria, and to eliminate and/or weight the criteria to avoid bias); and is the program designed to present investments that satisfy the criteria without representing that the provider is recommending them or that they are necessarily individualized to the plan?

- *The service provider may present non-individualized model plan menus that other similar businesses have chosen or that reflect a conservative, moderate, or aggressive investment approach, with an explanation of objective differences between the menus.*

COMMENTARY: As noted, the first step in the selection of an investment line-up for a 401(k) plan is to select the asset classes (or investment categories) that will enable the participants to assemble portfolios in their accounts that appropriately balance the risk tolerance of the participant with the participant's need for return. That is a fundamental part of modern portfolio theory, which in turn is a fundamental part of ERISA's investment concepts. However, it is probably fair to say that many small plan sponsors do not understand the concepts of modern portfolio theory, the selection of asset classes that are not highly correlated to each other, and so on. As a result, they need help . . . not with individualizing the investments to their plan or their participants—because plan sponsors know the demographics of their workforces (*e.g.*, ages, compensation, education levels, etc.), but instead with understanding and applying the broad concepts of asset classes and investment criteria. Given proper information and tools, plan sponsors can likely make decisions about which line-ups are appropriate for their plans. That is, plan sponsors can individualize the general information, categories of investments, alternative investment line-ups, and so on, to their plans. But, in all likelihood, they will have a difficult time doing that without being provided with general alternatives (that are not individualized, but instead are hypothetical) to accept, reject or modify.

In this sense, the suggestion of alternative generic line-ups (based on the practices of other plan sponsors or on general risk tolerance approaches by knowledgeable investors) can provide plan sponsors with valuable information to make decisions about the appropriate line-ups for their plans.

To avoid confusion, the alternative should be fully described (that is, it should be clear who prepared the line-ups and for what purpose), the responsibility of the plan sponsor to individualize the investment line-up should be clearly stated, the conflicts (if any) of the provider should be disclosed, and the ability of the plan sponsor to substitute, remove or add investments to the line-up should be prominently stated in writing.

- *In the context of responding to an RFP, it is very common for service providers to provide a non-individualized model plan menu of investment options. This is necessary for pricing purposes and it is made very clear that the model menu is not being recommended. This should not give rise to fiduciary status.*

  <u>COMMENTARY</u>: The purpose of the "non-individualized" investment menu is usually to provide the plan sponsor and fiduciaries with an illustration of revenue sharing and its impact on the cost of the recordkeeping services. To make the illustration meaningful, the provider will often provide an investment menu that is similar to the one that is currently in the plan (for example, funds in the same investment categories and/or with similar levels of revenue sharing). Without this information, it may be difficult for plan sponsors and fiduciaries to fully understand the indirect revenues and the true costs. In fact, based on the Department's interim final 408(b)(2) regulation, recordkeepers must provide similar information to responsible plan fiduciaries in order to engage in a reasonable arrangement. However, from the plan sponsor's/fiduciary's perspective, it is important to have an illustration before selecting the investments . . . in order to understand the impact of investment selection.

  Again, even though the illustrations are intended to be general and not individualized to the plan, there is a possibility that unsophisticated plan sponsors could interpret the investment line-up as being a proposal of specific investments for their plan. As a result, and in order to avoid that kind of confusion, it would be reasonable to require that the provider specifically state that the investment line-up is being presented for illustrative purposes only and is not a recommendation of investments to be included in the particular plan. In addition, the provider should state the rationale for the reference to the particular investments, for example, whether they were popular investment selections in the same or similar investment categories, whether they were selected to provide revenue sharing to cover the cost of recordkeeping the plan, or both . . . and so on.

- *The service provider may provide objective reasons that a plan fiduciary might choose one fund over another or might choose one model portfolio over another.*

COMMENTARY: General commentary and data may be valuable to plan sponsors in making their decisions. So long as the commentary or data is based on generally accepted investment theories and prevailing investment industry practices—as opposed to the individualized needs of the particular plan or its participants—it should not be considered investment advice. For example, recordkeepers might state that a particular investment has low volatility ratings, which may be preferred by many participants. Alternatively, a recordkeeper may note that an investment manager has overseen the particular mutual fund for a long period of time. Also, the provider may note that, even though a fund had poor performance in the recent past, the manager has a good long-term track record.

This type of information should include a specific disclosure that, in making the comments, the provider has not taken into account the particular needs of the plan or other factors specific to the plan or its participants. The information should clearly state that, instead, the commentary is based on generally accepted investment theories and prevailing investment industry standards that would apply to all plans and to long-term investing generally.

- *In some cases, a plan fiduciary may have decided to remove an investment option and may ask a service provider for a replacement fund that is, based on objective criteria, very similar to the fund being removed. Responding to this request with objectively similar funds—or a single fund if only one is objectively similar—should not give rise to fiduciary status.*

COMMENTARY: The Department could easily take an approach similar to Interpretive Bulletin 96-1 where it permits specific investments to be included in an asset allocation model, so long as the plan sponsor is told that there are other similar investments available to a plan and is told where information on those other investments can be obtained. Also, the disclosure should specifically state the criteria used by the provider in selecting the "objectively similar fund." (Also, providers should be able, without fiduciary status, to provide a calculator where plan sponsors can generate that kind of information for themselves.)

Of course, there should also be a disclosure that, in performing the analysis, the provider did not take into account the individualized needs of the particular plan and its participants, but instead applied general objective criteria. Further, to the extent that the provider, or any affiliate, receives any revenue sharing, internal crediting, or other fees or revenues from the similar fund, it should provide a statement that other choices may be available with lower expense ratios, different revenue sharing arrangements that are non-proprietary, and so on. In other words, any conflicts of interest should be disclosed together with a specific description so that the plan sponsor could properly evaluate the conflicts.

This issue is, in some ways, similar to the "reasonably similar" provision in ERISA section 404(c)(4). That is, under 404(c)(4), plan sponsors must select reasonably similar funds if they desire to maintain 404(c) protection on a conversion or similar events. In that case, it would be helpful and appropriate for non-fiduciary service providers to give plan sponsors information about "reasonably similar" investments on their platform, so long as it is made clear that (i) the recommendations are not individualized to the particular plan or its participants and (ii) adequate disclosure is made about conflicts of interest, the methodology of the analysis, and the availability of other reasonably similar alternatives.

Also, under the Aetna Advisory Opinion (AO 97-16A), providers can both remove and replace investment options on their platform if they follow the steps outlined in the advisory opinion. Perhaps that methodology could be extended, explained and amplified in the final regulation or in the preamble to the final regulation.

- *In some cases, the service provider encourages a plan to have at least one investment option in every specified asset class and to have a set of target date funds (or similar investments).*

  COMMENTARY: As mentioned earlier in this letter, many small plan sponsors are unsophisticated and do not understand the concepts of modern portfolio theory, such as, for example, the selection of asset classes or investment categories that are not highly correlated to one another. As a result, it is helpful to plan sponsors for providers to offer one or more sample line-ups of investment categories. That might be in the form of a single suggested set of investment categories or it may be several alternatives, for example, a conservative arrangement for less sophisticated workforces, a moderate arrangement, and an aggressive arrangement for more sophisticated workforces. However, it would be up to the plan sponsor to determine the individualized needs of its plan and its participants; that is, whether it is it appropriate for the workforce to have a conservative, moderate or aggressive line-up.

  While these services are helpful to small and or unsophisticated plan sponsors, they are not individualized. To ensure that they are not misunderstood, there should be specific representations to that effect, as well as a disclosure of any conflicts of interest.

- *A service provider might design its arrangements so that all "mapping" is done to the plan's QDIA.*

  COMMENTARY: Fiduciary status should be avoided if the provider has made it clear, at inception, that its sole method of intake for new plan clients is through a QDIA default process. Alternatively, if the provider has several alternative intake processes (for example, 404(c)(4) mapping, 404(a)(5) defaults to QDIAs, or other mapping procedures), and the plan sponsor may select from among them, the plan sponsor would have made the decision about the particular approach and the offering of the alternative should not be viewed as fiduciary advice.

  The key to this approach is that the service provider's approach or approaches for the intake of new plans should be described in writing to the plan sponsor prior to the provider being selected as the recordkeeper for the plan. The alternatives should be clearly and prominently described. In addition, any conflicts of interest (*e.g.*, proprietary products or increased compensation) should be described.

- *The service provider may also use the seller exemption. It makes little sense to prohibit a service provider from using the seller exemption in situations where the service provider is selling a particular plan menu.*

  COMMENTARY: The selling exemption is being interpreted in a variety of ways by the private sector. For example, some are interpreting it as applying only where the seller owns or creates a particular asset. That might include the seller of real estate or the seller of an insurance policy. (Similarly, the agent portion of the seller's exemption is being interpreted in a variety of ways by the private sector. For example, some believe that it applies only to situations where a person is contractually an agent of the seller of property as described above.) Another example of an interpretation of the selling exemption is that a seller may distribute so-called "proprietary" products. For example, in that case, an investment management firm might manage a mutual fund which, of course, it does not own. Instead, it has a fiduciary (under the securities laws) management advisory relationship. Can the investment manager, or an affiliated entity, sell something it does not own? Would it be entitled to the selling exemption? Those questions are unresolved.

  Similarly, is an unrelated broker-dealer entitled to the seller's agent status where it does not have a traditional agency relationship with the mutual fund and particularly where the broker-dealer has independent legal obligations to the plan, for example, the suitability standard? Those issues are unresolved.

The Department needs to provide additional guidance in this area to avoid confusion and unexpected violations of the prohibited transaction rules. Given the lack of definition in the proposed regulation of a "seller" and of an "agent," it has been particularly difficult for the private sector to understand the limitations, if any, on this exception from the prohibited transaction rules. It is imperative for the Department to provide additional guidance.

As an additional comment, the so-called platform exception is being interpreted in a number of ways in the private sector. Perhaps the most obvious application is the situation where a provider has a limited line-up of mutual funds and other investments, for example, 200 investment alternatives. In that context, the exception is easily understood. Some providers, though, interpret the exception to apply to "open architecture" recordkeepers (*i.e.*, the recordkeeper is the "platform") where thousands of investments are offered. It is important that the Department clarify its intentions on this issue. Otherwise there is a risk of inadvertent fiduciary status and resulting 406(b) prohibited transactions.

Finally, the proposal provides that the second prong of its definition is satisfied if the "person" or an affiliate is a registered investment adviser or serves as a fiduciary for the plan in any respect. Both of those provisions are unworkable. For example, most bundled providers have affiliated registered investment advisers. They may provide fiduciary investment advice to other plans (but not the subject plan), they may manage affiliated mutual funds or collective trusts, or they may provide other investment services not related to the subject plan. In fact—and as is often the case, the plan sponsor and participants may not even know that the provider has are affiliated RIA. Nonetheless, in those circumstances, virtually any list of investments could be viewed as "recommendations," even though the investments are not individualized to the plan or its participants. The risk of litigation in that scenario is unreasonably high with no corresponding benefit to the plan. Needless to say, it will have a chilling effect.

Similarly, a bundled provider may have an affiliated ERISA fiduciary who has no impact on the selection of investments to be offered in a 401(k) plan. For example, the investment manager of a stable value collective trust is an ERISA fiduciary for a contract or product and must make that disclosure under the 408(b)(2) regulation. As with registered investment advisers, the indirect fiduciary status would result in the possibility of also being an investment adviser for selection of the plan's investment alternatives where a list of investments is provided to the plan sponsor even if it is clear that the list is not individualized to the needs of the plan or its participants. It is not good policy to put providers at risk with no corresponding benefit to plans or participants.

Please contact me if you would like further information on any of these comments.

Very truly yours,

C. Frederick Reish

CFR:mes/shm

cc: Phyllis C. Borzi, Assistant Secretary of Labor, U.S. Dept. of Labor, EBSA
Michael L. Davis, Deputy Assistant Secretary, U.S. Dept. of Labor, EBSA
Fred J. Wong, Pension Law Specialist, U.S. Dept. of Labor