Morgan Stanley

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U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

RE: RIN 1210-AB82 – Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions

Ladies and Gentlemen:

We respectfully submit Morgan Stanley's comments pursuant to the Department of Labor's Request for Information regarding its Fiduciary Rule and related Prohibited Transaction Exemptions ("RFI") published in the Federal Register on July 6, 2017. These comments should be considered in conjunction with our most recent July 20, 2017 submission to the Department and are primarily intended to address certain key topics as described in Questions 2-18 of the RFI.

In our July 20, 2017 submission, we asked that the Department delay the January 1, 2018 applicability date of the Fiduciary Rule and related Prohibited Transaction Exemptions, as we believe that such a delay is prudent and necessary and in the interest of retirement investors. In addition, we strongly encouraged the Department to announce a delay very quickly after the end of the fifteen (15) day comment period. Financial institutions, especially those serving hundreds of thousands of retirement investors, such as Morgan Stanley, require significant lead times to train and educate its financial advisers and support staff, building operational and control functions to comply and ensure effective communication to clients. Given the uncertainty surrounding the Rule over the past nine months, it will be difficult, if not impossible, absent the curtailment of certain products and services, to effectively comply with the necessary exemptive relief if a delay is not granted immediately.

With respect to the remaining questions posed in the RFI, and as described more fully herein, Morgan Stanley believes the Department should consider the following:

- **New exemptive relief, promulgated in concert with the Securities and Exchange Commission, should be premised on financial institutions maintaining their own policies and procedures that ensure that its financial advisors are acting in their client's best interest when providing investment advice.** The Department and the SEC should explore the creation of a regulatory framework that features harmonized standards applicable to all retail investors and simplified sales practices that can be applied across the industry regardless of a financial institution's business model.

- **The Best Interest Contract exemption, and any new streamlined exemption(s), should be constructed in a manner so as to not restrict client choice or stifle market innovation.** We encourage the Department to develop exemptive relief that allows financial institutions to make their own decisions about the types of investment products offered to its clients. Any rulemaking that effectively limits investment options, preferences one type of investment over another, or prevents financial institutions from developing new products, is ultimately not in the best interest of the clients.

- **The contract requirement in the Best Interest Contract exemption and Principal Transaction exemption should be eliminated.** Financial institutions do not need to be "incentivized" to comply with existing law in running their businesses. The existence of a private right of action in the exemptions acts, instead, as a deterrent to firms who wish to serve retirement investors.

- **We agree with the Department that full and fair disclosure is necessary and think it should be the foundation of any interaction with a retirement investor.** We strongly advocate for a simplified disclosure regime in the Best Interest Contract exemption, and in any other regulatory response the Department develops. In particular, we believe such disclosure should be based primarily on existing disclosure requirements (preferably, ERISA section 408(b)(2)).

Notwithstanding the ensuing discussion regarding improvements to the exemptions laid out herein, Morgan Stanley firmly believes that the most appropriate path forward requires the Department to coordinate closely with the Securities and Exchange Commission to develop a regulatory framework that applies to all retail investors. Considering the overwhelming industry desire to have a harmonized standard of care, and both agencies' public statements that each welcomes coordination with the other, we strongly urge the Department to work towards that end.

As mentioned in our July 20, 2017 submission, Morgan Stanley is supportive of the joint development of a workable best interest standard and appropriate set of protocols that will allow for a financial service provider's primary regulator (e.g., SEC and/or FINRA for a broker-dealer) to enforce that standard of care across all retail investors while satisfying any retirement-specific considerations important to the Department.

In developing this harmonized standard, we encourage the two agencies to settle on an enhanced standard of care that incorporates "best interest" considerations not dissimilar to the Impartial Conduct Standards that are inforce and protecting retirement investors today. However, as discussed more fully above, we strongly believe the compliance with this increased standard of care should lie directly with the financial institution providing investment advice and the agencies that regulate it and not via a deputized army of private litigators. Financial institutions should be required to maintain robust policies and procedures designed to ensure that financial advisers are acting in the best interest of clients. Failure to maintain or comply with such policies and procedures should have consequences, in the form of regulatory enforcement, self-correction procedural mechanisms and via traditional conflict dispute arrangements (e.g., FINRA arbitration), where the failure has caused direct client harm. Furthermore, compliance with an enhanced standard of care should be supplemented with fair and full disclosure of a financial institutions' business model, fees, services, and material conflicts of interest.

This type of principles-based standard of care, coupled with a more reasonable compliance framework will allow financial institutions to offer a robust suite of products to the broadest segment of retirement investors, and will not serve to stifle product and platform innovation while still keeping the interests of clients of paramount importance.

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Since the Fiduciary Rule and Related Prohibited Transaction exemptions, the Best Interest Contract exemption (the "BIC exemption") and the Principal Transaction exemption (the "PrTE") (together, the "Exemptions"), were finalized in April of 2016, Morgan Stanley has made significant changes to its business model in an attempt to comply with the new regulatory construct. As we have seen, many, if not all, other broker-dealers have taken similar (or vastly different, for that matter) steps. Unfortunately, many of these machinations have led directly to restricted product and platform offerings available to retirement investors. While we believe the Department was attempting to develop a regulatory framework that would benefit retirement investors and be workable for financial institutions, clearly it could not have intended to restrict the services and investment products offered to those same investors.

A primary example of this type of problematic change is the industry's varied reaction towards the offering of mutual funds. Since the announcement of the Fiduciary Rule and BIC exemptions, as the Department has seen, intermediaries have been working with mutual fund companies on the possibility of amending the fee structure existing share class structures, the development of T-shares, and, to a lesser extent, the implications of offering "clean" shares.

Each of these potential approaches to offering compliant mutual fund charge structures has its merits as well as drawbacks. However, we believe that financial institutions should be allowed to decide which of these options to offer based on client demand and traditional market factors without having the Department provide its blessing to one specific approach. Financial institutions, such as Morgan Stanley are in the unique position of being a key player within the capital markets and financial services industry, while, simultaneously, having intimate knowledge of the needs and desires of American consumers through its financial advisor network.

From all accounts, it appears that the Department is seriously considering potential new exemptive relief based on intermediaries that offer "clean" shares as the vehicle for mutual fund purchases. We believe the Department may be misguided if it dictates to the financial services industry and consumers that only one mutual fund share pricing structure is appropriate for retirement investors. We also believe an exemption for a single fund structure would not address other critical aspects of the Best Interest Contract exemption that relate to offering mutual funds. Developing product-specific exemptions can be short-sighted as the industry is constantly evolving. Further, most broker dealers develop their brokerage platforms to accommodate multiple types of investment products, a true benefit for those clients that want access to open-architecture investing. As a general matter, we urge the Department to allow the financial services industry, based upon the demand and interests of customers, to organically build upon the existing mutual share class structure and the manner in which these securities are distributed.

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In the RFI, the Department asked industry participants to comment on whether or not financial institutions would be sufficiently incentivized to comply with the Impartial Conduct Standards if the contract and related warranties were removed as conditions to the BIC exemption and PrTE. For the reasons outlined herein, we strongly encourage the Department to eliminate the contract requirement, the private right of action and the contractual warranties from the Exemptions altogether.

Morgan Stanley, like all reputable financial institutions, maintains a comprehensive set of policies and procedures that are designed to comply with applicable law, function as a guidepost for its employees and, at the same time, serve as protection for the firm's clients. We have strong incentives to comply with these policies and procedures, as the cost of non-compliance has the effect of creating reputational risk for the firm, inviting regulatory scrutiny and financial penalties from the firm's prudential regulators, and endangering the financial well-being of our most treasured resource: our clients. If Morgan Stanley took such a non-compliant approach, it would simply not survive, much less thrive.

On a practical level, the contractual requirements under the Exemptions have two very damning fallouts. For one, as alluded to above, financial institutions, as a result of these requirements, are taking drastic, sometimes draconian, steps to revise their business models to effectively eliminate the possibility that they could get sued. Ultimately, this type of "de-risking" is at the expense of retirement investors, who may not have the ability to purchase and hold an investment that would be beneficial to them. Second, if financial institutions were to embrace the existing Exemptions and the attendant contract requirement, even the most stringent attempts to comply with the Exemptions' other conditions could provide a windfall opportunity for enterprising plaintiff's attorneys who are looking to capitalize on even the slightest missteps from well-intentioned financial institutions, even where the harm to retirement investors is minimal or non-existent. While some financial institutions (large and small) have decided to limit products and services to retirement investors due to the perceived threat of litigation, we fear the movement would change to a stampede the moment the first lawsuit is filed, leaving all but the wealthiest retirement investors with no access to investment advice.

Fortunately, we were heartened to read Secretary Acosta's acknowledgment in his May 22nd, 2017 Wall Street Journal Op-Ed piece that the Exemptions, as currently constructed, could serve as a "boon to trial attorneys" as a result of the private right of action associated with the contract and warranty conditions. Clearly, the Secretary shares our concern on this important issue. Further, this type of requirement seems to fall squarely in line with the President's February 3rd, 2017 memorandum directing the Department to examine the Fiduciary Rule and Exemptions with special consideration of "Whether the Fiduciary Duty Rule is likely to cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services." We believe that reasonable minds can agree that the response to this inquiry is clearly that the contract requirements under the Exemption would absolutely lead to increased litigation and, as a result, higher costs in the financial services industry.

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Pursuant to question 13 of the RFI, the Department asks whether there are ways in which to simplify the BIC exemption disclosures. The Department goes on to ask whether or not model disclosures could be helpful to establishing a disclosure regime. As discussed below, Morgan Stanley advocates a simplified disclosure regime based on existing requirements.

We understand that the securities marketplace can be confusing, especially for those individuals without financial expertise. The myriad types of securities available, the different vehicles in which consumers invest, and the variable fee structures associated with these securities can be enough to bewilder even those investors with a working knowledge of the financial markets. In consideration of these premises, Morgan Stanley agrees that any exemptive relief should have, as its cornerstone, full and fair disclosure requirements.

Naturally, the questions center around the form in which these disclosures should be presented to clients, the frequency with which they should be delivered, and the content contained therein. In this regard, we urge the Department to resist the temptation to "re-invent the wheel" with respect to disclosure obligations. Rather, we believe that existing disclosure requirements should be built upon, as opposed to creating new disparate disclosure.

In our view, the disclosure requirements under ERISA section 408(b)(2) serve as an ideal foundation for any disclosure the Department views necessary under the Fiduciary Rule. Current 408(b)(2) disclosures are designed to provide ERISA-covered retirement plans with robust information regarding the financial institutions services and compensation to assist those plans in assessing the reasonableness of such compensation. As a primary matter, while the 408(b)(2) disclosure is meant to cover only ERISA plans, it could also easily be constructed to apply to IRAs in light of the Fiduciary Rule and, for that matter, non-retirement accounts as well. Having a single standard disclosure applicable to all of their retail accounts would certainly reduce client confusion. To satisfy the Department's requirement that the retirement investor is fairly informed of relevant conflicts of interests, we would propose to add relevant and material conflicts of interest to this existing disclosure construct. Additionally, financial institutions could add relevant disclosures and general descriptive information about their business models to satisfy some of the more granular aspects of its business not necessarily covered by the 408(b)(2) disclosure as it exists today.

And, as for delivery method and timing, we would propose that these disclosures would be provided at account opening and, annually thereafter. In addition, financial institutions would maintain public websites that housed the disclosures such that retirement investors could access the most recent disclosure without having to contact their financial adviser or service provider. To the extent there are any material changes to the disclosures, financial institutions would be required to update the website within 60 days of such change in relevant information.

Importantly, we view this type of simplified, scalable disclosure regime as critical in complying with different regulatory changes that may occur in the coming months and years. We are concerned that the states will soon be adopting or changing their own fiduciary standards and disclosure requirements, as recently demonstrated in Nevada. It is highly inefficient to develop myriad and disparate disclosure systems when there is an existing structure that, with the additional disclosures described above, can satisfy the vast majority of regulators' concerns.

Lastly, as for the concept of model disclosures, we do not believe that it is practical to develop a standard set of disclosures to be applicable across an entire industry. Firms, even within the same industry, can maintain vastly different operating structures and forcing these firms to adopt a template or model set of disclosures just will not work. Again, as iterated above, we encourage the Department to allow financial institutions to provide services to their client without undue encumbrance and, unfortunately, model disclosures are a step in the wrong direction.

We thank the Department for considering our thoughts and comments on the RFI and look forward to continued dialogue in the months and years to come.

Sincerely,

Anne T. Cooney

Anne T. Cooney
General Counsel of Wealth Management