

August 7, 2017

*Via Electronic Submission*

(RIN 1210-AB82)  
Office of Exemption Determinations, EBSA  
Attention: D-11933  
U.S. Department of Labor  
200 Constitution Avenue N.W., Ste 400  
Washington, DC 20210

**Re:** Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions

Dear Ladies and Gentlemen:

LPL Financial LLC (“LPL”) appreciates the opportunity to respond to the Department of Labor’s (the “Department”) request for additional input from the public about possible additional exemptive relief or changes to its fiduciary rule (the “Rule”). This submission is made pursuant to the Department’s Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions published in the Federal Register on July 6, 2017.

In the comments that follow, we offer our proposal regarding the creation of guiding principles that will promote innovation and allow financial institutions to better serve and protect investors. We also provide suggestions to clarify the definition of fiduciary investment advice in the Rule and to address class action risk associated with the Best Interest Contract (“BIC”) Exemption.

**I. The Department should propose a new principles-based exemption for advice with respect to mutual fund sales.**

In its request for information, the Department notes that it has received public input suggesting that innovations in the financial services industry, specifically the development of mutual fund “clean shares” (i.e., a class of shares of a mutual fund without any front-end load, deferred sales charge, or other asset-based fee for sales or distributions), may warrant more streamlined exemptions or rule changes. LPL applauds the Department’s willingness to recognize and facilitate innovations in the financial services industry as it considers potential changes to the Rule, and encourages the Department to further encourage and facilitate product and service innovations more generally by adopting a principles-based exemption for financial institutions rendering investment advice about mutual funds to retirement investors. We believe that adopting a principles-based approach, rather than granting exemptions regarding mutual funds that are specifically tailored to the approaches currently being considered and developed by industry participants, would help the Department achieve its goals of protecting retirement investors, while also providing flexibility to accommodate more innovation in the future, and thus competition, in the mutual fund industry.

The Department has expressed the following goals with respect to the Rule:

- The Rule is intended to protect investors from financial professionals who: “may give imprudent and disloyal advice; steer plans and IRA owners to investments based on their own, rather than their customers’ financial interests; and act on conflicts of interest...”<sup>1</sup>
- The Rule should not “create a highly prescriptive set of transaction-specific exemptions,” but instead should “flexibly accommodate a wide range of current types of compensation practices, while minimizing the harmful impact of conflicts of interest on the quality of advice.”<sup>2</sup>

Consistent with these goals, it is our recommendation that the Department grant a new exemption for mutual funds based on three conditions that financial institutions should follow when rendering advice about mutual fund investments to retirement investors. Those conditions would require financial institutions to do the following:

1. **Provide advice that meets the impartial conduct standards.** To meet the impartial conduct standards, the financial institution and its financial professionals must:
  - ***Provide advice that is prudent and loyal.*** The standards of prudence and loyalty are based on longstanding concepts derived from ERISA and the law of trusts, and also draw on the “best interest” advice construct under the BIC Exemption. Under these standards, the financial institution and its financial professionals must provide prudent investment recommendations, and put investors’ interest ahead of their own financial interests or those interests of its affiliates and other parties in which they have a pecuniary interest.

The Department recently clarified that these standards can be satisfied even “if a fiduciary adviser recommends ... investments that generate commissions or other payments that vary with the investment recommended,” so long as the financial institution safeguards compliance with the impartial conduct standards.<sup>3</sup> Further, the Department clarified that financial institutions “retain flexibility to choose precisely how to safeguard compliance with the impartial conduct standards, whether by tamping down conflicts of interest associated with adviser compensation,” or some other means.<sup>4</sup> We request that the Department confirm this interpretation in any new exemption it grants.

- ***Receive no more than reasonable compensation in connection with the investors’ purchase, sale, or holding of mutual fund shares.*** The recommended mutual fund transaction must not cause the financial institution to receive, directly or indirectly, compensation for its services that is in excess of reasonable compensation within the meaning of ERISA Section 408(b)(2), Internal Revenue Code (the “Code”) Section 4975(d)(2).

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<sup>1</sup> Definition of the Term “Fiduciary”; Conflict of Interest Rule – Retirement Investment Advice, 81 Fed. Reg. 20,946 (Apr. 8, 2016).

<sup>2</sup> *Id.*

<sup>3</sup> Conflict of Interest FAQs (Transition Period) (May 2017).

<sup>4</sup> *Id.*

We note that the ERISA and Code provisions do not provide explicit definitions of what constitutes “reasonable” compensation; however, in adopting the BIC Exemption, the Department explained that the principle of reasonable compensation requires that “compensation not be excessive, as measured by the market value of the particular services, rights, and benefits”<sup>5</sup> a fiduciary provides to its investors.

We would also ask that the Department recognize other applicable rules adopted or guidance issued by the Securities and Exchange Commission (“SEC”) or an applicable self-regulatory organization in its interpretation of “reasonable compensation.” Specifically, the Financial Industry Regulatory Authority (“FINRA”) has adopted rules that govern the nature and amount of commissions received by broker-dealers in connection with mutual fund transactions. Two FINRA rules are particularly relevant here: Rule 2121, which prohibits broker-dealers from charging more than a “fair commission or service charge, taking into consideration all relevant circumstances”; and Rule 2341, which prohibits broker-dealers from effecting sales and redemptions of mutual fund shares that charge excessive sales charges. FINRA Rule 2341 also limits asset-based sales charges (i.e., 12b-1 fees) to 0.75% of a fund’s average annual net assets and limits shareholder service fees to 0.25% of average annual net assets.

- ***Not make materially misleading statements.*** To meet this standard, financial institutions and financial professionals should fairly disclose information regarding their advice, compensation and material conflicts of interest.
2. **Provide transparency through separate written disclosure of potential conflicts of interest, fees, and other charges.** Prior to, or at the time of account opening, and upon any material change to the disclosed information, the financial institution must provide the investor with separate written disclosure that describes material conflicts of interest and discloses any fees or charges imposed on its investors, and any compensation it expects to receive from third-parties in connection with mutual funds recommended to its investors.
  3. **Minimize financial incentives for financial professionals to favor sales of particular mutual funds.** The financial institution must structure its mutual fund sales arrangements to minimize financial incentives for its financial professionals to favor sales of particular mutual funds. This condition would tightly constrain the operation of conflicts of interest by mitigating the risk that a financial professional’s recommendation of a particular mutual fund is not influenced by the compensation he or she is eligible to receive.

This exemption should apply broadly and not be limited to the recent innovation of “clean shares” that the Department has highlighted as a possible “long-term solution to the problem of mitigating conflicts of interest with regards to mutual funds.”<sup>6</sup>

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<sup>5</sup> 81 Fed. Reg. at 21,029.

<sup>6</sup> Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions, 82 Fed. Reg. 31,278, 31,279 (July 6, 2017).

## **II. LPL’s mutual fund only platform is intended to meet the guiding principles underlying the proposed exemption.**

LPL has announced that it is building an investment platform that is expected to serve as a portal through which its brokerage investors can purchase shares of mutual funds (the “Platform”). Though the Platform is a work in progress, it is intended to be structured in such a way that it can satisfy the principles underlying the conditions of the proposed exemption discussed above, and otherwise have the flexibility to meet regulatory and market changes.

### ***A. The Platform.***

To invest through the Platform, an investor must purchase shares of a designated money market or similar type of mutual fund (“Gateway Fund”). Shares of the Gateway Fund will be “clean shares” without any front-end load, deferred sales charge or asset-based fee for sales or distribution, but each separate purchase of Gateway Fund shares will be subject to an upfront sales commission payable to LPL. LPL will share a portion of this upfront sales commission with its financial professionals. Investors may also be eligible for discounts on that upfront sales commission based on the amount of assets invested.

After purchasing Gateway Fund shares, the investor can exchange to and among approximately 1,500 mutual funds across twenty mutual fund sponsors available on the Platform (“Platform Funds”), which offer “load-waived” share classes. LPL will act as agent in arranging purchases and redemptions of the Platform Funds and the Gateway Fund. Investors will not be charged upfront commissions or other sales charges or transaction fees (other than fees, if any, imposed directly by the Platform Funds for short-term redemptions) by LPL, the Gateway Fund, or any of the Platform Funds in connection with any redemption of holdings or subsequent investments and reinvestments. This allows investors to make purchases and redemptions of Platform Funds over time without incurring any additional transaction fees. Thus, payment of the upfront sales commission for Gateway Fund shares affords LPL investors with access to a broad array of mutual fund offerings and, most significantly, the right to exchange investments freely among different funds and across mutual fund families.

LPL will receive compensation from the Platform Funds and their affiliates in a generally consistent amount based on the value of investors’ total investments in such Platform Fund. This compensation will be comprised of revenue sharing payments, recordkeeping and sub-transfer agency fees, shareholder servicing fees, and distribution fees paid pursuant to a Rule 12b-1 plan. Of that total fund compensation, LPL will receive from each of the Platform Funds approximately the same amount in Rule 12b-1 fees. LPL will share a portion of the Rule 12b-1 fees with its financial professionals.

***B. Provide advice that meets the impartial conduct standards.***

LPL has designed the Platform to facilitate compliance with the impartial conduct standards. In particular:

- ***Provide advice that is prudent and loyal.*** In an effort to meet these standards, LPL has sought to mitigate the conflicts of interest that arise through recommendations by financial professionals of mutual funds by designing the Platform to provide for the same general amount of compensation from the Platform Funds. As further discussed below in the section describing the consistency of LPL's charges, this minimizes the incentive for financial professionals to favor certain mutual fund offerings over others.

Once on the Platform, LPL investors also have the benefit of free exchanges among 1,500 mutual funds and across twenty mutual fund sponsors. This means that an investor can redeem shares of the Gateway Fund, use those proceeds to reinvest in any of the Platform Funds, and subsequently switch assets between Platform Funds without additional charge. Typically, financial institutions limit the exchange privilege offered to mutual fund shareholders so that investors have the ability to exchange investments in a fund for another fund *within the same fund family* at no additional cost. In this respect, the Platform will offer investors greater flexibility and broader choice to switch funds if their investing needs change.

Though the Platform's compensation structure is designed to be of greater value for investors who expect to diversify their holdings across multiple mutual funds and make purchases and redemptions on a recurring basis, their financial professional's compensation ultimately does not depend on this behavior. While mitigating conflicts of interest, this aspect of the Platform also complements the general nature of mutual fund investing and the behaviors of retirement investors.

- ***Receive no more than reasonable compensation in connection with investors' purchase, sale, or holding of mutual fund shares.*** We believe that the commissions and other fund compensation that would be received by LPL and its financial professionals in connection with the Platform will be reasonable in relation to the value of the services that an investor would receive by participating on the Platform. The assessment of this reasonableness is a subjective test measured against the market value of the particular services, rights, and benefits pursuant to Department guidance and also in light of FINRA's fairness standard.
- ***Not make materially misleading statements.*** To meet this standard, and as discussed in more detail below, LPL will fairly disclose information regarding their advice, compensation and material conflicts of interest.

***C. Provide transparency through separate written disclosure of potential conflicts of interest, fees, and other charges.***

To provide greater transparency to investors, LPL will provide investors with a brochure that describes the Platform in detail prior to or at the time of account opening. The brochure will disclose, among other things: (i) the amounts of the up-front sales commission for purchases of the Gateway Fund and the Rule 12b-1 fees and other compensation payable with respect to the Platform Funds, (ii) that the upfront sales commission would not apply if an investor purchased shares of the Gateway Fund directly from the fund or another broker-dealer; and (iii) that investors could purchase shares of the Platform Funds, either directly from such funds or from another broker-dealer, without first having to purchase shares of the Gateway Fund and incurring an upfront sales commission. The brochure will also contain a description of the Platform services and LPL's and its financial professionals' material conflicts of interest with respect to the Platform. Investors will also receive a prospectus for the Gateway Fund and the Platform Funds, which contain required disclosures about the amount of fees and expenses associated with the funds, and other legally required disclosures.

We also note that investors will receive a confirmation containing the information required by Rule 10b-10 under the Securities Exchange Act of 1934 (the "Exchange Act") each time a purchase of Gateway Fund or Platform Fund shares is made. This information will include, among other things, information about the transaction and the amount of the applicable upfront sales commission.

***D. Minimize financial incentives for financial professionals to favor sales of particular mutual funds.***

The Platform minimizes financial incentives for financial professionals to recommend particular mutual funds because it exclusively consists of clean shares of the Gateway Fund and "no-load" shares of the Platform Funds. Fees will be applied consistently across the Platform with LPL and its financial professionals receiving upfront sales commissions from investors and compensation from each of the Platform Funds and their affiliates based on the value of investors' total investments in such Platform Fund. A tiered schedule generally will operate to reduce the upfront sales commission that the investor would need to pay. Fees and discounts will be applied uniformly and consistently across the Platform, and as such, compensation will generally be consistent regardless of the Platform Fund selected.

Further, while purchase and redemption transactions would traditionally incur supplemental fees and commissions, LPL eliminated such commissions in its establishment of the Platform to further reduce incentives for its financial professionals to engage in "churning."

***E. Conclusion.***

As the mutual fund industry, driven by client needs and advancements to technology, continues to evolve, we believe it is critical for regulators to foster this type of innovation. Prematurely favoring particular products or approaches to complying with updated regulatory schemes would be a step in the wrong direction and stifling to further improvements. A principles-based approach to fiduciary recommendations with respect to mutual funds, such as the one described above, would give industry participants the freedom to innovate within a system that ensures that investors are effectively protected from conflicts of interest and imprudence.

### **III. Retail retirement investors should be able to define the scope of fiduciary relationships when working with financial professionals**

To preserve investor choice, it is critical to permit the investor to define the scope of a financial professional's role, including the capacity (fiduciary or otherwise) in which he or she serves the investor. Under both common law and ERISA, an investor may agree to limit the scope of a fiduciary's duties.<sup>7</sup> But, under the expanded definition of fiduciary investment advice, many conversations that no reasonable person would view as fiduciary in nature, can be pulled within the scope of the fiduciary rule regardless of their context, merely because they include a "recommendation," which the Department has defined as a "suggestion" to take a particular course of action.

We continue to believe that investors should be able to choose and define the specific services that the financial professional will provide. This should be accomplished with clear disclosures and through a meeting of the minds between the investor and his or her financial professional, including when the financial professional will be acting as the investor's fiduciary and when he or she will not. As long as the investor receives full and fair disclosure of the financial professional's services and the nature of any conflicts of interest, the investor should be able to understand the potential conflicts and agree that the financial professional is acting in a non-fiduciary capacity.<sup>8</sup> For example, with appropriate and clear disclosure that the person is marketing and not acting as a fiduciary providing impartial advice, a financial professional who is an investor's fiduciary should be able to sell the investor an additional service or product without being deemed a fiduciary and violating the prohibited transaction rules.<sup>9</sup>

After over fifteen months of experience with implementing the Department's fiduciary rule, we believe retail retirement investors would benefit if the definition of fiduciary investment advice were revised to allow such investors to define and limit the scope of fiduciary relationships when working with financial professionals. We have seen many financial institutions struggle to develop compliance strategies to address the risk of operating under the substantially broadened fiduciary investment advice definition. In many cases, firms are limiting their services and offerings to retirement investors, and restricting the types of conversations and communications financial professionals can have with retirement investors to avoid the risk of tripping over the fiduciary line.

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<sup>7</sup> See BOGERT'S TRUSTS AND TRUSTEES, § 542 (2014) ("Though strictly construed by the courts, exculpatory clauses have been upheld, subject, however, to certain exceptions based on public policy."); RESTATEMENT (SECOND) OF TRUSTS § 70, cmt. d ("[A] trustee's duties, like trustee powers, may be affected by the terms of the trust."). Similarly, the statutory definition of fiduciary under ERISA provides that a person is a fiduciary only "to the extent that" he or she is acting as such. ERISA § 3(21); see DOL Regs. §2509.75-8, Q: FR-16 (stating that the personal liability of a fiduciary is limited to the fiduciary functions that he or she performs with respect to the plan); *Frank Russell Co. v. Wellington Management Co.*, 1998 WL 481230 (3d Cir. 1998) (holding that a corporate management business decision was not subject to ERISA fiduciary duties).

<sup>8</sup> See Amendments to Form ADV, Investment Advisers Act Release No. 2711 (Mar. 3, 2008), 73 Fed. Reg. 13958 (Mar. 14, 2008) ("[I]nvestors have the responsibility, based on disclosure they receive, for selecting their own advisers, negotiating their own fee arrangements, and evaluating their advisers' conflicts. Therefore, it is critical that clients and prospective clients receive sufficient information about the adviser and its personnel to permit them to make an informed decision about whether to engage an adviser, and having engaged the adviser, how to manage that relationship.")

<sup>9</sup> This analysis is supported by the Department's regulations under section 408(b)(2) of ERISA. Specifically, in Example 7, the Department states that a fiduciary to a plan who is a president of a bank that proposes to provide administrative services to the plan for a fee, would not be viewed as self-dealing where he or she does not take part in the other fiduciaries' decision to hire the bank. DOL Reg. § 2550.408b-2(f), Example 7.

The expansive definition of fiduciary investment advice has disrupted relationships between retail retirement investors in many ways. As just one example, when an investor is making a decision to hire a financial professional, it is common for the investor to interview the financial professional and to learn about the services and investment products he or she offers. This conversation is important for the investor to make a good hiring decision and to feel comfortable that the financial professional being hired is right for his or her investment needs. As part of this conversation in the past, the investor might ask the financial professional for hypothetical investment strategies, or what types of services and products the financial professional might recommend if the investor were to hire him or her. We believe these discussions are critical to helping the investor evaluate the financial professional and his or her services and offerings. However, under the new definition of investment advice, any “recommendation” (defined as a mere “suggestion”) could be viewed as resulting in fiduciary status, even where the investor has not yet decided to hire the financial professional, and the financial professional is just providing hypothetical investment scenarios to help the investor better understand his or her services.

The Department helpfully clarified in the preamble to the final rule that the so-called “hire me” conversations are outside the scope of fiduciary status and that financial professionals can “tout the quality” of their services.<sup>10</sup> However, it is unclear whether the “hire me” exception covers broader discussions of a financial professional’s services, including regarding hypothetical investment scenarios discussed above, and many other conversations that are clearly intended to be, and would be understood by retail retirement investors to be, non-fiduciary. Uncertainty here will cause financial institutions to limit the types of pre-hire sales conversations a financial professional can have and inhibit investors’ ability to evaluate his or her services. As such, we believe that the definition of fiduciary investment advice should be clarified such that a financial professional and financial institution will only be deemed to be fiduciaries with respect to investment recommendations made *after* the investor decides to hire them to provide fiduciary investment advice.

#### **IV. The warranties regarding policies and procedures in the BIC Exemption and the Principal Transactions Exemption should be eliminated.**

Consistent with the proposed exemption we outlined above, we reiterate our support for the Department’s stated intent to protect investors by requiring financial institutions and financial professionals who provide investment advice to retail retirement investors to comply with the impartial conduct standards. These standards, which currently apply under the Exemptions, require that financial institutions and professionals:

- Provide advice that is prudent and loyal;
- Receive no more than reasonable compensation; and
- Fairly disclose information regarding their advice, compensation and material conflicts of interest.

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<sup>10</sup> Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Advice, 81 Fed. Reg. 20946 at 20968 (Apr. 8, 2016).

Moreover, as we stated in our comment letter regarding the potential additional delay, we are pleased by the prospect of the SEC and the Department working together to develop a standard of conduct for advice to all retail investors, and on harmonizing the fiduciary rule with that standard. In particular, consistent with our support for the Department's impartial conduct standards, we encourage the SEC to consider basing its uniform standard of conduct on the principles underlying the impartial conduct standards. In fact, the standards that broker-dealers and registered investment advisers must adhere to today are analogous to the impartial conduct standards and the policies and procedures required to meet these standards may provide an alternative to the policies and procedures currently required under the BIC and Principal Transaction Exemptions. These policies and procedures may make the additional requirements for policies and procedures that many have found to be overly prescriptive unnecessary.

Of primary concern here are the stringent requirements imposed on financial institutions and professionals' compensation, including with respect to when different compensation can be received for different recommendations. This requirement is subject to a contractual warranty that creates significant class action risk. This requirement and accompanying risk has resulted in many firms making the decision to reduce and limit product and service offerings for retirement investors.

We note here that, consistent with long-standing common law principles, under the Investment Advisers Act of 1940 and the Exchange Act, an investor may consent to a conflict of interest if the financial professional provides full and fair disclosure of the conflict of interest. In this regard, we urge the Department to conclude that financial institutions can meet the duty of loyalty by disclosing conflicts of interest, and by complying with any additional SEC and FINRA requirements with respect to managing and mitigating conflicts.

Moreover, we encourage the Department to consider that the SEC and FINRA have a rigorous and well-developed examination and enforcement infrastructure that could be used to ensure that the impartial conduct standards are complied with, thereby eliminating the need for a private right of action and related class action risks. We believe that, of all elements of the rule and exemptions, the significant class action risks associated with the private right of action are at the root of most if not all of the rule's unintended consequences, including increased costs of, and reduced access to, investment advice and financial planning services. To address this issue, rather than requiring financial institutions to enter into a contract warranting that they have adopted the requisite policies and procedures under the BIC and Principal Transactions Exemptions, we encourage the Department to rely on SEC and FINRA examination and enforcement programs to enforce the impartial conduct standards.

We believe the SEC and FINRA can enforce the impartial conduct standards through their authority to ensure that broker-dealers and registered investment advisers. Specifically, registered investment advisers and broker-dealers must put in place written policies and procedures that are tailored to their business, including with respect to the provision of advice to retirement accounts. The SEC and FINRA have authority to bring enforcement actions related to whether a firm is complying with the procedures it has adopted as a result of the Department's rules.

SEC and FINRA also have authority to review firm disclosures to ensure that they match firm practices, and so they can help ensure that any disclosures made in connection with the BIC Exemption are consistent and adequate in light of the firm's practices. Moreover, both regulators would be able to refer any matters relating to compliance with the rule and Exemptions to the Department or IRS for the relevant agency's substantive review. By relying on these protections, the Department can eliminate the

contractual warranty requirements under the BIC and Principal Transaction Exemptions, and still have some surety that the impartial conduct standards will be enforced for all retail retirement investors, including IRAs.

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Thank you for considering our comments and suggestions. We look forward to working with the collaboratively with Department to better serve and protect American investors. Please do not hesitate to contact me should you wish to discuss any of the concepts set forth in this letter.

Sincerely,

A handwritten signature in cursive script, reading "Michelle B. Oroschakoff".

Michelle B. Oroschakoff

Chief Legal and Risk Officer