Message To: e-OED@dol.gov

From: Fil Williams

Subject: Comments – Proposed Amendments to PTE 86-128

RIN 1210-AB32; Notice of Proposed Rulemaking (NPRM) – Definition of the Term "Fiduciary"; Conflicts of Interest Rule – Retirement Investment Advice; ZRIN: 1210-ZA25; Notice of Proposed Best Interest Contract Exemption (BICE) and related class exemption proposals (D-11712, et al.) – specifically, ZRIN: 1210-ZA25 – Proposed Amendments to and Proposed Partial Revocation of Prohibited Transaction Exemption 86-128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers (File No. D-11327)

On May 5, 2015, I submitted written comments on the above matter in my capacity as a private citizen. As noted at that time, my interest in this matter is purely academic and derives from years of service to the U.S. Department of Labor (DOL) working in the Employee Benefits Security Administration (EBSA) and its predecessor agencies (e.g., the Pension and Welfare Benefits Administration or "PWBA," and the Office of Pension and Welfare Benefit Programs or "OPWBP" – which was once part of the Labor Management Services Administration or "LMSA" at DOL).[1]

To the extent that my personal experience in carrying out my duties as a DOL employee may be helpful to the formulation of a complete public record in this matter, I would like to offer the following additional comments for whatever consideration the DOL or other interested persons may deem appropriate.

Proposal to Amend Prohibited Transaction Exemption (PTE) 86-128 [2]

As discussed in the preamble to the NPRM and related documents, published in the Federal Register on April 20, 2015 (80 Fed. Reg. 21928, et al), concerning the definition of the term "fiduciary" at 29 CFR § 2510.3-21, by reason of "investment advice" for a fee or other compensation, PTE 86-128 allows an investment advice fiduciary to cause a pension plan or individual retirement account (IRA) that is a recipient of such advice to pay the fiduciary or its affiliate a fee (e.g., a sales commission) for effecting or executing securities transactions as an agent for the plan or IRA. The DOL is proposing to amend PTE 86-128, along with certain other existing class exemptions, to require that fiduciaries relying on the exemption adhere to the same impartial conduct standards that will be required for relief under the proposed "Best Interest Contract Exemption" (BICE). Proposed amendments would eliminate the current relief provided by PTE 86-128 for investment advice fiduciaries to IRA owners, in connection with investment advice provided to IRAs, requiring instead that such fiduciaries rely upon the BICE to obtain the necessary prohibited transaction (PT) relief for the receipt of their compensation.

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[1] Interested persons are advised that I served almost my entire career as a pension law specialist with EBSA and retired in January 2013, after completing over thirty-three (33) years of Federal service with DOL

[2] Class Exemption for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers, 51 Fed. Reg. 41686 (Nov. 18, 1986), amended at 67 Fed. Reg. 64137 (Oct. 17, 2002).

Several additional changes are being proposed to PTE 86-128 that will affect securities transactions by broker-dealers and banks for plans and IRAs under PTE 75-1, a multi-part class exemption.[3] The DOL is proposing, among other things, to revoke provisions in Part I(b) and (c) of PTE 75-1 (relating to non-fiduciary brokerage services to plans and IRAs) and require affected persons seeking to engage in securities transactions to instead rely upon existing statutory exemptions contained in ERISA § 408(b)(2) and Internal Revenue Code § 4975(d)(2) for brokerage services.

Some Relevant History concerning PTE 86-128

On January 24, 1985, the DOL published in the Federal Register a proposed class exemption to replace the existing class exemptions known as PTE 79-1 and PTE 84-46 for certain securities transactions involving employee benefit plans and broker-dealers (B-Ds). 50 Fed. Reg. 3427 (Jan. 24, 1985). PTE 79-1 had provided relief similar to PTE 86-128 for B-Ds (or their affiliates) who, when serving as plan fiduciaries, use their discretionary authority as fiduciaries to effect or execute securities transactions as an agent for their client plans and receive a commission. PTE 84-46 had provided similar PT relief specifically for insurance company pooled separate accounts, holding "plan assets" subject to ERISA, that recaptured brokerage profits generated by such securities transactions. Thus, the proposal to replace PTE 79-1 and PTE 84-46 eventually became the class exemption known as "PTE 86-128."

In this regard, I had the privilege of being the DOL listed contact person for further information regarding the PTE 79-1 / 84-46 proposal (PTE 79-1 Replacement Proposal). During months that followed its publication in the Federal Register in 1985, I received telephone calls from attorneys and other interested persons regarding pertinent issues and proposed requirements to address concerns raised by the 79-1 Replacement Proposal.

The telephone inquiries often involved highly technical matters relating to the 79-1 Replacement Proposal, many of which were handled by DOL personnel who were more familiar than I was with the issues at hand, as my direct involvement in the background discussions and drafting of the 79-1 Replacement Proposal had been minimal. However, to the extent that my direct personal experience with matters raised at that time allows for specific recollections about pertinent issues now being considered by DOL regarding amendments to PTE 86-128, I would like to offer the following comments:

- Certain commentators / interested persons objected to the idea of requiring that all relief provided for brokerage services to plans for PTs described under ERISA § 406(a) – as opposed to § 406(b) (relating specifically to fiduciary self-dealing and conflict of interest concerns that were being dealt with by the class exemption) - should be derived solely from the statutory exemption contained in ERISA § 408(b)(2) and regulations at 29 CFR § 2550.408b-2. Expressed concerns may have been one reason why DOL decided to address PT issues relating to the provision of brokerage services to plans by B-Ds, both for relief under § 406(a) and 406(b), in various advisory opinions (AOs) and information letters throughout

[3] 40 Fed. Reg. 50845 (Oct. 31, 1975), as amended at 71 Fed. Reg. 5883 (Feb. 3, 2006).

the 1980s and beyond. For example, many regional banks were interested in such PT issues in the mid-1980s because they were starting to offer discount brokerage services to their client plans through one or more affiliated B-Ds – another example of marketplace concerns about high transaction costs. These AOs were also important because they analyzed the provision of brokerage services to plans based on the regulations at 29 CFR § 2550.408b-2, issued by DOL in 1977, which were not in effect when PTE 75-1, Part I, was finalized in 1975. The § 408(b)(2) regulations clarified, among other things, that the statutory exemption would not exempt possible violations of § 406(b) by B-Ds in the provision of such services.

Note – as to present concerns: There were perhaps many reasons why members of the financial services industry providing brokerage services during the 1980s may have been uncomfortable with a new requirement to use ERISA § 408(b)(2) for brokerage services to plans in order to obtain PT relief for § 406(a) under PTE 86-128 (e.g., routine § 406(a) PT compliance for non-fiduciary services was based on PTE 75-1, Part I). Nevertheless, that requirement was adopted by DOL, in its replacement of PTE 79-1, to help ensure that total compensation paid by plans for services was reasonable when fiduciary self-dealing concerns were present.

Variations in compliance practices (via use of a statutory or administrative PTE) may have developed that will be impacted by a DOL position that "406(a) relief" for non-fiduciary brokerage services must occur by way of § 408(b)(2) and its regulations due to the proposed revocation of PTE 75-1, Part I(b) and I(c).

These compliance concerns are more relevant now that regulations under ERISA § 408(b)(2) – per amendments to 29 CFR § 2550.408b-2(c), mandate that specific disclosures be made by B-Ds when they are a "covered service-provider" to a pension plan (e.g., when they act as fiduciaries or as non-fiduciary investment advisers; when they receive third-party or related party compensation).[4]

In any event, B-D / fiduciary compliance with PTE 86-128 and § 408(b)(2) will need to be effectively monitored and enforced by DOL for pension plans covered by Title I of ERISA. Finalization of the current regulatory and class exemption amendments in the near future must allow for appropriate mechanisms for DOL to ensure statutory and administrative PTE compliance (e.g., additional enforcement resources; co-operation from affected industry firms; adequate record-keeping).

- In 1985-86, during consideration of the PTE 79-1 Replacement Proposal and beyond, there was a great deal of interest raised by commentators and others about DOL concerns with pension plans incurring excessive transaction costs and the ability of responsible plan fiduciaries, who were independent and objective, to adequately monitor such costs and any related benefits on an ongoing basis. Specifically, there were numerous comments and discussions about:

[4] This particular concern will not apply to brokerage services provided to IRAs because IRAs are not a "covered plan" for purposes of specific disclosures required under the amended "408(b)(2)" regulations.

- Possible "churning" of client plan accounts (i.e., excessive trading activities generating significant sales commissions to B-Ds);

- The ability of an independent fiduciary (I/F) to discern whether "churning" or other suspicious trading patterns were occurring, and the need for portfolio turnover ratio information or other disclosure;

- The existence of "soft dollar" arrangements with B-Ds providing "research" to client plans, in accordance with pertinent federal securities law, when commission revenue (i.e., "hard dollars") received from a client plan justified such an arrangement with that plan, and the ability of an I/F to determine whether the client plan was benefiting from the "research" provided with the "soft dollars" in ways that justified its continuance; and

- Various trade execution options and trading alternatives that could reduce or eliminate transaction costs (e.g., cross-trades of securities between plan accounts and other accounts managed by fiduciaries affiliated with B-Ds), without raising other issues (e.g., investment managers favoring certain accounts over others in cross-trades decisions).[5]

These concerns, as well as technical issues relating to disclosures and other conditions required, were discussed in the preamble to PTE 86-128 when it was finalized in 1986. In general, PTE 86-128 has been successful in dealing with the concerns / issues noted by commentators during the 1980s for pension plans covered by Title I of ERISA. The DOL has continued to deal with such issues in other regulatory projects as an evolving process.

As currently noted by DOL in the preamble to the proposed amendment to, and proposed partial revocation of, PTE 86-128, marketplace developments for IRAs and investments in securities (whether self-directed by an IRA owner or otherwise directed by responsible fiduciaries) have changed significantly in the last 30 years (e.g., compensation structures have become more complex). Interested persons believe that now is an opportune time for DOL and the financial services industry to revisit these PT / PTE issues in the context of what relief is appropriate for IRAs and IRA owners to allow for effective continuance of B-Ds to execute securities transactions as (or as affiliates of) fiduciaries, and under what conditions such PT relief should be granted. New PTE relief for IRAs, allowing for, among other things, effective monitoring of compensation arrangements by IRA owners where fiduciary self-dealing and conflict concerns are present, is long overdue.

Thank you for the opportunity to submit these additional comments to DOL.

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[5] Facilitating possibilities for cross-trades to save transaction costs led DOL to provide some PT relief for cross-trades in PTE 86-128, additional individual PTEs for cross-trading programs by investment managers in the late 1980s and beyond, and another class exemption – specifically for cross-trades by index and model-driven funds containing plan assets – PTE 2002-12 (67 Fed. Reg. 6614; Feb. 12, 2002). Eventually, Congress provided a statutory exemption for cross-trades by large pension plans in amendments to ERISA in 2006 (via the Pension Protection Act of 2006) – i.e., ERISA § 408(b)(19), for which DOL provided regulations at 29 CFR § 2550.408b-19.