Office of Exemption Determinations
U.S. Department of Labor
Proposed Best Interest Contract Exemption
Comment

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A. Point of Sale Individual Transactional Disclosure

Section III(a) of the proposed Best Interest Contract Exemption (the “Exemption”) requires disclosure, *before* the execution of the purchase of an Asset, of the Total Cost of investing in the Asset for 1-, 5-, and 10-year periods in the form of a chart.

Compliance with such a point of sale disclosure in many cases could substantially impede or prevent the best execution of the trade in the best interest of the investor.

The public markets at times are very volatile. Volatility sometimes creates very attractive buying opportunities; opportunities that often last only for a very short period of time. If a financial advisor had to defer executing a trade until the financial advisor, or the compliance department, determined whether a “recommendation” had been made, and, if so, prepared and delivered a fee disclosure chart, the buying opportunity in many cases would evaporate before the trade could be executed.

A good broker also often can earn his or her commission by analyzing the buy and sell market orders on an applicable exchange, and timing a purchase to achieve the best execution for the investor; rather than merely placing an order at market. The delay inherent in complying with the proposed point of sale disclosure would impede such efforts.

The Exemption as proposed presents a substantial potential detriment to the investor. At a minimum, the Exemption should contain exceptions where there is little or no potential benefit of the disclosure to investor, the potential detriment outweighs the benefit, or the investor wishes to access the markets free of the regulatory detriment.

Financial advisors often are compensated only on the basis of a commission for executing a trade. For example, the purchase of a stock or bond typically does not involve any fee other than a commission at the time of the purchase. There is no additional fee over a 5- or 10-year period. The commission is determined by a schedule typically provided in advance to the investor. An investor can calculate the amount of the commission in advance on the basis of the information or formula contained in the schedule. The Exemption should contain an exception to a rule with so much potential detriment to the investor for transactions, like the above, where the Total Cost is imposed only at the point of purchase pursuant to a fully transparent fee schedule that was provided previously to the investor.

The Exemption also should at least contain an exception that allows the investor to waive the point of sale notice. Many investors understand the brokerage fees before placing an order, particularly where the fee is a one-time commission imposed at the time of execution. Most sophisticated investors also understand indirect fees, such as 12b-1 fees charged by mutual funds. Investors should not be saddled with cumbersome procedures that thwart best execution merely to receive a notice that they do not need or want.

B. Managed Accounts

Financial advisors often recommend a professional investment manager to manage all or a portion of an investor's account. The investment manager has discretionary control over investments in the account. The investment manager typically is registered, but the account is not part of a regulated investment company, such as a mutual fund. The account is managed individually (although the investments may be based on a model portfolio or investment strategy).

Fees for such managed accounts often are a flat fee, for example 1% per year of assets under management. The fee typically is shared between the brokerage firm and the investment manager. For example, the investment manager might receive ½%, and the brokerage firm would receive the remaining ½%. All trades are executed by the brokerage firm for no additional fee; and the brokerage firm provides all administrative services, such as a monitoring the account and consulting with the investor, tax reporting, account statements, distributions, etc. for no additional fee. Such arrangements often provide superior investment performance at lower cost to the investor than a mutual fund. The basis for computing the fee is disclosed in advance; and the exact dollar amount charged each quarter is shown on a monthly statement. (I don't understand the need for any additional disclosure.)

As I read the proposed regulation on fiduciary status on account of rendering investment advice, recommending the investment manager would cause both the financial advisor and associated brokerage firm to be a fiduciary. However, the definition of "Asset" in Section VIII of the Exemption does not appear to include a managed account as described above. Since the scope of the Exemption extends only to Assets, I find no exemption from the prohibited transaction rules for such a managed account. If so, the new rules as proposed would deprive investors of a highly attractive and profitable way to obtain professional investment management for a reasonable fee that is fully transparent and easy to understand.

In general, I think it is a mistake to promulgate an exclusive list of specific investment vehicles that are the only investments permitted in a retirement income plan. Markets and investment vehicles change over time. Besides omitting highly attractive investments, like the above, from the list initially, future attractive vehicles likely would be prohibited as well. Amending regulations to add attractive investments takes a lot of time, and is very uncertain.

It would seem much more appropriate and desirable to set out fiduciary guidelines for determining which investments are prudent and which are not. Persons who are knowledgeable about the investments available in the marketplace, and who have the expertise to evaluate them, are much better suited to apply the guidelines from time to time in the evolving marketplace.