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Invested in America

asset management group

July 20, 2015

By Email

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210
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Office of Exemption Determinations
Employee Benefits Security Administration
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RE: Comment Letter on (1) the Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice; Proposed Rule (RIN 1210–AB32); and (2) the Proposed Best Interest Contract Exemption (ZRIN 1210–ZA25)

Ladies and Gentlemen:

The Asset Management Group (the "AMG")[1] of the Securities Industry and Financial Markets Association ("SIFMA") appreciates the opportunity to provide the U.S. Department of Labor's ("Department") Employee Benefits Security Administration with comments on (1) the Proposed Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice (the "Proposed Rule")[2] and (2) the Proposed Best Interest Contract Exemption (the "Proposed BIC Exemption").[3]

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[1] The AMG's members represent U.S. asset management firms whose combined assets under management exceed $30 trillion. The clients of AMG member firms include, among others, registered investment companies, endowments, state and local government pension funds, private sector Employee Retirement Income Security Act of 1974 pension funds and private funds such as hedge funds and private equity funds.

[2] Definition of the Term "Fiduciary"; Conflict of Interest Rule—Retirement Investment Advice; Proposed Rule, 80 Fed. Reg. 21927 (April 20, 2015) (proposal to amend 29 CFR Parts 2509 and 2510).

[3] Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960 (April 20, 2015) (proposal to amend 29 CFR Part 2550). The term "proposal" is used with respect to the entirety of the Department's Proposed Rule and related proposed exemptions with respect to its Conflict of Interest release of April 14, 2015 and subsequent publication in the Federal Register on April 20, 2015.

The AMG's members are already fiduciaries under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") when they act as discretionary investment managers or provide investment advice for clients that are employee benefit plans subject to ERISA, individual retirement accounts ("IRAs") and other plans subject to the Internal Revenue Code of 1986, as amended (the "Code"), and their participants and beneficiaries, as well as entities that may be deemed to constitute "plan assets" by reason of 29 CFR 2510.3-101 as amended by Section 3(42) of ERISA or otherwise (all such "employee benefit plans," "plans" and other entities deemed to constitute "plan assets" being referred to collectively as "Plans").

The Proposed Rule broadly expands the scope of investment advice. We respectfully submit that this expansion is not authorized by ERISA as the Proposed Rule extends investment advice beyond the plain meaning of applicable terms set forth in Title I, Part 4, and in particular Sections 3(21) and 404.

We are concerned that this expansion of the "investment advice" definition will hamper asset managers' ability to act in the best interest of Plan clients. By operation of the Proposed Rule, asset managers will be less able to provide information and education to Plans than they are able to currently. They may also be restricted in making available services and/or products to Plans and/or market participants for use with their Plan clients that are intended to facilitate wise investing at a reasonable cost and improve retirement investment outcomes. If products and services are provided, they may become more expensive. Separately, because the proposal broadly imposes fiduciary obligations on market participants with whom asset managers transact on behalf of Plans, those market participants will be less willing to engage in activities and services that assist us in carrying out our fiduciary duties, and will restrict information where providing it may transform their role into a fiduciary one. Moreover, asset managers and investors, already deemed sophisticated, will be burdened by standards designed for retail retirement savers.

The AMG's members, separate and apart from their role as fiduciaries to Plans, create and manage registered mutual funds, exchange traded funds, real estate investment trusts and hedge funds and other private funds and products that are purchased as investments for Plans. Because the respective investment objectives of Plans will vary, different products and strategies will be best suited to help them achieve their objectives. As drafted, the Proposed Rule and Proposed BIC Exemption result in substituting the variety of products currently available with a *de jure* or *de facto* "legal list," and make the burdens of offering many funds and products effectively prohibitive. The AMG is concerned that both the Proposed Rule and the Proposed BIC Exemption will have the effect of limiting or restricting asset managers' products that are available to Plans and promoting certain types of products (*e.g.*, low-cost index products) over others.

The AMG shares the Department's concern that Americans are not saving enough for retirement as well as its goal of ensuring that Plans receive the advice and assistance they need for optimal retirement benefits. The AMG also supports a "best interest" standard for financial professionals that would apply across all investment recommendations made to investors. However, the AMG believes that the Department's objectives and a best interest standard should be achieved by the appropriate regulatory authorities through means that allow fiduciaries to operate effectively and preserve investor choice. While we respectfully believe that the means chosen by the Department are not within its power under ERISA, we have set forth below our recommendations on how the Proposed Rule and the Proposed BIC Exemption should be revised to allow asset managers to act in the best interest of their clients and maximize returns for retirement savers.

I. **The Proposed Definition of the Term ''Fiduciary''; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210–AB32)**

As explained in detail below, the broad expansion of the definition of "investment advice" combined with a narrow, burdensome carve-out for larger plans and sophisticated fiduciaries[4] will unduly limit services and products available and increase expenses for Plans managed by asset managers.

The AMG respectfully does not believe that this changed scope is supported by or consistent with ERISA.

In addition, the AMG believes that the expanded scope will negatively impact asset managers' ability to carry out their fiduciary duties to Plans and provide products used by Plans. Although the proposal is ostensibly aimed at largely (if not exclusively) protecting retail investors, including middle-class and working families, the Proposed Rule, as drafted, imposes burdens and expenses upon "[l]arge . . . plans [that] are managed by financial experts who are themselves fiduciaries"[5] as well as other investors advised by sophisticated fiduciaries who already have a duty to look out for the investors' best interest, and qualified investors who are deemed sophisticated and, as such, qualified to make investing decisions themselves. Likewise, although the Department's clear aim is to help retirement savers, aspects of the Proposed Rule will have a contrary result by restricting products, information and services that asset managers can provide.

In light of these mismatches between purpose and effect, the AMG recommends:

- adopting an objective standard for what constitutes "investment advice," including a requirement of reasonable reliance and, at least with respect to sophisticated Plans and Plans advised by sophisticated asset managers, retaining the "mutual agreement," prong of the current rule;

- expanding the Counterparty Carve-Out (i) to harmonize the notion of "sophistication" to comport with long-established Department guidance and other

[4] *See* 80 Fed. Reg. at 21957 (proposed § 2510.3-21(b)(1)(i)), (hereinafter, the "Counterparty Carve-Out").

[5] *See Fact Sheet: Department of Labor Proposes Rule to Address Conflicts of Interest in Retirement Advice, Saving Middle-Class Families Billions of Dollars Every Year*, available at: http://www.dol.gov/ebsa/newsroom/fsconflictsofinterest.html.

regulatory standards and (ii) to apply to services and ongoing and incidental communications;

- reducing the burden of complying with the Counterparty Carve-Out;
- clarifying that marketing and selling products and services is not investment advice;
- expanding the application of Interpretative Bulletin ("I.B.") 96-1 to Plan sponsors and IRAs, as the proposal contemplates, but preserving its original contours so as not to chill needed information to help Plans make effective decisions; and
- conforming the swaps exception to the Department's Advisory Opinion 2013-01A and making the exception available for all Plans and IRAs.

A. Definition of Investment Advice Should be Narrowed

As is discussed at length in the comments submitted by SIFMA's broker-dealer members regarding the Proposed Rule ("SIFMA Letter," attached hereto as Appendix II) the proposed definition of "investment advice" is a marked departure from current law, in which the Department has proposed a rule that re-imagines Title I, Part 4, in particular Sections 3(21) and 404, of ERISA and goes well beyond what was contemplated by the statute.[6] The Proposed Rule significantly broadens the definition of investment advice in unclear and unpredictable ways that will hamper asset managers' ability to serve their Plan clients and will limit investment products

[6] *See* Remarks of Georgetown University Law Professor Roy Schotland on the careful balancing that the Department now attempts to reverse:

> While flat prohibitions [of all conflicts of interest] would be more 'pure,' such a course would not only disrupt arrangements that seems unwarranted absent a far plainer direction to do so; in addition, such a course would result in serious long-range harm to plan beneficiaries. . . . Congress [just] concluded an intensive look at the securities markets and industry and dealt quite explicitly . . . with the relationship between the broker-dealer function and the investment management function. Absent very clear direction, it would be questionable to treat the same problem, in the same industry more sweepingly than Congress deemed appropriate . . . . [I]n the name of protection against abuse, flat prohibitions would inflict greater injury than is likely to occur from abuse of conflicts of interest . . . . [I]t does seem necessary, in considering broker-dealers' conflicts, to keep in mind the anomaly which would occur if flat, sweeping prohibitions were imposed in this area, while the conflicts problems in . . . non-pension accounts were not subjected to appropriate safeguards. All these areas present conflicts, and by the nature of the problems and the reasons causing them to arise in the first place, intricate balancing to preserve potential benefits, and protect against potential dangers, is a difficult course but simply the only reasonable one.

and services available to Plans. While the AMG respectfully does not believe that the Department has the authority under ERISA to remove current core requirements from the definition of investment advice, such as mutuality of understanding that the advice will serve as a primary basis for investment decisions, the AMG provides below the practical difficulties and impossibilities of implementing such a rule and offers recommendations on how the definition could be made more workable.

1. *De Facto* Limitations on Providing Information

The Proposed Rule eliminates the current requirements that, in order for investment advice to give rise to fiduciary status, it must be a ***primary*** basis for an investment decision, provided pursuant to a ***mutual*** agreement, and provided on a ***regular*** basis. Instead, the architecture of the Department's proposal starts from the basic, but maximalist, premise that almost every communication and interaction with a Plan, plan fiduciary (such as an asset manager), plan participant or beneficiary, IRA, or IRA owner is a "Recommendation," broadly defined to mean any "communication that, based on its content, context, and presentation would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action."[7] Any "recommendation" to a Plan, plan fiduciary (such as an asset manager), plan participant or beneficiary, IRA, or IRA owner that is ***individualized*** or ***specifically directed*** could result in the person becoming a fiduciary to a Plan.

As a threshold matter, the absence of mutual assent is contrary to basic principles by which persons become bound by legal obligations.[8] By eliminating any notion that the parties should have a meeting of the minds regarding an asset manager's role, the Department opens the door to nearly indefensible claims by any person who in hindsight is upset with an investment

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[7] 80 Fed. Reg. at 21960.

[8] None other than the Honorable Learned Hand wisely commented:

> A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, ***which ordinarily accompany and represent a known intent***. If, however, it were proved by twenty bishops that either party, when he used the words, intended something else than the usual meaning which the law imposes upon them, he would still be held, unless there were some mutual mistake, or something else of the sort. Of course, if it appear by other words, or acts, of the parties, that they attribute a peculiar meaning to such words as they use in the contract, that meaning will prevail, but only by virtue of the other words, and not because of their unexpressed intent.

Hotchkiss v Natl. City Bank of New York, 200 F 287, 293 (SDNY 1911) (J. Hand) *affd sub nom. Ernst v Mechanics' & Metals Nat. Bank of City of New York*, 201 F. 664 (2d Cir. 1912) *affd sub nom. Natl. City Bank of New York v Hotchkiss*, 231 U.S. 50 (1913) and *affd sub nom. Mechanics' & Metals Nat. Bank v Ernst*, 231 U.S. 60 (1913) (emphasis added).

decision, whether or not the person relied at all on the information provided by the asset manager. This standard would allow a person who has not received fiduciary advice to later claim that he "understood" that it was investment advice, or that the asset manager "understood" that the information was targeted to the person, leaving the asset manager with an impossible task of proving that the claimant could not have so understood the statement.

Further, the broadening of the definition of investment advice, the absence of an objective test for determining whether information is individualized advice or specifically directed to a Plan and the elimination of the mutuality requirement will negatively impact the services asset managers can provide to Plans and the retirement outcomes of those Plans in a manner inconsistent with ERISA generally and Section 404 specifically. The removal of these elements will make it more difficult for asset managers to act as fiduciaries for Plan clients and will limit asset managers' ability to provide even basic information commonly provided to clients, Plans and non-Plans alike.

Additionally, the inclusion of the words "specifically directed to," in the absence of a mutuality requirement, adds ambiguity that is equally unsupportable. While conceivably advice (and not merely selling) may be fiduciary in nature if it is specifically directed to **and** individualized to a participant or Plan, "specifically directed to" standing alone captures non-individualized information, including television and newspaper advertisements. Clearly, there are situations where no reasonable Plan, asset manager or other market participant would expect that the advertiser is acting as a fiduciary, and it is fair to make sure that those are not inadvertently captured by the Proposed Rule. Would answering a phone or responding to a client's email be "specifically directed to" and/or "individualized" to the Plan? Would responding to a request for proposal ("RFP") that asks common questions such as the asset manager's style, experience, personnel, staffing, compliance and controls and other pertinent information that the Plan decides is "individualized" to its needs be deemed to be fiduciary advice because it is specifically directed to a Plan?

As asset managers, we deal with clients, both large and small, along with consultants who represent them, who routinely contact us about specific types of strategies and products. We describe the types of strategies and products available, and yet a literal reading of the Proposed Rule would strongly suggest that if we answered "yes, we have that strategy, one in a mutual fund, one in a collective fund, and one, (depending on asset size) in a managed account, each with slightly different returns, risk profiles and costs," we would be viewed as providing investment advice. This overly broad reach created by the "directed to" prong will make it more difficult for asset managers to provide basic information that can help plans make informed decisions on who to hire or how to invest Plan assets and should be deleted.

The AMG is also concerned that the Proposed Rule would effectively cause most market participants to have to assume that they were always dealing with a Plan – even where they had no evidence of whether or not a Plan was actually involved – and limit information accordingly. Asset managers regularly interact with clients in respect of both Plan and non-Plan accounts and are unable to control whether the information is used for Plan or non-Plan accounts. An individual receiving advice or other market information outside of a Plan context can be regarded as having received "advice" "individualized" to a Plan fiduciary simply because the individual happens to also be an IRA owner or Plan fiduciary. For example, if an asset manager is speaking to a corporate CFO with multiple accounts (corporate accounts, Plan accounts and perhaps even his own personal account), how can the asset manager be sure that any investment information provided in the conversation will not be used for the Plan account?[9] Can the asset manager's employee provide helpful market-related information in a way that he can be sure it doesn't bleed into an ***understanding by the Plan*** that the Plan believes is individualized to the Plan/IRA? These are not just theoretical concerns. As asset managers and as fiduciaries, we take compliance with ERISA very seriously. While we appreciate the fact that the Department may take a more practical view of the words it proposes, we all have to be cognizant of the fact that words on the page matter, and that the Proposed Rule will no doubt be used by third parties in addition to the Department in examining fiduciary status. With the line drawn as it is under the Proposed Rule, and the severe consequences of engaging in a non-exempt prohibited transaction for asset managers and other market participants, including the accompanying restoration of losses, punitive excise taxes, and other civil and equitable relief available, this will compel many undesired changes in behavior which we believe will inure to the detriment of Plans.

The AMG believes that the net effects of the Proposed Rule will be to limit the access of ordinary course information which most do not regard as "advice" to Plans and non-Plans alike. We doubt the Department intended to impose a market-wide "advice" free zone.

2. *De Facto* Limitations on Investment Products and Services

The broadly-worded definition of investment advice in the Proposed Rule may be interpreted as transforming asset managers who wholesale funds into fiduciaries for investors with whom they do not transact directly. Asset managers, separate and apart from managing Plan assets, sponsor mutual funds and other investment products. Some of these asset managers market their funds through third-party distributors (a/k/a wholesaling) and make information regarding the funds available via those distributors, the internet, social media, traditional advertising and educational sessions. They may hold or participate in conferences, have a booth at third party sponsored events or otherwise provide written pamphlets and items concerning their products and services as well as other non-individualized materials. They may also provide models, tools, and/or other analytics to other financial services firms, some of which may serve as fiduciaries to Plans. For example, asset managers may provide model portfolios and other investment tools to broker-dealers and other financial intermediaries to help them provide advice to the end Plan client. But, the models are non-customized portfolios that are not designed for any individual client and the model provider's only client is the broker-dealer or financial services company. The model providers typically have no relationship with or information about the financial services firm's clients.

[9] The proposal does not indicate whether the Department considered what the impacts would be under these and similar scenarios, which our members believe are daily occurrences. There was no empirical information provided that would estimate how many institutional non-Plan relationships alone would be affected, merely because the person to whom an asset manager is speaking happens to be a Plan participant in a 401(k) plan or happens to have an IRA.

These products and services are widely regarded as desired both by clients *and* the intermediaries that assist them. For example, model portfolios provide many intermediaries the framework to deliver a client-centered approach and enable efficiency by leveraging the particular sector or other asset class or style expertise of a given asset manager. Similarly, clients *and* intermediaries regard such portfolios as a cost-effective way of providing illustrative portfolios by an established asset manager (or managers), often utilizing the intermediary's share trading services to achieve economies of scale.

Asset managers and others also provide analytics and other tools to intermediaries because it helps them make appropriate choices in assisting *their* clients—including Plans. Under all of these situations, the intermediary receiving the product or service from the wholesaler or other product manufacturer (which may include asset managers), will typically decide how and where to use any such information or product. The recipient intermediary will "direct" such information to its clients (including Plans) and will decide which clients (including Plans) would benefit from such desired information or products based on the needs of such individual clients.

Since the intermediary may effectively individualize and direct to its clients the benefits of any such provided products, models or other services, we are concerned that such intermediaries may be improperly considered to be discretionary or investment advice fiduciaries under the Proposed Rule with respect to the Plan clients. As the institution that sells the product does not provide individualized advice to any of the intermediary's clients, and often has no idea whether Plans would be involved at all in the intermediary's end users, it would be a truly bad result for Plans (and other clients) were such desired products and services to be curtailed because the provider could be an investment advice fiduciary. AMG strongly urges the Department to clarify the Proposed Rule so as not to reduce choice by limiting such products and services.

3. Harm to Plan Investors Who Purchase or Hold Asset Management Products Directly

The AMG is concerned that the Proposed Rule will force asset managers to cease communications with retirement savers who have direct at-fund or "orphaned" retirement accounts (*i.e.*, accounts previously serviced by a broker-dealer who have ceased having an account relationship). Asset managers, in their role as fund sponsor, have historically provided support for these direct-at-fund accounts (including IRA accounts) despite the high costs of doing so. This role historically has not been a fiduciary one, nor is the role akin to ERISA fiduciary status supportable by the statutory language. Many fund sponsors, in addition to making information available through third-party distributors and other public channels of information, have a call center run by an affiliated transfer agent, provide online account access and send traditional mail to service direct-at fund retirement savers' accounts.[10] For example, an IRA owner with a $3,000 direct-at-fund account may contact the call center and ask if the mutual fund offers a target date fund and ask for additional information about that fund. As described

[10] For these traditional direct-at-fund accounts, only funds in the family of funds sponsored by the asset manager or its affiliates are available.

above, simply answering the question and providing the requested information raises substantial concerns that the response results in investment advice. Similar concerns would be created for those direct-at-fund account owners who use the sponsor's website to obtain information and make investment decisions via the website, especially if the website provides information for IRA owners to consider when deciding on a fund to purchase.

The costs and uncertainty of continuing to service direct-at-fund retirement accounts under the Proposed Rule will incentivize fund sponsors to eliminate those accounts and/or eliminate services currently provided. For small accounts like the $3,000 IRA, many fund sponsors can simply avoid the risk by moving those accounts to "redeem only" status and eliminate services. This result would be unfortunate but one that the proposal would encourage. This concern may become all the more pronounced depending on the shape and workability of any "grandfather" provision adopted with respect to the Proposal.

4. Valuations

The proposal deems the provision of transaction-based valuations – even if not in writing – sufficient to confer fiduciary status. Specifically, it provides that an "appraisal, fairness opinion, or similar statement whether verbal or written concerning the value of securities or other property if provided in connection with a specific transaction or transactions involving the acquisition, disposition, or exchange, of such securities or other property by a [Plan]" will deemed to be investment advice. The accompanying carve-out indicates that such valuations are not deemed to constitute investment advice if they are provided to "an investment fund, such as a collective investment fund or pooled separate account, in which more than one unaffiliated plan has an investment, or which holds plan assets of more than one unaffiliated plan under 29 CFR 2510.3-101" or "solely for purposes of compliance with the reporting and disclosure provisions under the Act, the Code, and the regulations, forms and schedules issued thereunder, or any applicable reporting or disclosure requirement under a Federal or state law, rule or regulation or self-regulatory organization rule or regulation."[11] Accordingly, valuations provided to pooled "plan asset" vehicles that are not strictly for those express legal purposes, such as monthly statements, would not receive the benefit of the carve-out. For Plan accounts not in a pooled fund (*e.g.*, a fund-of-one or separate account), there is effectively no carve-out, unless, of course, it relates to employer securities in respect of an ESOP.

In addition, these "new" liabilities will only work to Plans' disadvantage. The Department has not identified evidence that valuations outside of the context of ESOPs have been unfair, abusive, or otherwise unlawful. If all ordinary course appraisals, fairness opinions or statements of value are not excluded from the definition of advice, Plans may suffer the costs associated with market participants suddenly becoming at risk of fiduciary status. If the proposal regarding valuation were part of the final rule, there is a strong risk of uneven treatment of valuation in the marketplace and, as the SIFMA Letter indicates counterparties and other service providers to Plans will likely pay more for the same services that non-Plans do. The Department has stated that investment advice should hinge on whether a call to action or an explicit

[11] 80 Fed. Reg. at 21958.

endorsement has been made.[12] Valuation opinions or information, are not recommendations and therefore do not fall within this definition.

Respectfully, the Department does not have the statutory authority to deem pooled funds, prime brokers, securities lending agents, custodians or fund administrators ERISA fiduciaries in the course of valuing securities, loans, portfolio companies, or collateral, as they are not performing any of the functions described in Section 3(21) of ERISA.

If the Department nonetheless insists on a valuation prong to the fiduciary definition it should at least have a mutuality requirement and should be adjusted so it picks up only appraisals relating to specific recommendations for a specifically mutually agreed upon transaction in connection with a proximate acquisition or disposition of securities or other property. The exception should make clear that it covers all ordinary course valuations, including those provided to a separately managed account.

It should also make several improvements to its pooled fund carve-out. First, the carve-out covers valuations given *to* pooled funds but not valuations given *by* pooled funds to investors on a periodic basis. We request that it apply to both.

Further, as the pooled fund carve-out only applies to those that are "plan assets," it is not entirely clear that valuation for pooled vehicles, such as mutual funds or private funds that are ***not*** subject to ERISA, but in which Plans may invest are afforded the same carve-out. Non-plan asset funds value the fund daily, monthly or quarterly and the valuations are typically shown on custody statements for the account in which the fund investments are held. If a non-plan asset fund manager could become an ERISA fiduciary simply by providing values to Plan investors, our members' willingness to accept Plan investors would be severely impacted. We do not believe the Department intended to impose fiduciary advice status on such valuation and request clarification in any final rule.[13] Finally, many pooled funds may not be "pooled" at least initially—for example, when a bank collective investment fund accepts its first investor and another is anticipated to invest in the fund very shortly thereafter. Accordingly, we request that the Department remove the requirement that the fund cover at least two plans.

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[12] *See* 80 Fed. Reg. 21938 (Department referencing standard).

[13] The language of the proposal carves-out from the definition of fiduciary "the provision of an appraisal, fairness opinion or a statement of value to an ESOP regarding employer securities, ***to a collective investment vehicle holding plan assets***, or to a plan for meeting reporting and disclosure requirements[.]" This seems to limit the carve-out to plan asset vehicles. Later in the preamble, the explanation reads: "In response to comments, the proposal also contains an entirely new carve-out at paragraph (b)(5)(ii) specifically addressing valuations or appraisals provided to an investment fund (*e.g.*, collective investment fund or pooled separate account) ***holding assets of various investors in addition to at least one plan or IRA***." If the Department means to include all pooled funds, regardless of whether they are subject to the fiduciary requirements of ERISA, we would appreciate that clarification.

5. Alignment of Fiduciary Acknowledgment with ERISA's Definition of Fiduciary

If a market participant acknowledges that it is acting as a fiduciary with respect to investment advice, that market participant will be deemed a fiduciary under the Proposed Rule. The Department's carve-outs from the definition of "investment advice" are inapplicable to asset managers who affirmatively represent or acknowledge that they are acting as fiduciaries.

Although the AMG understands the aim of making carve-outs inapplicable to a market participant that acknowledges fiduciary status, the AMG recommends that the Department clarify the language used to reflect a basic tenet of ERISA: that you are only a fiduciary with respect to particular assets of a particular account and not a fiduciary in general.[14] As written, an asset manager that admits that it is an investment advice fiduciary for a portion of a Plan's assets is at risk that the Counterparty Carve-Out will not be available with respect to non-fiduciary services that it provides or is offering to provide with respect to Plan assets for which it is not acting as a fiduciary. Similarly, broker-dealers that wish to provide ordinary market color or other helpful information to a Plan (or to us, as their sophisticated fiduciary representatives), or that wish to offer a product or service to a Plan may be deemed "tainted" *ab initio* as a fiduciary even before there has been any interaction, or the sending of any information by mail, if another division is advising the Plan on investments for a different portion of the Plan's assets.

The AMG recommends that the Department clarify its intent in this section to make it consistent with the clear definition of fiduciary in the statute—namely, that a person is a fiduciary "to the extent" that the statutory tests are met.[15] Further, the AMG notes that an acknowledgment of fiduciary status "directly or indirectly (*e.g.* through or together with an affiliate)" is too broad. A representation that a person is a fiduciary should be made by that person, and not be left for interpretation.

6. Objective and Workable Standard for Fiduciary Advice

As stated above, AMG does not believe there is a statutory basis for the Department's broadened definition of "investment advice" under ERISA. If the Department nonetheless adopts a rule of this nature, we recommend that it provide clear, unambiguous and objective standards for determining when fiduciary advice is being given that do not limit the established

[14] *See* Section 3(21) of ERISA ("(A) Except as otherwise provided in subparagraph (B), a person is a fiduciary with respect to a plan ***to the extent*** (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan. Such term includes any person designated under section 1105 (c)(1)(B) of this title." (emphasis added)).

[15] *Id.*

practices of Plans or the financial institutions that deal with them. Specifically, we urge the Department to:

- Include an element that requires "reasonable reliance" by the Plan on any "advice," or alternatively, that the advice was "material" to the investment decision. The Department may wish to consider a standard that requires that the "recommendation" "be sufficiently individualized so as to form a reasonable basis for the Plan's reliance." We also recommend that for fiduciary status to attach, advice must be both individualized and specifically directed to a Plan.

- Reinstate the mutual agreement prong[s] of the current definition at least for sophisticated Plans, as we define them here, or alternatively, propose an objective, rather than a subjective standard for a "meeting of the minds." We also suggest that, at least with respect to sophisticated Plans, the Department consider reinstating the " a primary basis" prong or a requirement that the advice "significantly influence" a Plan. Paragraph 2(a)(ii) of the proposal could be revised to read: "Renders the advice pursuant to a written or verbal agreement, *mutual* arrangement, or *mutual* understanding that the advice is individualized to the advice recipient *to significantly influence* investment or management decisions with respect to securities or other property of the plan or IRA."

- Narrow the existing definition of "recommendation." At a minimum, the definition should relate to a ***qualitative*** "call to action" (*i.e.*, "this product is better than that one," "I think this product is the one you should go with," "this is the right choice for you") but should not include factual information, regardless of the source or form of presentation. Any communication that would not be a customer-specific recommendation within the meaning of applicable Financial Industry Regulatory Authority ("FINRA") rules should not be deemed to be a recommendation.

- Clarify that providing advice, model portfolios, tools and other analytics to financial services firms will not be considered investment advice when such information is not individualized to the needs of any specific Plan client of the financial service firm.

- Remove valuation from the definition of investment advice.

- Clarify that a person is a fiduciary only "to the extent" the statutory tests are satisfied.

7. Exception for Sophisticated Plans

The AMG recommends that "large . . . plans [that] are managed by financial experts who are themselves fiduciaries" be entitled to certain presumptions of sophistication to preserve flexibility and availability of desired information.[16] Given the Proposed Rule's baseline

[16] *See DOL Fact Sheet*, supra at note 5.

presumption that nearly all communications and interactions with a Plan–including those of asset managers—are recommendations, the Department should, at a minimum, require "mutual agreement" for sophisticated Plans or Plans represented by sophisticated fiduciaries. It should also consider reinstating the primary basis prong or include a new "significant influence" prong. This change both gives effect to the Department's stated belief that large Plans do not need additional protections and helps resolves some of the unintended consequences stemming from the breadth of the Proposed Rule.

For suggested changes to the Proposed Rule's language, see Appendix I.

B. Counterparty Carve-Out Should Be Harmonized with Existing Regulatory Standards for Sophistication

The Proposed Rule provides a carve-out from "investment advice" for "incidental advice provided in connection with an arm's length sale, purchase, loan, or bilateral contract . . . [including] an offer to enter into such a transaction"[17] with Plans meeting eligibility requirements (discussed below), referred to as the Counterparty Carve-Out.

The "Counterparty Carve-Out" is only available to (1) "benefit plans" with 100 or more participants which are managed by a fiduciary with management and control over the assets of the Plan which is independent of the counterparty or (2) a Plan that is represented by a fiduciary with management and control over the assets of the Plan and that is independent of the counterparty which has at least $100 Million in "benefit plan" assets under management.

The AMG believes that giving investment advice incidental to an arm's length sale is never fiduciary conduct. At minimum, however, rather than use a new test for sophistication (*i.e.*, the 100 participant or $100 million "assets under management" tests), the Department should adopt other more widely-utilized proxies for sophistication, including those used by the Department and asset managers, as discussed below. The standard the Department has chosen for the 100 participant test comes from reporting requirements, and does not bear on a Plan's sophistication. In addition, the $100 million "benefit plan" assets ignores commonly used proxies for sophistication (including those widely used by asset managers and other market participants since 1984) and runs the risk of bifurcating rules and creating additional complexities which can only lead to limitations for Plans.

1. Plans Represented by Fiduciaries Already Deemed Sophisticated

The Counterparty Carve-Out does not capture the full spectrum of asset managers that meet well-established standards of sophistication that more than qualify them to address the

[17] 80 Fed. Reg. at 21941.

Department's primary stated concern: the ability to differentiate between advice offered from a fiduciary and information offered from a market participant.[18]

First, the Counterparty Carve-Out does not capture the full scope of asset managers already deemed sophisticated under two of the Department's most widely-used prohibited transaction class exemptions: PTCE 84-14 for Qualified Professional Asset Managers ("QPAMs") and PTCE 96-23 for In-House Asset Managers ("INHAMs"). For example, a newly-registered investment adviser that has $90 Million of assets under management would not fall within the carve-out when it is otherwise sufficient for QPAM or INHAM status. Similarly, an asset manager that has billions or even trillions of dollars in assets under management would be precluded from relying on the carve-out if it had, for example, only $50 Million of ***ERISA*** assets under management. The Department has already indicated that QPAMs are "established institutions which are large enough to discourage the exercise of undue influence upon their decision-making processes" and which are "expected to maintain a high standard of integrity."[19] If a QPAM is presumed to be sophisticated enough to act under PTCE 84-14, a finding of $100 million "benefit plan" assets under management is superfluous and will only limit Plan investment choices and act as a constraint in the exchange of useful information. We also know of no exemption other than the proposed Counterparty Carve-Out where the Department has limited qualifying assets to those within employee benefit plans.

Second, the Counterparty Carve-Out should be extended to cover interactions with investment advice fiduciaries (who may not have discretionary authority over Plan assets) in order to avoid unnecessary restrictions when Plans use investment consultants to help with Plan

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[18] *See id.*:

> The overall purpose of this carve-out is to avoid imposing ERISA fiduciary obligations on sales pitches that are part of arm's length transactions where neither side assumes that the counterparty to the plan is acting as an impartial trusted adviser, but the seller is making representations about the value and benefits of proposed deals. Under appropriate circumstances, reflected in the conditions to this carve-out, these counterparties to the plan do not suggest that they are an impartial fiduciary and plans do not expect a relationship of undivided loyalty or trust. Both sides of such transactions understand that they are acting at arm's length, and neither party expects that recommendations will necessarily be based on the buyer's best interests. In such a sales transaction, the buyer understands that it is buying an investment product, not advice about whether it is a good product, from a seller who has opposing financial interests.

[19] *See*, *e.g.*, Proposed Prohibited Transaction Class Exemption 84-14, 47 Fed. Reg. 56945, 56947 (Dec 21. 1982). A similar case should be made for INHAMs under PTCE 96-23, since "The Department believes that [the standards adopted under PTCE 96-23 for INHAM status] will help to ensure that the INHAM is an entity that has developed an appropriate level of expertise in financial and business matters." Proposed Prohibited Transaction Class Exemption 96-23, 60 Fed. Reg. 15597, 15600 (March 24, 1995).

design, including the selection of asset managers and their products and services. Most consultants will likely become investment advice fiduciaries under the revised definition, which may result in asset managers feeling constrained to provide information, education or incidental advice to these consultants absent expansion of the Counterparty Carve-Out. Plans hire these sophisticated advisers to help them make decisions and it would not be in their interests if sophisticated "investment advice" fiduciaries were restricted in their ability to obtain information from, or engage the services of, asset managers because of concern that the Counterparty Carve-Out is not available.

Third, it is difficult to understand why other highly-regulated entities such as a U.S. registered broker-dealer would be denied a presumption of sophistication where such entities provide advisory, consulting and other related services, which would likely be treated as fiduciary in nature under the Proposed Rule.[20]

The Department's cost-benefit analysis provides no support for its more restrictive definition of sophistication that would not include this full spectrum of sophisticated fiduciaries that act on behalf of Plans. Instead, the Fiduciary Investment Advice Regulatory Impact Analysis focuses significantly on IRAs and notes in particular that with respect to the "confusion" as to whether a market participant is acting in a fiduciary capacity,

> The problem is ***particularly acute for smaller plan investors***, because, as GAO reported, 'Smaller plans may be exposed to conflicts of interest on the part of service providers, because they are less likely than large plans to receive investment assistance from a service provider that is acting as a fiduciary.'[21]

This does not provide a basis for covering Plans that are sophisticated or who rely on sophisticated advisers. Rather, the GAO study is directed primarily at "[s]maller plans, [who] on the other hand, often lack the resources to perform these tasks in-house or to hire an independent adviser who will act as an ERISA fiduciary."[22]

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[20] Although U.S. registered broker-dealers are not eligible QPAMs (unless otherwise meeting the conditions of Part VI(a)(1)-(4) of PTCE 84-14), we believe the principle should be extended to such "established financial institutions" (47 Fed. Reg. 56945, 56946 (Dec. 21, 1982)) in light of the fact that "[t]he new proposal . . . extends the fiduciary duty to more advisers." DOL Fiduciary Investment Advice Regulatory Impact Analysis (April 14, 2015) at 11. U.S. registered broker-dealers are subject to extensive regulation and oversight by the U.S. Securities and Exchange Commission and other self-regulatory organizations.

[21] DOL Fiduciary Investment Advice Regulatory Impact Analysis (April 14, 2015) at 140 (citing GAO Publication No. GAO-11-119, at 28) (emphasis added).

[22] *See* GAO Publication No. GAO-11-119, at 28. For an analysis of the Department's cost analysis for retail investors, *see* Appendix IV for Comment on the Department of Labor Proposal and Regulatory Impact Analysis.

For these reasons, the AMG recommends that the Department expand the Counterparty Carve-Out so that it is available to a broader range of sophisticated fiduciaries. We believe that a Plan represented by a fiduciary (whether investment advice or discretionary manager) that is itself a sophisticated financial party should be a sufficient enough proxy. At a minimum, we recommend that, in addition to the current list of sophisticated fiduciaries eligible for the Counterparty Carve-Out, any Plan represented by a large, sophisticated entity that is a bank, as defined in section 202(a)(2) of the Investment Advisers Act of 1940, savings and loan association, the accounts of which are insured by the Federal Savings and Loan Insurance Corporation, a state qualified insurance company and a registered investment adviser each meeting certain other conditions, or an in-house asset manager within the meaning of Part IV of PTCE 96-23 – should be eligible for the carve-out. We further understand that there are other widely-available standards of sophistication in the marketplace, including those that are identified in the SIFMA Letter, which we would also support. Taking either approach would only reflect current understandings prevalent in the market generally and would be consistent with the continued well-ordered activities of the institutional markets.

2. Qualified Clients

As the Department's study does not appear to provide any meaningful empirical support to show the prevalence of "confusion" to accounts not regarded as "retail" for other regulatory and commercial purposes, the AMG also recommends that, in addition to considering the standards in the SIFMA Letter, the Department extend the Counterparty Carve-Out to Plans of "Qualified Clients." These are "sophisticated" persons defined per Rule 205-2 promulgated by the Security and Exchange Commission ("SEC") under the Investment Advisers Act of 1940 to mean (i) a natural person or company with at least $1,000,000 under the management of the investment adviser or a net worth (as defined by the Rule) of more than $2,000,000, (ii) is a Qualified Purchaser (as defined under the Investment Company Act of 1940) or (iii) has certain defined roles with an investment adviser.[23] This standard, when first proposed by the SEC "included a financial and business knowledge test of client eligibility," such that,

> The adviser was required to reasonably believe that the client, alone, or acting with a representative, had the knowledge and experience in business and financial matters to evaluate the merits and risks of a performance fee arrangement. The purpose of the test was to ensure that the rule would be limited to advisory contracts with clients ***capable of fending for themselves***. It contemplated that ***these clients would be able to negotiate contract terms with the adviser which adequately protected their interests***."[24]

When later refined in 1985, the SEC also noted that: "The Commission has concluded that it is consistent with the protection of investors and the purposes of the [Investment Advisers

[23] 17 CFR 275.205-3.

[24] Investment Advisers Act Release No. 865, 48 Fed. Reg. 27771 (July 10, 1983) (emphasis added).

Act] ***to permit clients who are financially experienced*** and able to bear the risks associated with performance fees to ***have the opportunity to negotiate compensation arrangements which they and their advisers consider appropriate***"[25]

Please see Appendix I for AMG's suggested language.

C. Counterparty Carve-Out Should Apply to Services and Incidental Communications.

Because the Counterparty Carve-Out only excludes from the general definition of investment advice, incidental advice provided ***in connection with an arm's length sale, purchase, loan, or bilateral contract or related offers***, it may be read to apply only to transactions entered into on a principal basis and not include services such as execution services, valuation services, prime brokerage services, custodial services—and perhaps most importantly—investment management fiduciary services. This omission is surprising but we hope it is merely an inadvertent omission.[26] We also urge the Department to clarify that sales of products such as investment funds by the fund itself or through any sponsor or distributor or other intermediary would qualify for the carve-out, as well as selling activity in connection with acting as an agent to the plan.

If services are not excepted, asset managers may no longer be offered certain services or will incur higher costs to obtain services while acting as Plan fiduciaries. For example, asset managers currently receive market and trading information (*e.g.*, identifying where there is liquidity, describing the pros and cons of differing execution strategies, offering an outlook on overseas markets or providing a sector analysis) from futures commission merchants, prime brokers and other market participants with whom asset managers execute transactions on behalf of Plans. This information is provided as a service to asset managers without a fee or direct linkage to further business. Absent inclusion in a carve-out, market participants may be forced to assume that this service amounts to investment advice (thereby making them investment advice fiduciaries) and may, as a result, discontinue providing it to asset managers acting on behalf of Plans.

Asset managers, as service providers, may become similarly constrained in their own communications with Plans and their fiduciaries. If an asset manager wanted to call one of its Plan clients to discuss large trends evolving in the debt or equity markets (for example, the recent performance of a broad-based index such as the S&P 500® or the Barclays Capital U.S. Aggregate Bond Index) of which the client may not be aware, it may now have to think twice in doing so out of a concern that the information could be considered investment advice under the Proposed Rule. These conversations happen all of the time and Plans view them as desirable and helpful support and information in complying with their fiduciary obligations. Idea generation is

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[25] Investment Advisers Act Release No. 996, 50 Fed. Reg. 48556 (Nov. 26, 1985) (emphasis added).

[26] In the 2010 Proposal, the "Sellers" Exception, the predecessor to the Counterparty Carve-Out failed to cover services. The Department received many comments on this point but has not addressed those comments in the Proposed Rule.

often a two way street, and many asset managers and Plans regard the dynamic exchange of ideas essential to capturing value.

For these reasons, the AMG believes the carve-out should be rewritten to cover services, including services provided to and offered by asset managers. See proposed language in Appendix I.

D. Compliance with Counterparty Carve-Out Should Be Made Less Burdensome

Regardless of whether the Department accepts the changes recommended above, we urge the Department to eliminate the unnecessary burdens imposed on counterparties, asset managers and Plans for the exception to be available.

As proposed, a counterparty wanting to use the Counterparty Carve-Out must perform diligence to confirm eligibility under the proposed tests for sophistication (*i.e.*, 100 participants or $100 million assets under management of "benefit plan" money) by one of two methods. Under the "plan size" method, the counterparty must receive a written representation from the independent Plan fiduciary that the independent fiduciary exercises authority or control with respect to the management or disposition of the Plan's assets (as described in section 3(21)(A)(i) of ERISA), that the employee benefit plan has 100 or more participants covered under the Plan, and that the independent fiduciary will not rely on the person to act in the best interests of the Plan to provide impartial investment advice, or to give advice in a fiduciary capacity. In addition, the person must fairly inform the independent Plan fiduciary of the existence and nature of the person's financial interests in the transaction and cannot receive a fee or other compensation directly from the Plan, or Plan fiduciary, for the provision of investment advice (as opposed to other services) in connection with the transaction. Finally, the person must know or reasonably believe that the independent Plan fiduciary has sufficient expertise to evaluate the transaction and to determine whether the transaction is prudent and in the best interest of the Plan participants (the person may rely on written representations from the Plan or the Plan fiduciary for this purpose).

Under the "assets under management" alternative, a counterparty can rely on the Counterparty Carve-Out if it knows or reasonably believes that the independent Plan fiduciary has responsibility for managing at least $100 million in employee benefit plan assets. In the case of an individual Plan, the person may rely on the most recent Form 5500 Annual Return/Report and in the case of an independent fiduciary acting as an asset manager for multiple Plans, a person may rely on representations from the independent fiduciary regarding the value of Plan assets under management. As with respect to the "plan size" test, the person must inform the independent fiduciary that the person is not undertaking to provide impartial investment advice, or to give advice in a fiduciary capacity and will not receive a fee or other compensation directly from the Plan or Plan fiduciary, for the provision of investment advice (as opposed to other services) in connection with the transaction.

This diligence requirement is unnecessarily burdensome and complex, and will operate to the detriment of Plans by increasing costs, limiting access to information and potentially delaying execution. For example, when Plans or sophisticated asset managers acting on behalf of Plans enter into transactions with broker-dealers, the potential delays in execution occasioned by the trading counterparty's need to assure itself that the Counterparty Carve-Out will be satisfied by obtaining or confirming the information required by the Carve-Out would almost certainly inure to the disadvantage of Plan clients. Obtaining a written representation regarding Plan size and sophistication before a market participant can enter into or offer to enter into a transaction is impractical, at best.

We believe that the proscriptive conditions necessary to demonstrate diligence are not only superfluous, they are outright harmful. Instead, we suggest that the carve-out merely include a condition that the market participant has a reasonable basis to believe that the sophistication standard has been satisfied. Please see AMG's suggested changes to the Counterparty Carve-Out in Appendix I.

E. The Proposed Rule Should Clarify that Marketing of Products and Services is not "Investment Advice"

Because the Proposed Rule broadly treats communications with Plans as "recommendations" without excluding the selling and marketing activity of asset management products and services, the AMG is concerned that sales and marketing activities may trigger fiduciary status under the Proposed Rule. Each introductory conversation, each pamphlet and each marketing material given before a Plan signs an agreement with an asset manager or enters into a transaction runs the risk that the asset manager becomes an investment advice fiduciary at that point with respect to the information provided. The asset manager may not be able to sell its own investment management services to sophisticated or retail Plans because of, in the former case, a concern that "services" is not within the ambit of the Counterparty Carve-Out transactions, and in the latter case, any communication, any response, even to a request for proposal or the like could be viewed as investment advice if "directed" to a Plan. This maximalist approach forces asset managers and other market participants to find an appropriate carve-out to avoid fiduciary status where common sense would indicate no fiduciary status is even remotely intended.

It is our collective experience that, in deciding whether to hire or continue engaging a specific asset manager, Plans and their representatives want asset managers to discuss different strategies, styles and other features of investment management services and other products so that they can make informed decisions. Absent carving out these communication, the Proposed Rule will likely result in Plans receiving less information rather than more in deciding which asset manager to hire. We do not believe this was the Department's intent and urge the Department to provide for a carve-out that allows a person to sell a product or service without fear of inadvertently becoming a fiduciary.

We note that there are a number of common circumstances in which individuals – of all stripes, incomes, sophistication levels etc. – know or reasonably should conclude based on the context of the interaction that the person with whom they are interacting is "selling" something. Where the seller makes it clear that it is selling a product or service (or the Plan recipient should know under the circumstances that the asset manager is going to earn a fee on the sale of product), we do not think that that clear sales activities should confer investment advice status.

Likewise, material containing boilerplate or non-individualized marketing or research materials is simply not investment advice.[27]

The AMG has a two-part recommendation. First, the AMG recommends expanding the Counterparty Carve-Out to permit asset managers to market their asset management products and services to Sophisticated Plans (as defined in Appendix I), as they and their representatives should not realistically have "difficulty" in distinguishing between sales and investment advice. Second, the AMG recommends carving out marketing of asset management products and services to non-Sophisticated Plans where the marketing is preceded by disclosure in writing (and not in fine print) that the market participant is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity. This disclosure should be provided in advance of the initiation or execution of any transaction or service, as explained more fully in the SIFMA Letter. We have provided proposed language in Appendix I.

F. Other Suggested Revisions to Counterparty-Carve Out

The Counterparty Carve-Out does not apply to pooled funds that are considered Plan assets and are subject to ERISA. We recommend that the Department adjust the language to clarify that pooled funds are included in the Counterparty Carve-Out and assume that this is merely a technical correction. This is reflected in our suggested language in Appendix I.

In addition, we do not believe fiduciary obligations should extend to arms-length referrals – including to asset managers – where neither side assumes that the counterparty to the Plan is acting as an impartial trusted adviser. In this regard, we agree with the concerns and solutions proposed in the SIFMA Letter.

G. Investment Education Carve-Out Should Preserve the Current Ability to List Specific Investment Options

The Proposed Rule includes an investment education carve-out, which is purportedly "similar to the carve-out in the 2010 proposed regulation." However, the Proposed Rule provides that, "[a]s a departure from IB 96-1, a new condition of the carve-out for investment education is that the information and materials not include advice or recommendations as to specific investment products, specific investment managers, or the value of particular securities or other property."[28]

We respectfully believe that this "departure" and the addition of the "new condition" makes the carve-our neither "similar to" the carve-out in the 2010 proposal nor similar to the

[27] *See* NASD Notice to Members 01-23 ("[A] member that sends a customer or group of customers information about a security might include a statement that the member is not providing the information based on the customers' particular financial situations or needs. Members may properly disclose to customers that the opinions or recommendations expressed in research do not take into account individual investors' circumstances and are not intended to represent 'recommendations' by the member of particular stocks to particular customers.").

[28] 80 Fed. Reg. at 21945.

"materials within the meaning of an earlier Interpretive Bulletin issued by the Department in 1996."[29] In 1996, the Department adopted I.B. 96-1:

> In view of the important role that investment education can play in assisting participants and beneficiaries in making informed investment and retirement-related decisions and the uncertainty relating to the fiduciary implications of providing investment-related information to participants and beneficiaries, the Department is clarifying, herein, the application of ERISA's definition of the term "fiduciary with respect to a plan" in section 3(21)(A)(ii) to the provision of investment-related information to participants and beneficiaries.[30]

It further stated that:

> Interpretive Bulletin 96-1 identifies categories of information and materials regarding participant-directed individual account pension plans that do not, in the view of the Department, constitute "investment advice" under the definition of "fiduciary" in ERISA section 3(21)(A)(ii) and the corresponding regulation at 29 CFR 2510.3-21(c)(1).[31]

However, the Department apparently now believes that "even when accompanied by a statement as to the availability of other investment alternatives, [such types of specific asset allocations that identify specific investment alternatives in I.B. 96-1 investment education] function as tailored, individualized investment recommendations, and ***can effectively steer recipients*** to particular investments, but without adequate protections against potential abuse."[32] We respectfully disagree, and note the Department has not provided any empirical information to support this assertion. Moreover, the Department noted at the time that the response to I.B. 96-1 was "overwhelmingly positive." The AMG is perplexed why this change is necessary to accomplish the Department's goals, especially since it was not included in the Department's original 2010 proposal and no evidence has been provided that circumstances have changed materially since the release of I.B. 96-1.

The Proposed Rule, as written, ignores the fact that Plans and their participants want "visual" or interactive scenarios, such as different generic model asset allocations, and need suggested investments for what would be included in those asset allocations, so that they understand how to apply the information. The imposition of a restriction on the use of a given

[29] *Id*. at 21944.

[30] Interpretive Bulletin 96-1; Participant Investment Education, 61 Fed. Reg. 29586 (June 11, 1996).

[31] *Id.*

[32] 80 Fed. Reg. at 21934.

asset manager's name or product will almost certainly have the result of decreasing the availability of critical information Plans need to make informed decisions. We fear that the net effect of these substantial changes may be to chill investment firms' appetite to provide any sort of investment education that could be viewed as crossing the line into investment advice fiduciary status.

At a bare minimum, the Department should permit lists of available alternative funds and other investments by asset class without highlighting any one particular investment. Such a breakdown of available investment options under a participant directed defined contribution plan is already required by the participant disclosure rules in the Department's participant directed disclosure rules.[33] Such lists of investments can be accompanied by appropriate disclosures, including statements that the products listed are just examples, information about where additional products can be found, and notes, if applicable, that the listed products are not the entirety of what is available and that other products may be similar or superior.

Although one of the stated reasons for the Proposed Rule is the Department's insistence that the Plan universe has evolved dramatically since 1975 from a largely defined benefit world to a defined contribution world, I.B. 96-1's more recent publication and basis clearly puts it in a different category. I.B. 96-1 was developed ***specifically*** with respect to a defined contribution and participant-directed universe in mind:

> It has been represented to the Department that, while a number of employers sponsoring ***participant-directed individual account pension plans*** have instituted programs intended to educate their employees about investment principles, financial planning and retirement, many employers have not offered programs or offered only limited programs due to uncertainty regarding the extent to which the provision of investment-related information may be considered the rendering of "investment advice" under section 3(21)(A)(ii) of ERISA, resulting in fiduciary responsibility and potential liability in connection with participant-directed investments.[34]

The sudden changes to this long-held guidance is inconsistent with the Department's expressed continuing goal of facilitating financial literacy.

Practically speaking, removing product and manager specific references will mean that the Department will have chosen to affirmatively place a speculative and unsubstantiated generalized concern about "steering" participants above the very real consequences that a Plan fiduciary, participant, beneficiary or IRA owner would be forced to undertake additional research at its own cost to find viable products that could fit the information permitted. Equally likely, the person may just fail to spend additional time or money necessary to determine specific

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[33] *See* 29 CFR 2550.404a-5.

[34] 61 Fed. Reg. at 29586 (emphasis added).

appropriate investments and simply give up because it is too hard. This results runs counter to the Department's goal of increasing retirement savings and improving investment outcomes.

At the end of the day, we think the Department's assumptions are incorrect and will inure to the detriment of Plans. Imagine if the Food and Drug Administration were somehow to regulate what pharmacists could say to customers, who, for example, visited their pharmacy asking about which over the counter medicines might address certain symptoms. Assume a customer comes into the pharmacy with a persistent and productive cough, runny nose and some occasional aches and pains. How helpful would it be to the ailing customer if the pharmacist were only able to talk about things such as acetaminophen, bromhexine, acetylcysteine, guaifenesin, ammonium chloride, ammonia, senega, sodium citrate, ipecacuanha, codeine, ibuprofen, dextromethorphan, dihydrocodeine, pholcodine, or pentoxyverine? What if the customer asked which products contained which ingredients, but all the pharmacist could tell the customer (who by this time may be exhausted from all of her coughing) is that she should go consult the many bottles which are generously lining the multiple shelves in the pharmacy?

Even less useful information is provided by a pie chart that provides an asset allocation with broad categories such as "fixed income" or "equities" with no specific references to products. Each of these categories is very broad and can encompass a variety of strategies, sub-strategies and other important differences. The Department's elimination of specific possible investment options will have the undesired result of causing Plan fiduciaries, participants, beneficiaries and IRA owners to think less about what is right for their Plans. It will either be too expensive, too time consuming, or too complicated for an individual to "connect the dots" so they can make informed investment decisions. Thus, we urge the Department to retain the ability to list specific invest alternatives, as provided in I.B. 96-1, but to retain the expansion of this "safe harbor" to all types of Plans.

H. Swaps Carve-Out Should be Conformed to Advisory Opinion and Made Available for All Plans and IRAs.

The proposal provides a carve-out (the "Swaps Carve-Out") to "allow swap dealers, security-based swap dealers, major swap participants and security-based major swap participants who make recommendations to plans to avoid becoming ERISA investment advice fiduciaries when acting as counterparties to a swap or security-based swap transaction."[35] As the preamble to the Proposed Rule states:

> Paragraph (b)(1)(ii) of the proposal specifically addresses advice and other communications by counterparties in connection with certain swap or security-based swap transactions under the Commodity Exchange Act or the Securities Exchange Act. This broad class of financial transactions is defined and regulated under amendments to the Commodity Exchange Act and the Securities Exchange Act by the Dodd-Frank Act. Section 4s(h) of the Commodity Exchange Act [], and section 15F of the Securities

[35] 80 Fed. Reg. at 21943.

> Exchange Act of 1934 [] establishes similar business conduct standards for dealers and major participants in swaps or security-based swaps. Special rules apply for transactions involving "special entities," a term that includes employee benefit plans under ERISA, but not IRAs and other non-ERISA plans.[36]

AMG seeks three clarifications with respect to this carve-out. The first, as noted above, would make this exception applicable to all Plan accounts. There is no reason why a small Plan or a very sophisticated IRA should not be able to engage in a swap under appropriate circumstances, assuming the account is an eligible contract participant.[37] The second is that it should cover the services inherent in swap transactions, such as, but not limited to, swap clearing arrangements. Third, the carve-out needs to cover pooled funds that hold plan assets, which is a significant omission. These latter two changes are critical to conform this carve-out to the relief the Department recently gave in Advisory Opinion 2013-01A. While the Department has indicated that it did not intend to cut back on that relief, the carve-out is inadequate to cover swap clearing arrangements. For proposed language, please see Appendix I.

II. <u>The Proposed Best Interest Contract Exemption (ZRIN 1210–ZA25)</u>

The AMG has serious concerns about the ripple effect of the Proposed BIC Exemption, including significant reductions in retirement investment choices, increased costs and, ultimately, reduced retirement savings and benefits. While the Proposed BIC Exemption has direct application to broker-dealers, the impact will also be felt by asset managers who may be restricted from making investments for certain Plans, and may be forced to limit products and services that they offer. As such, in addition to agreeing with the comments submitted by SIFMA's broker-dealer members regarding the Proposed BIC Exemption (the "SIFMA BIC Letter," attached hereto as Appendix III), the AMG offers its own comments in order to explain how the Proposed BIC Exemption will impact asset managers' Plan clients and investors.

A. Narrow Scope of "Assets" is Inconsistent with Core ERISA Principles

The narrow scope of the Proposed BIC Exemption with regard to investments within the Department's definition of "Asset," as explained in the SIFMA BIC Letter, will mean that advisers who rely on the Proposed BIC Exemption will be unable to use their judgment to advise Plans to invest in the Plan's best interest and, instead, will be limited to a *de facto* legal list of "approved" products. What happens when an investment product that may be best suited for a tax-deferred arrangement is not "on the list?" Should that product only be made available for non-Plan accounts, even though those accounts are not tax efficient? Should an inferior substitute be sold to the Plan even though on a relative basis, it clearly is not in the individual's best interest? If a Plan wishes to purchase an interest in a non-publicly traded REIT that is better suited to be held in a tax-deferred vehicle but it is not on the "approved" list what are the

[36] *Id*. at 21942.

[37] *See, e.g.*, 77 Fed. Reg. 9734, 9823-9829 (February 17, 2012) and the presumptions prescribed therein.

potential savings impacts? All things being equal, the retirement beneficiary or saver will likely have less money for retirement because the Proposed BIC Exemption effectively constrains economically rational choices and will result in suboptimal savings.

AMG does not believe that the Department possesses the authority to impose an "approved list" of this nature. In light of its impact, the AMG agrees with the SIFMA BIC Letter's recommendation of, at minimum, revising the scope to cover "securities or other property," as this standard is already used under the existing definition.[38]

B. Compensation Structures Should Permit Service Providers to "Continue Receiving Common Types of Compensation"

In addition to the limitations imposed by the narrow scope of "Assets" covered by the Proposed BIC Exemption, the lack of clarity regarding permissible compensation structures will cause broker-dealers to stop offering some products to Plans, if they use the Proposed BIC Exemption at all. The Preamble to the Proposed BIC Exemption includes five examples of "broad approaches to [individual employee] compensation structures that could help satisfy the contractual warranty regarding the policies and procedures [concerning Material Conflicts]."[39] It notes that ***"[c]ertainly***, one way for a financial institution to comply is to adopt a '***level-fee***' structure, in which compensation for [individuals] does not vary based on the particular investment product recommended. But the exemption does not mandate such a structure."[40] Practically speaking, however, a careful examination of the Department's suggested alternatives and risk measuring tips would lead one to conclude that the Department is strongly indicating that departures from a fee-leveling and/or fee offset model will have, at a minimum, a largely uphill battle in demonstrating compliance with the Impartial Conduct Standards in the Proposed BIC Exemption.

As the SIFMA BIC Letter explains, the architecture of the Proposed BIC Exemption and its Impartial Conduct Standards raise significant questions as to whether "[u]nder the exemption, advisers will be able to continue receiving common types of compensation."[41] Products offered by asset managers have different compensation structures (*e.g.*, compensation for an exchange traded fund may be a commission and for an actively managed mutual fund revenue sharing, and some funds may or may not employ 12b-1 or other fees). Broker-dealers and asset managers alike will likely find it too difficult to determine how "[c]ommon forms of compensation in use today in the financial services industry, such as commissions and revenue sharing . . . whether paid by the client or a third party such as a mutual fund" can possibly fit into the Proposed BIC Exemption's Impartial Conduct Standards.[42] Because of this difficulty, there is a risk that a

[38] *See* ERISA § 3(21)(A)(ii); 29 CFR 2550.3-21(c)(1)(i).

[39] 80 Fed. Reg. at 21971.

[40] *Id*. (emphasis added).

[41] *See DOL Fact Sheet*, *supra* at note 5.

[42] *Id*.

salesperson selling asset management products and services that includes recommendations or related advice would have to fit within a fee-leveling and/or fee offset model. Asset managers and other market participants would be forced to eliminate any differential or third party compensation arrangements with such salespersons (including attendance at training or other seminars to which advisers may be invited), as well as any bonus or incentive programs for them. The receipt of such education by the financial adviser could be viewed as impermissible compensation under the Proposed BIC Exemption. This may have the effect of forcing Plans to more expensive asset-based products.

In addition, the complexities of compliance carry significant risks for any market participant relying on the Proposed BIC Exemption. None of the conditions provides room for *de minimis* or immaterial actions (or omissions). With the specter of excise taxes and penalties arising out of any inadvertent foot-faults, AMG believes that the structure of the Proposed BIC Exemption will effectively force broker-dealers to offer only those products and services which pose the fewest opportunities for failure (*e.g.,* ETFs and mutual funds without sales loads, revenue sharing or 12b-1 fees). This will operate to limit Plan choice.

As a further consequence of the conditions of the Proposed BIC Exemption, some asset managers will conclude that they must discontinue (or severely limit) mutual fund share classes that include 12b-1, subtransfer agency or other payments from the fund, or payment of distribution and marketing (*i.e.,* revenue sharing), thus limiting choice, reducing services and increasing costs. Some Plans, particularly smaller Plans, prefer share classes that include such payments to cover omnibus recordkeeping or other costs to manage the Plan. Many of these Plans do not have the cash to make payments upfront and thus need such arrangements. Also, if asset managers are effectively forced to move to share classes with only advisory fees and revenue sharing is curtailed, education and other informational material provided by financial advisers generally could "dry up," as such education is often paid for by the asset manager or its product. The Department's cost-benefit analysis does not account for these detrimental impacts.

Additionally, the Proposed BIC Exemption raises troubling questions as to the ability of fiduciaries to offer their proprietary products (as defined by the proposal). Although the Proposed BIC Exemption expressly contemplates the offering of proprietary products by fiduciaries, it requires, among other things, that offerors of proprietary products adhere to Impartial Conduct Standards, as defined in the Proposed BIC Exemption (and elsewhere under the architecture of the Department's proposal), and mitigate any material conflicts of interest. The Proposed BIC Exemption would *de facto* impose significantly higher hurdles to a fiduciary in the offering of its own products as compared to the products available through competitors. Apart from the anti-competitive impacts of the Proposed BIC Exemption and the proposal taken as a whole, it could have a chilling effect on the ability of fiduciaries to offer proprietary products that are otherwise in the best interest of their clients.

The net impact of compensation arrangements which will need to be adopted to conform to the Proposed BIC Exemption's compensation requirements will be detrimental to retirement and other clients. If the Proposed BIC is used at all, it will be available only with respect to a narrow set of products and services. For these reasons, the AMG agrees with the recommendations made in the SIFMA BIC Letter.

C. Exemption for Pre-Existing Transactions Should Allow for Transition without Loss of Services or Access by Retirement Savers

For the reasons set forth in the SIFMA BIC Letter, the AMG recommends adjusting the transitional relief to provide retirement savers sufficient continuation of services and access to information. We do not believe that it would be in the best interests of retirement savers to deny transition relief for sales or other dispositions of assets already held in such accounts. The AMG would further recommend that any acquisitions or dispositions that are effected after the applicability date of the regulation pursuant to any standing or automatic investment instructions effected before the applicability date be afforded protection under the Proposed BIC Exemption.

These recommended modifications would allow investors and advisers to continue on previously agreed courses of action, with the relief to end immediately upon any new recommendation or transaction that otherwise would trigger the contractual and other requirements of the Proposed BIC Exemption. Finally, and perhaps most importantly, affirmative signatures should not be required by any Plan or on behalf of any Plan as part of any transition. Such a requirement would put Plans in a netherworld in which asset managers and other market participants will be encouraged to do nothing while they wait for a signature that may or may not come. Such a requirement would not be in the best interest of retirement savers.

D. Request for Comment on a Low-Fee Streamlined Exemption

We disagree with an approach that would provide a separate class exemption for advice concerning low-fee index funds. As such, we agree with the SIFMA BIC Letter's recommendation of even-handed treatment of investments in the Proposed BIC Exemption and in the Proposed Rule.

* * *

The AMG respectfully believes that the Department's Proposed Rule and Proposed BIC Exemption are profoundly flawed and should not be adopted. If the Department nonetheless proceeds with these rulemakings, for the reasons stated above, we request that the Department revise the Proposed Rule and Proposed BIC Exemption in line with the AMG's recommendations.

The AMG thanks the Department for the opportunity to comment. Should you have any question, please do not hesitate to contact Tim Cameron at 202-962-7447 or tcameron@sifma.org or Laura Martin at 212-313-1176 or lmartin@sifma.org.

Respectfully submitted,

Timothy W. Cameron, Esq.
Managing Director
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Laura Martin
Managing Director & Associate General Counsel
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APPENDIX I

The following are the AMG's suggested changes to the text of the Proposed Rule, in addition to the general recommendations set forth in the AMG's comment letter. The AMG believes that even with these changes the Department would be adopting a regulatory architecture that exceeds its statutory authority, but that these revisions would ameliorate a number of the Proposed Rule's significant adverse effects.

(a) INVESTMENT ADVICE. For purposes of section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (the "Act") and section 4975(e)(3)(B) of the Internal Revenue Code (the "Code"), except as provided in paragraph (b) of this section and except with respect to any Sale described in paragraph (f)(10) hereof, a person renders individualized investment advice directly to a plan or IRA described in paragraph (f)(2) of this section, with respect to specific moneys or other property of a specific account (but only to the extent of such investment advice) upon which such plan or IRA reasonably relies in making an investment decision, and in the case of a Sophisticated Plan (as defined in paragraph (f)(9) hereof), only if such advice is rendered pursuant to a mutual agreement between the person and the Sophisticated Plan that such investment advice will form a primary basis for or will significantly influence the Sophisticated Plan's investment decision, if, for any such plan or IRA described in this paragraph (a)--

(b)(1)(i) COUNTERPARTIES AND SERVICE PROVIDERS. In such person's capacity as a counterparty or service provider to a plan or IRA (including for this purpose, any entity deemed to constitute the assets of any such plan or IRA by reason of Section 3(42) of the Act), the person provides advice to a plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner who is independent of such person and who exercises authority or control with respect to the management or disposition of the plan's or IRA's assets or provides investment advice to the plan's or IRA's assets, with respect to an arm's length service arrangement, sale, purchase, loan or bilateral contract between the plan or IRA and a person, or with respect to a proposal to enter into such a service arrangement, sale, purchase, loan or bilateral contract if, prior to or in connection with the entering into a relationship or any such transaction, such person has a reasonable belief that such plan or IRA is a Sophisticated Plan.

(b)(1)(ii) SWAP TRANSACTIONS. The person is a counterparty, service provider or representative thereof or of the plan in connection with a swap or security-based swap if, the plan or plan asset vehicle is represented by a fiduciary independent of the person; the person is a swap clearing firm or other service provider in relation to a swap, swap dealer, security-based swap dealer, major swap participant, or major security-based swap participant; the person (if a swap dealer, security-based swap dealer, clearing firm or other similar service provider), is not acting as an advisor to the plan or plan asset vehicle in connection with the transaction; and in advance of providing any recommendations with respect to a transaction or a series of potential transactions, the person obtains a written representation from the independent plan fiduciary, that the fiduciary will not rely on recommendations provided by the person.

(f)(1) “RECOMMENDATION’’ means a communication that, based on its content, context, and presentation, would reasonably be viewed as qualitative, or as an endorsement or call to take or refrain from taking any investment action, provided however, the term recommendation shall not include any communication that would not be a recommendation within the meaning of applicable Financial Industry Regulatory Authority (“FINRA”) rules.

(f)(9) “SOPHISTICATED PLAN” means

(a) any plan or IRA (including any account or entity the assets of which are deemed to constitute the assets of any such plan or IRA by reason of Section 3(42) of the Act), or group of plans established or maintained by the same employer, including an affiliate thereof (as defined in Part VI(c) of Prohibited Transaction Class Exemption 84-14), or employee organization, which has at least $50,000,000 in total assets, or any plan, or group of plans if their assets are pooled in a single master trust, with 100 or more participants or beneficiaries, in either such case as of the last day of the previous calendar year; or

(b) any plan or IRA (including any account or entity the assets of which are deemed to constitute the assets of any such plan or IRA by reason of Section 3(42) of the Act), the assets of which, with respect to any communication, recommendation or interaction by or with any person, is under the advisement (including, without limitation, as a consultant), direction or management of a fiduciary (within the meaning of Section 3(21) of ERISA), that is:

(i) a person that is (A) a bank, as defined in section 202(a)(2) of the Investment Advisers Act of 1940, which bank has, as of the last day of its most recent fiscal year, stock (common and preferred), surplus, undivided profits, contingency reserves and other capital reserves (for purposes of this paragraph (f)(9), “Equity Capital”) in excess of $1,000,000, (B) a savings and loan association, the accounts of which are insured by the Federal Savings and Loan Insurance Corporation, that has made application for and been granted trust powers to manage, acquire or dispose of assets of a plan by a State or Federal authority having supervision over savings and loan associations, which savings and loan association has, as of the last day of its most recent fiscal year, Equity Capital, or capital, paid-in and contributed surplus, unassigned surplus, contingency reserves, group contingency reserves, and special reserves (for purposes of this paragraph (f)(9), “Net Worth”) in excess of $1,000,000, (C) an insurance company which is qualified under the laws of more than one State to manage, acquire, or dispose of any assets of a plan, which company has, as of the last day of its most recent fiscal year, Net Worth in excess of $1,000,000 and which is subject to supervision and examination by a State authority having supervision over insurance companies, or (D) an investment adviser registered under the Investment Advisers Act of 1940 that has total client assets under its management and control or under advisement in excess of $85,000,000 as of the last day of its most recent fiscal year, and either (I) shareholders’ or partners’ equity in excess of $1,000,000, or (II) payment of all of its liabilities including any liabilities that may arise by reason of a breach or violation of a duty described in Section 404 or 406 of the Act is unconditionally guaranteed by—(a) a person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such investment adviser if the investment adviser and such affiliate have shareholders' or partners' equity, in the aggregate, in excess of $1,000,000, (b) a person described in (b)(i)(A), (B) or (C), or (c) a broker-dealer registered under the Securities Exchange Act of 1934 that has, as of the last day of its most recent fiscal year, Net Worth in excess of $1,000,000;

(ii) a U.S. registered investment adviser which qualifies as an "in house asset manager" for purposes of Part IV of Prohibited Transaction Class Exemption 96-23, as may be amended from time to time; or

(iii) a U.S. registered broker-dealer;

(c) an IRA or participant-directed individual account plan (within the meaning of Section 3(34) of the Act) that is under the management or direction of

(i) a natural person who, or a company that, enters into an advisory or discretionary management agreement on behalf of such an IRA or plan, where such advisory or management agreement will cover at least $1,000,000 of the assets of such plan or IRA;

(ii) a natural person with a net worth (together with assets held jointly with a spouse) of more than $2,000,000 (disregarding for this purpose any such natural person's (or spouse's) primary residence and disregarding for liability purposes any indebtedness secured by such primary residence, up to the estimated fair market value of the primary residence at the time the arrangement is entered into (except that if the amount of such indebtedness outstanding at the time of calculation exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess must be included as a liability) and including as a liability any amounts of indebtedness of any such primary residence in excess of the estimated fair market value of the residence; or

(iii) a natural person (including any person who holds a joint, community property, or other similar shared ownership interest in certain outstanding securities under 15 USC 80a–3(c)(7)) who owns not less than $5,000,000 in investments, (as may be defined by the U.S. Securities and Exchange Commission from time to time.

For purpose of section (f)(9), the term "fiduciary" shall also include, in the case of an IRA, the individual for whose benefit the IRA was created, or in the case of a participant-directed individual account plan (within the meaning of Section 3(34) of the Act), the participant if such participant's individual plan account is under such participant's control (within the meaning of 29 CFR 2550.404c-1).

(f)(10) "SALE" means any communication to or interaction with any plan or IRA (which for purposes of this section (f)(10) includes any entity deemed to constitute the assets of any such plan or IRA by reason of Section 3(42) of the Act) or representative thereof which is related to, in contemplation of, or which may form a basis of the offering of any product or service to such plan or IRA or such person's representative or is intended by such person to foster the entering into of the product or service arrangement, to further the maintenance or administration of any existing relationship, or to explore the potential expansion of such relationship through the consideration of information relating to any product or service, provided however, with respect to any plan or IRA that is not a Sophisticated Plan, such person shall promptly following the first direct introduction to or first direct interaction between such person with such plan or IRA that is related to, in contemplation of, or which may form a basis of the offering of any product or service to such plan or IRA, and in any event prior to the initiation of or execution of any transaction or service following the inception of the relationship, communicate to such plan or IRA (i) that any information is provided in connection with the sale of a product or service or for consideration in connection with any future sale of any product or service and is not investment advice within the meaning of this section; and (ii) that such plan or IRA should not rely on the communicating person to provide impartial advice in connection with any information, material or communication provided with respect to the sale or proposed sale of such product or service.

We also recommend the following changes to paragraph (b):

(b) CARVE-OUTS--INVESTMENT ADVICE. Except for advice described in paragraph (a)(1) of this section with respect to which the person has represented or acknowledged that it is acting as a fiduciary as described in paragraph (a)(2)(i) of this section with respect to a particular account and a particular transaction or series of transactions, the rendering of advice or other communications in conformance with a carve-out set forth in paragraph (b)(1) through (6) of this section shall not cause the person who renders the advice to be treated as a fiduciary under paragraph (a) of this section.

APPENDIX II

Letter from the Securities Industry and Financial Markets Association re: RIN1210-AB32 (the "SIFMA Letter")

July 20, 2015

By U.S. Mail and Email: e-OED@dol.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule, Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: RIN1210-AB32

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to provide comments regarding the Department of Labor's ("Department") proposed regulation under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") that will redefine the term "fiduciary" under section 3(21) of ERISA and section 4975(e) of the Internal Revenue Code of 1986, as amended (the "Code"). SIFMA appreciates the opportunity to comment and hope that our comments are helpful to the Department as it assesses the impact of the proposal on plans and their participants as well as IRAs and other retail accounts.[2]

SIFMA shares the Department's concern that American workers are not saving enough for retirement. SIFMA members know that financial professionals are already subject to a suitability standard that requires that they put the interests of their clients first and SIFMA

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] The rule covers all employer sponsored retirement plans, all employer sponsored welfare plans, IRAs, Individual Retirement Annuities, Coverdell Education Savings Accounts, Archer MSAs and Health Savings Accounts.

welcomes a best interest standard, implemented by the appropriate regulatory authorities, when financial professionals are providing investment recommendations. While SIFMA may differ with the Department on the appropriate means to remedy the lack of adequate retirement savings on the part of American workers, we look forward to working with the Department to increase and improve retirement security and to preserve the current investment choices available to retirement investors, as well as their choice of the type of professional services they want and need. SIFMA respectfully requests an opportunity to testify at the Department's August 10-13, 2015 hearing.

Attached hereto are SIFMA's submissions for the related rulemakings being undertaken by the Department. These attachments are an integral part of this submission.[3]

Overview

While SIFMA believes that the provision of individualized advice should be covered by a best interest standard when both the financial professional and the client agree that a fiduciary account is what they both expect, this proposed rule goes too far and will have significant adverse consequences for Americans trying to save for retirement. The following is a list of only some of the consequences of the Department's proposed rule.

- The proposed rule will curtail access to many beneficial services and products available to retail retirement investors.
- The proposed rule will significantly limit retail retirement investors' ability to tailor the kind of services they want in light of their individual circumstances and instead will be forced into a "one size fits all" solution.

[3] See Appendices numbered 1-8.

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- Fiduciary liability will attach, with either no exemptive relief or limited and operationally difficult relief, without any reliance by the client and without a mutual understanding of the services for which the client is contracting.
- A person could become a fiduciary merely by marketing his or her own services, advertising one-on-one counseling and the business generally, and urging a potential client to hire the financial professional.
- Fiduciary liability could attach to generally available, non-individualized materials from a financial institution, including research, product brochures, and lists of investments that a financial institution "follows".
- The newly created best interest contract exemption proposed a best interest standard with conditions and elements that are, for all practical purposes, impossible to meet: providing advice without regard to what one might earn requires that the financial professional not know what he could be paid. Retail retirement investors overwhelmingly will be offered only wrap programs or fee based advisory accounts to avoid the logistical issues of complying with the BIC exemption's numerous and onerous conditions. Where an advisory account is not suitable or where the account holds less than $50,000, the account will likely be terminated and the IRA often will have no one-on-one professional assistance available to them.
- Bond quotes, account statements, and periodic reporting of pooled fund values could make the dealer, the custodian or the pooled fund sponsor fiduciaries.
- The Department's reversal of its long held view that distribution advice is not investment advice translates all distribution conversations into a fiduciary breach with no exemptive relief at all for the rollover or for any fees charged in the IRA.
- The education carve-out will be virtually useless to a participant who is not financially literate and can't translate generalities into some realistic choices.
- The effective date for the proposed rule is unrealistically short.

- There are more cost effective ways to achieve the Department's goal of ensuring that a best interest standard applies to IRAs.

SIFMA understands that the Department wants to ensure financial services providers are looking out for their customer's best interest. The industry and its many regulators shares that goal. But this proposal will not achieve that goal without significant revisions. In addition, SIFMA has filed comments on the exemptive proposals that are part of this package, but it should be clear from the outset that virtually all of the exemption amendments, as well as the new exemptions, are not administrable, and thus fail to meet ERISA's statutory requirement that the Secretary may not promulgate an exemption unless it is administrable.[4]

It should also be clear that SIFMA does not share the Department's assessment of current practices and purported costs in the financial services industry, nor does it agree with the Department's assessment of the benefits and costs that would result from implementation of these proposals. SIFMA is submitting separate reports on those topics today, prepared by NERA[5] and Deloitte Consulting[6].

SIFMA shares the Department's interest in ensuring that investors receive appropriate, informed assistance with decisions concerning retirement. However, SIFMA respectfully believes that this proposed exemption, and the package of proposals accompanying it, are not the proper way of proceeding. SIFMA also does not believe that the Department may use a new definition of "fiduciary," in combination with its exemptive authority, as a means of establishing a new regulatory and enforcement program for financial professionals, ERISA plans, and non-ERISA

[4] ERISA Section 408(a).
[5] Appendix 1
[6] Appendix 2

plans such as IRAs. SIFMA expresses this objection with regard to the BIC Exemption, and the other, related exemptive rules that have been proposed.

Finally, SIFMA believes that the Department's proposals exceed its statutory authority, the SEC and FINRA are that the appropriate authorities to develop and implement a best interest standard for financial professionals, and that the Department should defer to those regulatory authorities rather than adopt this new definition of "fiduciary" and the related exemptive rules. Nothing in these comments should be understood to mean that SIFMA concurs with the construction of ERISA and the Code underlying the Department's proposals. Rather, SIFMA offers these comments to assist the Department in improving its proposals in the event it decides to move forward with this package of regulatory changes despite the serious concerns they present.

Comments on specific provisions can be found on the pages indicated below:

Background and Current Law

The statutory definition of "fiduciary" (ERISA § 3(21), paralleled almost verbatim in Code § 4975(e)(3)) has three parts, two of which pertain to plan investments. First, persons who exercise discretionary authority or control over the investment of plan assets are fiduciaries. Second, a person who does not have that degree of control but who "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan" is also a fiduciary (ERISA §3(21)(A)(ii)).

Very soon after the enactment of ERISA, the DOL issued a regulation[7] defining the circumstances under which a person would be treated as providing investment advice under ERISA § 3(21)(A)(ii). That regulation remains in effect today. It provides that a person will be deemed to be providing "investment advice" within the meaning of Section 3(21)(A)(ii) only if:

> (i) Such person *renders advice to the plan as to the value of securities or other property, or makes recommendation as to the advisability of investing in, purchasing, or selling securities or other property*; and
>
> (ii) Such person either directly or indirectly (*e.g.*, through or together with any affiliate)—
>
> > …
> >
> > (B) Renders any advice described in paragraph (c)(1)(i) of this section *on a regular basis* to the plan *pursuant to a mutual agreement, arrangement or understanding*, written or otherwise, between such person and the plan or a fiduciary with respect to the plan, *that such services will serve as a primary basis for investment decisions* with respect to plan assets, *and that such person will render individualized investment advice* to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.

[7] 29 C.F.R. § 2510.3-21(c) (filed with the Federal Register on October 28, 1975) ("1975 regulation").

The italicized language establishes a five-part test with respect to advice regarding securities or their value: to provide "investment advice," a person must (1) render advice as to the value of securities or other property or make recommendations as to the advisability of investing in, purchasing or selling securities or other property (2) on a regular basis (3) pursuant to a mutual agreement, arrangement or understanding that (4) the advice will serve as a primary basis for investment decisions, and that (5) the advice will be individualized based on the particular needs of the plan.

The April 2015 Proposal

The Definition of Advice

In a marked departure from current law, the Department has proposed a rule that re-imagines Section 3(21) of ERISA and goes well beyond what was contemplated by the statute.[8] The proposed rule adds two significant categories to the kind of advice that would make one a fiduciary, and significantly revises the test for the provision of such advice to eliminate any

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[8] See the remarks of Georgetown University Law Professor Roy Schotland on the careful balancing that the Department now attempts to reverse:

> "While flat prohibitions [of all conflicts of interest] would be more 'pure,' such a course would not only disrupt arrangements that seems unwarranted absent a far plainer direction to do so; in addition, such a course would result in serious long-range harm to plan beneficiaries. . . . Congress [just] concluded an intensive look at the securities markets and industry and dealt quite explicitly . . . with the relationship between the broker-dealer function and the investment management function. Absent very clear direction, it would be questionable to treat the same problem, in the same industry more sweepingly than Congress deemed appropriate . . . . [I]n the name of protection against abuse, flat prohibitions would inflict greater injury than is likely to occur from abuse of conflicts of interest . . . . [I]t does seem necessary, in considering broker-dealers' conflicts, to keep in mind the anomaly which would occur if flat, sweeping prohibitions were imposed in this area, while the conflicts problems in . . . non-pension accounts were not subjected to appropriate safeguards. All these areas present conflicts, and by the nature of the problems and the reasons causing them to arise in the first place, intricate balancing to preserve potential benefits, and protect against potential dangers, is a difficult course but simply the only reasonable one."

reliance or even mutual understanding on the part of the advice recipient with respect to the role that the advice will play in his or her decision-making.

The proposed rule specifies four types of advice that may – when provided *directly* to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner in exchange for a fee or other compensation – make a person a fiduciary if the person represents or acknowledges that it is acting as a fiduciary within the meaning of ERISA, or if the person "[r]enders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA."

The four types of advice are:

> (i) A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property, including a recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA;
> (ii) A recommendation as to the management of securities or other property, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA;
> (iii) An appraisal, fairness opinion, or similar statement whether verbal or written concerning the value of securities or other property if provided in connection with a specific transaction or transactions involving the acquisition, disposition, or exchange, of such securities or other property by the plan or IRA;
> (iv) A recommendation of a person who is also going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (i) through (iii).

SIFMA believes that it is sensible to define advice with respect to individualized recommendations provided directly to a person regarding investments and managers (subparts (i) and (iv)) although the recommendation and any action taken based on that recommendation should be close in time.[9] However, we have three concerns about this definition:

(i) the second prong of the definition is too vague and the language used – recommendation as to the management of securities or other properties -- needs to be revised to reflect the quite different purpose that is described in the preamble to avoid confusion and misunderstanding;

(ii) the third prong of the definition on valuation should be reserved until it can be fully and appropriately addressed by the Department; and

(iii) based on language in the preamble, it appears that the fourth prong of the definition should cover not only recommendations of investment advice fiduciaries but also other referrals.

Each of these concerns is described in more detail below. But as an overarching point, SIFMA strongly disagrees that distribution recommendations are fiduciary advice within the meaning of ERISA. They are not investment advice. Nothing in the statutory language or the legislative history is consistent with the Department's interpretation, and the Department's "new" view is flatly inconsistent with its own legal interpretation in 2005.

1. The Prong Dealing with "Management"

The proposed regulation provides that fiduciary advice includes a recommendation as to the management of securities or other property, including recommendations as to the management of

[9] We think that the rule needs a time proximity test. If a financial professional unsuccessfully attempts to sell an IRA to a plan participant, but months or years later, the participant on his or her own, opens an IRA at the financial institution (not through that same financial professional) and that financial institution receives a fee, the future looking receipt of compensation definition is drafted to make the financial institution a fiduciary without any exceptions or carve-outs. SIFMA urges the Department to add a time proximity standard to the definition.

securities or other property to be rolled over or otherwise distributed from the plan or IRA. "Management of securities" is a broad and vague formulation, and would appear to duplicate the first prong of the definition. The preamble, however, provides helpful clarification on the Department's meaning with respect to "management". It suggests that the second prong of the advice definition was intended to cover advice regarding the rights appurtenant to securities and other properties held by a plan.[10] We respectfully request that the Department use this very clear language instead of the over-inclusive term "management". SIFMA members are concerned that this vague language at best appears duplicative of the first prong, and at worst, hides a variety of issues that could be a trap for the unwary. If the Department's intention is as described in the preamble, the language should be more narrowly drafted to reference these duties. If the Department has other issues in mind, SIFMA would welcome a discussion of those issues. We suggest that this prong be rewritten to provide as follows:

> (ii) A recommendation as to the exercise of rights appurtenant to assets of the plan;

Such a revision would clearly indicate the meaning of "management" in this context and distinguish it from prongs (i) and (iv) of the definition.

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[10] "(2) Recommendations as to the Management of Plan Investments

The preamble to the 2010 Proposal stated that the ``management of securities or other property" would include advice and recommendations as to the exercise of rights appurtenant to shares of stock (e.g., voting proxies). 75 FR 65266 (Oct. 22, 2010). The Department has long viewed the exercise of ownership rights as a fiduciary responsibility because of its material effect on plan investment goals. 29 CFR 2509.08-2 (2008). Consequently, individualized or specifically directed advice and recommendations on the exercise of proxy or other ownership rights are appropriately treated as fiduciary in nature. Accordingly, the proposed regulation's provision on advice regarding the management of securities or other property would continue to cover individualized advice or recommendations as to proxy voting and the management of retirement assets in paragraph (a)(1)(ii).

We received comments on the 2010 proposal seeking some clarification regarding its application to certain practices. In this regard, it is the Department's view that guidelines or other information on voting policies for proxies that are provided to a broad class of investors without regard to a client's individual interests or investment policy, and which are not directed or presented as a recommended policy for the plan or IRA to adopt, would not rise to the level of fiduciary investment advice under the proposal. Additionally, a recommendation addressed to all shareholders in a proxy statement would not result in fiduciary status on the part of the issuer of the statement or the person who distributes the proxy statement. These positions are clarified in the proposed regulation." 80 FR 21939 (Apr. 20, 2015)

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2. Valuation as Part of the Advice Definition

SIFMA also urges the Department to apply the same reasoning it applied to ESOP valuations and reserve the valuation section of the proposed regulation entirely. First, valuation information is not a recommendation and should not be investment advice. The point of the regulation is to capture the person recommending the investment, not the person providing the values from market sources. Nothing in the statutory language of ERISA or the Code, nor their legislative history, would support the Department's view that a value placed on an asset is investment advice. Values placed on assets are neither a call to action, nor an explicit endorsement. The Department has no authority to expand the concept of investment advice to include valuation information.

As drafted, however, apparently all statements of value are fiduciary advice, regardless of whether they are part of investment recommendations. SIFMA agrees that valuations should be accurate and complete and made in good faith, but those standards do not transform pricing information and administrative functions into fiduciary advice.

In determining not to include ESOP valuations in this rulemaking, the Department has apparently correctly concluded that it is not appropriate to expand the definition of investment advice to remedy every theoretical or potential abuse and uncertainty. In describing why the valuation provisions were included in the 2010 proposal, the Department noted:

> First, the proposal specifically includes the provision of appraisals and fairness opinions. As discussed above, the Department concluded in AO 76-65A that a valuation of closely held employer securities that would be relied on in the purchase of the securities by an ESOP would not constitute investment advice under the current regulation. However, a common problem identified in the Department's recent ESOP national enforcement

> project involves the incorrect valuation of employer securities. Among these are cases where plan fiduciaries have reasonably relied on faulty valuations prepared by professional appraisers. The Department believes that application of the proposal to appraisals and fairness opinions rendered in connection with plan transactions may directly or indirectly address these issues, and align the duties of persons who provide these opinions with those of fiduciaries who rely on them. Accordingly, paragraph (c)(1)(i)(A)(1) of the proposal specifically includes the provision of appraisals and fairness opinions concerning the value of securities or other property. This paragraph is intended to supersede the Department's conclusion in AO 76-65A, but is not limited to employer securities. Therefore, if a person is retained by a plan fiduciary to appraise real estate being offered to the plan for purchase, then the provision of the appraisal would fall within paragraph (c)(1)(i)(A)(1) of the proposal, and may result in fiduciary status under ERISA section 3(21)(A)(ii). The Department would expect a fiduciary appraiser's determination of value to be unbiased, fair, and objective, and to be made in good faith and based on a prudent investigation under the prevailing circumstances then known to the appraiser.
>
> Fn. 7: The Department's Employee Benefits Security Administration (EBSA) maintains a national enforcement project designed to identify and correct violations of ERISA in connection with Employee Stock Ownership Plans. One of the most common violations found is the incorrect valuation of employer securities. …[11]

The Department has not stated that there is evidence that valuations outside of the context of ESOPs have been unfair, abusive, or otherwise unlawful.[12] There is no justification for causing an investment adviser, custodian bank, broker-dealer or other entity that provides regular reporting of values to participants as required by the account agreement, the constituent documents of the investment vehicle, the securities law or Commodity Futures Trading Commission (“CFTC”) requirements regarding marking of collateral to become an ERISA fiduciary without a demonstrated need to remedy or prevent bias or abuse and SIFMA does not

[11] 75 FR 65265, and fn. 7 thereto.

[12] We note that while the Department has alleged ESOP valuation abuses, courts have properly imposed liability on the fiduciary who knew or should have known that the valuation was flawed, not on the appraiser. Simplifying the Department’s enforcement burden is not a substitute for statutory authority.

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believe that the Department intended this result.[13] This is especially true where the Department affirmatively intends that those firms that provide privately held stock valuation for ESOP purposes may continue to be outside of these rules. The Department has recognized that existing professional standards for appraisals are consistent with the fiduciary duty as proposed, but has not demonstrated a need for the proposed “additional layer of protection for consumers” set forth in the proposal.

If the proposal regarding valuations were part of the final rule, there is a strong risk of uneven treatment of valuation in the marketplace. The potential for additional compliance resources, enforcement actions and liability under ERISA in connection with plan valuation, as opposed to all non-plan valuations, would further complicate contractual arrangements and increase costs.

We note that while the Department believes it has narrowed the rule, it is, in fact, broader than the 2010 proposal. Whether a value given is “in connection with” a transaction is not a clear standard, and encourages looking back in hindsight as to whether a value shown on a regular account statement was “in connection with” a transaction. The carve-out is not helpful: it covers valuations given *to* pooled funds but not valuations given *by* pooled funds to investors on a periodic basis. [14] If a hedge fund or private equity fund could become an ERISA fiduciary simply by providing values to plan investors, their willingness to accept ERISA and IRA

[13] To the extent that the counterparty and swap carve-outs are revised to cover services, including valuation services, this consequence may be avoided for institutional accounts, but it would still remain an issue for all other accounts.
[14] At one point, the preamble notes, in listing the carve-outs: “(6) the provision of an appraisal, fairness opinion or a statement of value to an ESOP regarding employer securities, to a collective investment vehicle holding plan assets, or to a plan for meeting reporting and disclosure requirements; and” which seems to limit the carve-out to plan asset vehicles. Later in the preamble, the explanation reads: “In response to comments, the proposal also contains an entirely new carve-out at paragraph (b)(5)(ii) specifically addressing valuations or appraisals provided to an investment fund (e.g., collective investment fund or pooled separate account) holding assets of various investors in addition to at least one plan or IRA.” If the Department means to include all pooled funds, regardless of whether they are subject to the fiduciary requirements of ERISA, we would appreciate that clarification.

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investors would be severely impacted. The effect on the capital markets, small and new business, and capital formation would be significant.

The proposed rule is open to the following questions:

- Funds (whether or not plan asset funds) value the fund daily, monthly or quarterly and these values are shown on custody statements for the account in which the fund interests are held, without a legal requirement to do so. Does the proposed rule apply to an unaffiliated fund administrator that calculates NAV for mutual/hedge/private equity funds pursuant to the respective fund's guidelines for calculating the valuation? There does not seem to be a carve-out for providing this information to plans, which potentially could use the information to enter into a transaction.
- Custody, prime brokerage and securities lending also may be impacted because the definition of investment advice is so broad and the valuation carve-out is so narrow. Does providing clients statements of value of assets held in custody or out on loan (normally but not always taken from recognized independent pricing services) constitute investment advice under the proposed rule? We understand from the Department's public statements that it did not mean to cover these kinds of valuations, and even if covered, are intended to be covered by a carve-out for institutional accounts. SIFMA urges the Department to clarify that these types of valuations do not constitute fiduciary investment advice.
- Securities lending also will be impacted. Does the proposed rule apply when the securities lending agent provides a valuation of the value of loaned securities or collateral, or marks collateral to market? The valuation is being provided by the securities lending agent to ensure that there is sufficient collateral as required by the securities lending agreement and if it is an ERISA account, in part to ensure compliance with PTE 2006-16, the securities lending exemption. The Department should clarify that these

types of valuations are excluded from the rule by the carve-outs for counterparties and swaps (modified as discussed below).

- Asset managers seeking to obtain real estate appraisals will be hard pressed to find willing appraisers if they will become fiduciaries by providing an appraisal. The Department fails to assess the impact of the rule on real estate investing for plans and on the acquisition of private equity investments by institutional investors. See, in the connection, the 2010 comments provided by the American Society of Appraisers, National Association of Independent Fee Appraisers, Institute of Business Appraisers, Real Estate Appraisal Coalition, American Society of Appraisers, and the Appraisal Foundation.
- Mergers and acquisitions will be severely impacted if fairness opinions in connection with the transaction will make the investment bank an ERISA fiduciary to the deal if any plans or IRAs are shareholders. Such a result would have massive consequences in the capital markets.
- Does a quote from a dealer in a completely self-directed brokerage account where no recommendations are provided constitute fiduciary advice, if the plan, participant or IRA owner goes ahead and purchases the bond based on the quote? It would be very harmful to the markets if dealers are not assured that they can give price quotes without coming within this prong.
- With respect to a single plan investment pool for which participants are provided a daily NAV, would this function be considered fiduciary advice?

There is no statutory authority to deem private equity funds, other pooled funds, prime brokers, securities lending agents, custodians or fund administrators ERISA fiduciaries in the course of valuing securities, loans, portfolio companies, or collateral. Nor does it make sense at all that a quote from a bond dealer regarding the price at which it would buy or sell a bond from or to an IRA or a plan maintained by a small business suddenly would be considered "investment advice". All of the effort that went into making sure that the bond markets would not be affected by the fiduciary rules of ERISA is simply discarded in this proposal. This effect on bond dealers has broad implications for the bond market and how investors behave when seeking to purchase or sell a bond. Few bonds are shown with firm bids/offers. Most are subject to revision or are indicative bids.[15] In the bond market, investors compare the quoted prices to a comparable yield curve to see if they are getting a good price. These market comparisons, whether through an automated tool or through a financial professional, may be covered by the definition of investment advice and may not be carved out by reason of the valuation or counterparty carve-outs.

If the Department believes that it has identified a problem with respect to valuation of privately held stock for an ESOP, it should bring those cases, as it repeatedly has. Making factual appraisal functions into fiduciary functions will merely cause appraisal firms to turn down assignments for plans, dealers to refuse to quote values for plans, and custodians to refuse to price any asset not valued by a third party public source. The Department has failed to consider the costs of this change to plans and participants. The comments raising precisely these points in 2010 have been ignored by the Department; only ESOPs have been eliminated from the regulation but the flaw in the Department's approach remains.

The proposal will turn routine and required valuations and market quotes into fiduciary acts in a manner that will surely affect normal market practice. SIFMA urges the Department to reserve the valuation prong of the definition of advice. When the Department determines that it is appropriate to tackle the issue of valuations, it should do so in a coordinated manner, and not

[15] Whether bond dealers will provide the bids required in the proposed exemption for principal transactions is questionable, especially if providing the quote could make them a fiduciary, if they know that the request for a quote is for a plan or IRA.

focus first on an area where there has been no abuse, leaving aside the area where it has determined the problem is the most urgent.[16]

3. The prong dealing with advice on managers

The fourth prong defines advice as a recommendation of a person who is also going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (i) through (iii). The preamble suggests that the fourth prong of the advice definition was intended to capture individualized recommendations and advice as to the selection of investment managers and advisers. However, the prong appears to apply to all recommendations or referrals without limitation. We are concerned that this broad definition, especially when coupled with "the specifically directed to" language discussed below, will preclude information and access that is beneficial to retirement investors. [17]

SIFMA suggests that this prong be rewritten to provide as follows:

> (iii) A recommendation as to the advisability of engaging a person who is also going to receive a fee or other compensation for providing any of the types of advice described in ERISA Section 3(21)(A) (i) or (ii).

Such a revision would indicate that fiduciary status extends to those persons that offer advice as to the advisability of an adviser or discretionary asset manager based on the needs of the plan or investor, but not to referrals of such advisers or managers where no recommendation or advice is given as to the advisability of engaging a particular advisor or manager.

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[16] For the reasons described more fully below, the valuation carve-out addresses virtually none of the concerns described here.
[17] In addition, the BIC exemption specifically needs to provide relief for the recommendation of discretionary management programs.

Rollovers as Part of the Advice Definition

1. Sales conversations

As stated above, SIFMA believes that the Department's 2005 legal interpretation regarding rollovers is correct and that there is not a basis for the Department to depart from it. Even supposing some extension to rollovers were appropriate, SIFMA members have concerns with respect to the drafting of the rollover language in paragraphs (i) and (ii). The rule should not capture sales pitches that are no more than a "hire us to provide services to your retirement assets" appeal. There is no carve-out for a plan participant to merely listen to and participate in a sales conversation about an IRA rollover. There is no carve-out for a call center conversation, initiated by a participant or eligible employee, to discuss distribution options[18]. Sales conversations need to be clearly carved out of the rule, and that includes sales conversations about rollovers.

2. Education

While the Department's intent to include rollovers in the scope of the rule is quite clear, we strongly believe that there needs to be a clear line: factual education about distribution and rollover options and processes should not be fiduciary advice. This kind of education should not be subject to fiduciary liability. On the other hand, mutually agreed upon, individualized investment advice about distribution investments should be fiduciary advice, if that is what the participant chooses to contract for.[19] Without clear lines, distinctions blur, information becomes unavailable and participants suffer.

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[18] We note that the education bulletin in general should provide for education to eligible employees because it is that education that may encourage the employee to participate in the plan.

[19] Indeed, the education carve-out, described in more detail below, is internally inconsistent and confusing about rollover education, which will surely chill all such discussions for fear of falling outside the carve-out, even as the

SIFMA fundamentally disagrees that every conversation regarding rollovers should be treated as fiduciary advice. SIFMA simply does not agree that participants cannot distinguish a sales call from trusted advice.[20] SIFMA does not agree that it is in the best interest of plan participants to discourage all conversations regarding distributions. Rollover education starts with a conversation urging participants to keep the assets in a retirement account and not liquidate these retirement assets. We agree that premature liquidation could subject participants not only to a less secure financial future but potentially to current tax penalties as well. The fact that financial firms urge participants and IRA owners to keep their assets in retirement accounts and not dissipate them on boats or vacations or other discretionary spending is one of the greatest strengths of the financial professional system. If a policy goal is to avoid "leakage" out of the retirement system so that Americans save sufficiently for retirement, an effective strategy to pursue that goal would be to encourage one- on- one educational conversations with investment professionals about the pitfalls of taking distributions (as opposed to a strategy that relies on the hope that now, than to hope participants will stumble happen across the right information for their needs before they switch jobs and cash out of their former employer's retirement plan). Although current financial needs are far more real and acute for many people than are financial needs after retirement, real, but often financial professionals often can help participants

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Department acknowledges that "[i]n most instances participants will be better off if they preserve all or most of the their account balance in a tax-preferred vehicle, be it a plan or an IRA."[19] As described in more detail below, FINRA Regulatory Notice 13-45 provides a useful example of how to operationalize a conversation about rollovers without veering into investment advice. We urge the Department to consider its use as a safe harbor. As a public policy matter, we should not stifle call centers, which are the last place where a neutral and fact based conversation can take place to inform participants of their options, prevent leakage and provide information on options when leaving assets in the employer's plan is not possible.

[20] Recent research suggests consumers can distinguish between a sales call and fiduciary advice. People don't trust sales calls or other unsolicited advice. *See, e.g.,* "Trust and Financial Advice," J. Burke and A. Hung, RAND Labor and Population Working Paper, WR-1075 (Jan. 2015), at 1. ("...we find that financial trust is correlated with advice usage and likelihood of seeking advisory services. Analysis of the experiment shows that trust is an important predictor of who chooses to receive advice, even after controlling for demographic characteristics and financial literacy. However, providing unsolicited advice has little impact on behavior, even for individuals with high levels of trust." This finding underscores SIFMA's view that unsolicited advice – sales conversations – should not be deemed fiduciary advice.

understand the importance of saving early and often for retirement and why they should consider exhausting all other resources before cashing out of the retirement system. If every sales conversation or every educational conversation is fiduciary advice, all participants suffer. SIFMA urges the Department not to drive all discussion of the benefits of retaining some form of tax-favored account into the realm of fiduciary advice.

3. The consequences of an overbroad rule

Leakage from retirement plans is at an epidemic high. In 2010, one in four American workers with a 401(k) or other defined contribution plan tapped their retirement account for current expenses. This "leakage" reached $70 billion in 2010, equal to nearly a quarter of all contributions that year. As Alicia Munnell and Anthony Webb found in a study released earlier this year:

> "The ability of our model to match the SIPP public use data corroborates our leakage estimates; leakages reduce wealth by 22 percent. They are more significant than fees (14 percent) but less significant than the effects of non-participation among eligible employees and the immaturity of the system (30 percent and 27 percent). In total, all these factors reduce retirement wealth by two thirds."[21]

Yet the Department's focus on fees to the exclusion of coverage and leakage is unfortunate. We urge the Department to reconsider its narrow limited carve-out for educational rollover conversations and no carve-out at all for sales. The Department's approach likely will make the problem of retirement security worse, not better.[22] SIFMA believes that the Department has not

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[21] "The Impact of Leakages from 401(k)s and IRAs", Alicia Munnell and Anthony Webb, February, 2015, page 17.

[22] In 2005, the Department determined that it is not fiduciary advice when a person makes a recommendation regarding whether to take a distribution from a plan, whether that distribution should be in cash or in kind, and whether it should be rolled over to a plan or an IRA or invested in a non-tax favored account. Just five years later, in the 2010 Proposal, the Department decided that its 2005 determination was a mistake. With this 2015 iteration, the Department has decided that any recommendations about distributions, regardless of how general in nature, should be actionable fiduciary advice, regardless whether that advice relates to the securities involved in the

carefully considered alternatives here.[23] The Department has not provided any analysis as to why the flat, intentionally prohibitive approach is protective of participants or in their interest. Nor has it provided a basis for believing that the new rules will have a positive effect on reducing leakage.[24]

The Department's rule appears to assume that all plan sponsors want their terminated vested participants to remain in the plan. We think this assumption may be incorrect, especially in light of the cost and complexity of administering the accounts of participants who are no longer employees.[25] Some employees have such small balances that they are automatically cashed out. They need options or the tendency to simply take a distribution and spend it will overwhelm the best employer intentions. Moreover, the Department ignores participants' real concerns about their former employers and the chance that their retirement account may not be accessible when they need it. The Department minimizes the very real issue for participants who change jobs frequently, on average more than 11 times over their careers.[26] Leaving small account balances in a dozen or more plans creates a huge amount of work for participants. They need to keep up with menu changes in many plans, keep many plan sponsors apprised of address changes, name changes and beneficiary changes. It will likely be easier for a participant to have all of his or her

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distribution. These provisions should be reconsidered in light of the very serious adverse effect they will have on savings.

[23] FINRA Regulatory Notice 13-45, Rollovers to Individual Retirement Accounts, December 2013.

[24] We note that a recommendation to stay in the plan by a plan sponsor who may benefit from that decision will also be fiduciary advice and a prohibited transaction.

[25] Plan sponsors heavily depend on call centers to discuss distribution options with participants, and these call centers are an important source of one on one educational conversations when participants can describe their circumstances, their goals, and their concerns. But even a single balanced, factual conversation on distributions to individual participants could become fiduciary advice if it were deemed to be a recommendation directed to the participant who called. SIFMA believes that its members, plans and participants are ill-served by call center conversations that must end after the participant asks what specific alternatives exist for his or her plan account balance or IRA. Education is critical in this area, and the proposed rule should accommodate education about rollovers, and about other distribution issues that are confusing to participants, such as inherited IRAs, and required minimum distributions. Plan sponsors depend on call centers to communicate these issues to participants and it is in no one's interest to impede these conversations.

[26] See footnote 26, infra.

retirement assets in one place, allowing the participant to focus on one platform. It may allow the participant to have professional management, generally not available in a 401(k) plan, or a wider array of investment options. Indeed, the Department appears to believe plans should have available fewer investment choices, not more.[27] Participants may be legitimately worried about the stability of their employer, and the future of the plan. The Department concedes that the number of abandoned plans is significant and growing. It cannot be disputed that participants have had real difficulty obtaining their benefits when their former employer abandons the plan.

The effect of the proposal would likely make rollovers very difficult, if not impossible, to discuss with individuals. As currently drafted, discussions with participants regarding distributions and rollovers would be limited in scope. SIFMA urges the Department to adopt the sensible approach taken by FINRA under Regulatory Notice 13-45 to create a safe harbor for financial professionals so that participants can discuss rollovers in a balanced, educational way. We provide further detail on Notice 13-45 below in the context of our discussion of the education carve-out, and note that this FINRA guidance is expressly aimed at addressing the very conflicts with which the Department is concerned. There can be little doubt that the major societal issue that needs to be addressed here is the adequacy and preservation of retirement savings. It will do little good if the result of this proposed rule is that plan participants will be more confused, more concerned about the security of their assets being controlled by an entity with which they no longer are connected, more cut-off from sources of information and education that is readily accessible and more cut off from sources of financial literacy, especially during volatile economic cycles. The ultimate goal should be to create policy that encourages and simplifies the ability of individuals to retain savings in tax favored retirement accounts, regardless of whether they are plans or IRAs.

[27] See the comments of the Joint Trades to Assistant Secretary Borzi regarding Field Assistance Bulletin 2012-02, objecting to the Department's arbitrary requirement that a plan have no more than 25 investment alternatives.

The Department does not appear to have considered or analyzed the benefit to participants and their families of having all retirement assets in one place, where they can discuss their investment needs more holistically with a single person with respect to all of their savings. The Department also has not analyzed the behavioral impact on a young participant with a very low account balance when faced with the choice of electing to take (or being forced to take) a distribution or continuing to save for retirement. Participants in today's mobile workforce change jobs on average more than 11 times before they reach retirement age.[28] Fifty years ago, those job changes were far less frequent. For individuals who are now in their 20s and 30s, those numbers will surely rise. Employees often had little or no account balance in a retirement plan when they left the employer after a couple of years. Now, with automatic payroll deduction, immediate participation, automatic deferral rate increases and mandatory employer matches, participants will have a least a few hundred or a few thousand dollars when they change jobs after a year or two. The Department spends little time looking at how a young participant views that account balance, or the effort it takes to educate that participant effectively enough to cause that participant to continue to save that account balance rather than use it for immediate spending. But in the current employment environment of multiple employers over short periods, participants may be less likely to entrust even their small account balances in the plan to a former

[28] A BLS news release published in March 2015 examined the number of jobs that people born in the years 1957 to 1964 held from age 18 to age 48. The title of the report is "Number of Jobs Held, Labor Market Activity, and Earnings Growth among the Youngest Baby Boomers: Results from a Longitudinal Survey." The report is available on the BLS web site at: www.bls.gov/news.release/pdf/nlsoy.pdf. These younger baby boomers held an average of 11.7 jobs from ages 18 to 48. (In this report, a job is defined as an uninterrupted period of work with a particular employer.) On average, men held 11.8 jobs and women held 11.5 jobs. From ages 18 to 48, some of these younger baby boomers held more jobs than average and others held fewer jobs. Twenty-seven percent held 15 jobs or more, while 10 percent held zero to four jobs. For additional statistics on the number of jobs held, see the tables at: www.bls.gov/nls/nlsy79r25jobsbyedu.xlsx. See also Forbes Magazine, August 14, 2012: "The average worker today stays at each of his or her jobs for 4.4 years, according to the most recent available data from the Bureau of Labor Statistics, but the expected tenure of the workforce's youngest employees is about half that. Ninety-one percent of Millennials (born between 1977-1997) expect to stay in a job for less than three years, according to the Future Workplace "Multiple Generations @ Work" survey of 1,189 employees and 150 managers. That means they would have 15 – 20 jobs over the course of their working lives!"

employer, or tolerate receiving account statements from a dozen different employer plans accumulated over the first 10-15 years of their working lives.[29]

SIFMA's suggestions for changes to the education carve-out are discussed below.

Who is a Fiduciary?

1. Persons Who Acknowledge Fiduciary Status

The proposal defines investment advice fiduciaries in two subparagraphs. The first apparently is intended to deal with the financial professional who claims to be a fiduciary with respect to particular advice in a particular account and then later recants; however, it is written far more broadly. SIFMA supports the intent of this provision but urges the Department to clarify it, especially where it is used to create an absolute bar on the use of a carve-out.

Section (a)(2)(i) of the proposal provides:

> (2) Such person, either directly or indirectly (*e.g.*, through or together with any affiliate),-
>
> > (i) Represents or acknowledges that it is acting as a fiduciary within the meaning of the Act with respect to the advice described in paragraph (a)(1) of this section;

This provision needs to be narrowed in two important ways. First, the language "directly or indirectly (*e.g.* through or together with an affiliate)" is too broad. A representation that a person is a fiduciary should be explicit and express and not just an inference. That statement should be made by that person. It is too important a concept, with too much potential liability, to infer such

[29] The Department has also not analyzed the effect on the nonbank custodian rules if all IRAs are treated as nonpassive and the net worth requirement s applicable to all nonbank custodians are significantly increased.

status through loose language or comments made by an affiliate. Nor do we understand what it means to say "through an affiliate". The definition of fiduciary is a functional test and one becomes a fiduciary because of one's recommendations, not because one's affiliate has made a recommendation. See Advisory Opinion 97-16:

> "You have assumed that ALIC, an affiliate under common control with ALIAC, is a fiduciary with respect to the Plans by virtue of exercising authority or control over Plan assets invested in separate accounts maintained by ALIC. There is nothing, however, in your submission to indicate that ALIAC is in a position to (or in fact does) exercise any authority or control over those assets. Accordingly it does not appear that ALIAC would be considered a fiduciary merely as a result of its affiliation with ALIC."

In addition, SIFMA believes the language should be clarified to say "with respect to a particular account and a particular recommendation or series of recommendations". Unless that clarification is made, a representation that one is acting as a fiduciary with respect to particular advice given with respect to one account could automatically render the financial professional a fiduciary with respect to *all* accounts in a self-directed plan, regardless of whether individualized advice is given to more than one participant, or with respect to other plans of the same advice recipient plan sponsor, or several accounts of one individual, such as a person's individual account, his IRA, and his business accounts. The Department makes clear in the preamble to the BIC exemption that one can agree with a client on the scope of its fiduciary obligations – that is, fiduciary status can be transaction based, account based, or limited to a period of time, limited to the recommendation to buy, without any obligation to provide advice regarding how long an asset should be held or when it should be sold and does not require additional contract execution prior to each transaction recommended for an account.[30] This expansive definition should be narrowed in the same fashion.

[30] Dept. of Labor, Proposed Best Interest Contract Exemption, 80 FR 21960, at 21969.

The expansive language in Section (a)(2)(i) of the proposal definition should be narrowed to reflect the Department's intent reflected in the BIC exemption that a fiduciary and a client can agree on the exact contours of the fiduciary's responsibilities.in the same fashion. Accordingly, we ask the Department to revise this language so that the provision reads:

> "(2) Such person –
> (i) Expressly states that it is acting as a fiduciary within the meaning of the Act with respect to advice described in paragraph (a)(1) of this section that is or will be provided with respect to a particular account in connection with a particular recommendation of an investment transaction or a series of recommendations regarding such a transaction or series of transactions, provided that the express acknowledgement of fiduciary status with respect to a particular transaction, account or recommendation will not, by itself, cause the person to become a fiduciary with respect to any other transaction, account or recommendation."

2. Mutual Understanding

The proposal changes current law with respect to whether the parties must have a common understanding of the services being provided. The Department also errs in supposing that a fiduciary relationship within the meaning of ERISA or the Code can be formed by a single transaction, particularly a transaction of a nature customarily performed by broker-dealers. That is inconsistent with the on-going relationship of heightened trust and confidence historically associated with fiduciary status, and with the long-standing recognition—expressly embodied in the Advisors' Act—that a broker-dealer whose advice is merely incidental to a sale is not a fiduciary. The proposal provides:

> (ii) Renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.

These changes will cause confusion and costly litigation. The second prong of this definition of "investment advice" should relate to situations where the parties *agree* that the recommendations will play a significant role in the participant's decision-making. The Department's proposal, however, abandons the requirement that there be a mutual understanding, agreement or arrangement between the financial professional and the advice recipient about anything at all. Indeed, the preamble specifically notes that no meeting of the minds is required.[31] While we would have thought eliminating the notion that the parties should reach an understanding regarding whether the intent is that the financial professional be an investment advice fiduciary was merely a drafting issue rather than a substantive one, the preamble specifically notes that no meeting of the minds is required. By eliminating any notion that the parties should have a meeting of the minds regarding the financial professional's role, the Department opens the door to nearly indefensible claims by any person who in hindsight is upset with an investment decision, whether or not the person relied at all on the financial professional's related recommendations. SIFMA believes that the Department's elimination of the concept of a meeting of the minds opens the door to potentially false but nearly indefensible claims. This standard would allow a person who has not received fiduciary advice to later claim that he "understood" that it was investment advice, or that the financial professional "understood" that the information was targeted to the person, leaving the financial firm with an impossible task of proving that the claimant could not have so understood the statement. The standard also would place courts and arbitrators in the simple, but utterly one-sided, position of assuming that any arguable "recommendation" by a broker makes the broker a fiduciary with no room to consider the facts and circumstances of the situation. The nature of the advisory relationship should be demonstrably intentional for both parties. Whether one is a fiduciary governs bonding decisions, liability and risk decisions, training and systems management. It governs what the client should

[31] "The parties need not have a meeting of the minds on the extent to which the advice recipient will actually rely on the advice, but they must agree or understand that the advice is individualized or specifically directed to the particular advice recipient for consideration in making investment decisions." 80 CFR at 21940.

be charged, and what the financial professional and his financial institution can receive under the Department's proposed prohibited transaction exemptions. It should be a reasoned decision, by a plan, plan participant or IRA, to seek and agree to pay for investment advice, and both parties should understand the arrangement, the fees and the conflicts. Setting up a legal regime that allows or encourages individuals, with investment hindsight, to recast arrangements as fiduciary in nature and allow a unilateral, after the fact "understandings" regarding the nature of recommendations rather than requiring or encouraging the parties to reach an understanding up front regarding the nature of a financial professional's role and responsibilities simply is unreasonable.

There were scores of comments making this point in 2011 but these comments seem to have been ignored by the Department in this iteration. In causing the most casual recommendations to be deemed fiduciary advice, the Department seems to want to permit advice recipients to look backward and claim an understanding or agreement that did not exist at the time.[32] SIFMA's 2011 comment described the 2010 proposal as follows:

> "The Department's alternative test for defining "fiduciary" eliminates the regular basis test, the mutual understanding requirement, and the test that requires the advice to be a primary basis on which the client will make his or her investment decision. The elimination of these tests will result in a service provider becoming an unwitting fiduciary. No longer must the parties agree that the relationship is a fiduciary relationship. If the client "understands," long after information is provided by a service provider, that the relationship is, in retrospect, a fiduciary relationship, even if the service provider specifically disclaims that status, the client's one sided, opportunistic "understanding" carries the day. This is true, despite the fact that the client's one-sided understanding can be manufactured after the fact when any trade turns out less successfully than he anticipated. The formulation cannot work nor can it be validated. Allowing a plan fiduciary or participant to claim, after the fact, that he "understood" that a broker was offering

[32] The Department's defense of this position essentially acknowledges this point, stating that the new definition "would simplify the determination of fiduciary status *by eliminating difficult factual questions* relating to what constitutes a 'regular basis,' a 'mutual agreement,' a 'primary basis,' or 'individualized' advice." Dept. of Labor, Fiduciary Investment Advice Regulatory Impact Analysis, (Apr. 14, 2015), at 155 (emphasis added).

tailored fiduciary advice puts too great of a burden on the fiduciary, unless the Department allows brokers and others to have written agreements disclaiming fiduciary status and the Department recognizes that disclaimer. The elimination of the term "mutual" from the current regulation is particularly troubling. Agreements, arrangements and understandings are by definition mutual, suggesting that there are two people party to the agreement or arrangement. The most inchoate and subjective of the three terms - understanding - is made even more subjective and elusive by dropping the modifier "mutual." Thus, a regulation which should be (and currently is) a bellwether to guide standards of conduct instead becomes subjective, where no service provider will have a clear understanding of the expectations of its client. The deletion of the word "mutual" will cause significant disruption in the markets, changes in trading patterns for asset classes that currently trade on a principal basis and increases in costs to plans and IRAs, just as the Department feared in its economic analysis of the regulatory alternatives it rejected. See 75 FR 65275. Brokers will not take the risk that they will be later deemed to be fiduciaries, and in violation of the prohibited transaction provisions of ERISA and the Code. We urge the Department to retain the requirement that any agreement, arrangement or understanding be mutual to avoid permitting a much more subjective reading of the regulation. Any change in the regulation will be unworkable unless it is based on service provider and client agreement."

That comment is equally true with respect to the 2015 proposal, despite the Department's view that it listened to the criticisms and have proposed something that is "nothing like the earlier proposal". In connection with the 2010 Proposal, the Department staff said in many forums that the term "mutual" was superfluous and its deletion was merely editorial. Nevertheless, this time around, the preamble is more straightforward; it notes that both the primary basis test and the mutual understanding test were deleted to preclude a financial professional from "defeating" fiduciary status.

"Under the five-part test, fiduciary status can also be defeated by arguing that the parties did not have a mutual agreement, arrangement, or understanding that the advice would serve as a primary basis for investment decisions. Investment professionals in today's marketplace frequently market retirement investment services in ways that clearly suggest the provision of tailored or individualized advice, while at the same time disclaiming in fine print the requisite "mutual"

> understanding that the advice will be used as a primary basis for investment decisions."

SIFMA members believe that a claim that a relationship is a fiduciary relationship *should* be "defeated" if the parties do not mutually understand that they both intended a fiduciary relationship, with the additional liability on the part of the financial professional and the additional cost on the plan, participant or IRA owner. SIFMA does not agree with the Department's view that striking the essential component of "mutual" agreement is justified by the stated goal of easing the burden on Department investigators and "more effective enforcement".[33] Indeed, the Department's formulation requires only that if the financial professional understands that he is "specifically directing" his sales pitch to a person who has not agreed to be his client – and to whom he may never have spoken before – he becomes a fiduciary, even where the person on the other end of the phone neither sees the financial professional as a "trusted adviser" nor evidences any mutual understanding, reliance or trust of any kind.

3. A Reliance Standard

Under current law, a recommendation must be a primary basis on which the advice recipient makes up his or her mind on a course of action. That test is deleted entirely from this new proposal. The Department apparently believes that "a primary basis" is too high a standard. SIFMA disagrees. Nonetheless, we continue to be willing to discuss other standards. But the total elimination of any notion of reliance, or even a standard of importance to the recipient, is simply too one-sided. While the Department's formulation may make it easy for the Department to prove fiduciary status, it makes little sense in trying to define when a conversation legitimately

[33] *Id.*

should be considered "investment advice." In 2010, the Department's formulation was "advice which may be considered". The revised proposal is no better. In 2010, SIFMA noted:

> Similarly, the "may be considered" test is too vague and credits even the most casual conversation as fiduciary advice. Whenever someone talks, the listener "may consider" the speaker's words. The "may be considered" test is really an "I hear you" test. We urge the Department to consider a test which both parties to a conversation understand to be fiduciary advice, such as material reliance, substantial reliance, or a significant part of the plan's decision making process. The "may be considered" test is inconsistent with the level of reliance described by the Department in the preamble to the regulation. We note that this test may well capture every lawyer, accountant, actuary or other consultant that works on an investment policy, reviews asset allocations for purposes of an actuarial valuation, or looks at values for purposes of an audit. The Department's preamble specifically excludes these service providers from the first prong of the regulation's four prong test; it should exclude these service providers from all four prongs. See 75 FR 65266.

Interestingly, the preamble to the 2010 proposal states that the then proposed regulation "is intended to capture persons that significantly influence the decisions of plan fiduciaries and have a considerable impact on plan investment." 75 FR 65265. SIFMA soundly agrees with that formulation. This time around, the Department goes beyond the 2010 formulation and doesn't pretend to require that it is intended to "capture persons that significantly influence the decisions of plan fiduciaries and have a considerable impact on plan investment". SIFMA urges the Department to codify its explanation from its first proposal here in paragraph 2(a)(ii):

> "Renders the advice pursuant to a written or oral agreement, *mutual* arrangement or *mutual* understanding that the advice is individualized to the advice recipient *to significantly influence* investment or management decisions with respect to securities or other property of the plan or IRA."

As SIFMA has repeatedly stated, it concurs with a best interest standard, and concurs with financial professionals being subject to fiduciary liability when they are acting as fiduciaries at the client's request. If the standard now becomes "any consideration, regardless of how insignificant", then the proposal is even less practical and appropriate in its current form than the 2010 proposal.

4. Recommendations that are "Specifically Directed To" a Person

The third area with respect to which SIFMA urges the Department to modify its proposal is in connection with its newly created "specifically directed to" test in section 2(a)(ii). This test extremely troublesome and is inappropriate as a means of determining whether information properly should be considered fiduciary "investment advice, and accordingly should be eliminated. Moreover, the test is so overbroad and ambiguous that it makes the 2015 proposal as unworkable as the 2010 proposal. A test for fiduciary status that arguably identifies advertisements, group meetings, research reports, marketing materials and other clearly non-fiduciary communications as "investment advice" needs to be scrapped.

References to this language in the preamble underscore the Department's apparent intention to make every financial professional a fiduciary if his or her employer advertises on the radio, on television or in the newspaper, or suggests in any marketing material – whether or not that material is intended for plan participants or IRAs – that financial professionals give one-on-one advice. While SIFMA agrees that advice may be fiduciary in nature if it is specifically individualized to a participant pursuant to a mutual agreement to provide advice that will significantly influence investment decisions and is not merely selling, SIFMA believes that the Department is actually trying to capture non-individualized information – and the mere selling of one-on-one services -- with this change, including through broadly disseminated television and newspaper advertisements.[34]

[34] The Department concedes this point by calling out, as the problem it is trying to address, marketing materials rather than the agreement between the parties. Apparently in the Department's view is that where there may be a conflict between a public advertising campaign and an agreement entered into with a client, the advertising campaign, and not the agreement, should characterize the client relationship: "Thus, at the same time that

The Department notes in the preamble to the proposed rule that it “avoids burdening activities that do not implicate relationships of trust and expectations of impartiality”.[35] SIFMA agrees with that aim but unfortunately, we do not believe that the text of the proposal accomplishes this objective. Research reports sent to thousands of clients don’t implicate relationships of trust. Newspaper and television advertisements to the general public do not implicate relationships of trust. Sales calls, responses to requests for proposals, and product brochures do not implicate relationships of trust.

The preamble notes that this language “addresses concerns that the general circulation of newsletters, television talk show commentary, or remarks in speeches and presentations at financial industry conferences would result in the person being treated as a fiduciary.” However, the preamble then draws a direct line between the “specifically directed to” language and *advertising*, stating that advisers could not “continue the practice of advertising advice or counseling that is one-on-one or that a reasonable person would believe would be tailored to their individual needs and then disclaim that the recommendations are fiduciary investment advice in boilerplate language in the advertisement or in the paperwork provided to the client.” The rule, as proposed, could be read to capture virtually all general marketing materials that mention specific products and similarly could transform advertising and all selling of advice services into actionable fiduciary advice before there is individualized contact, let alone a mutual agreement, based on the Department’s “specifically directed to” formulation.

The language also risks capturing research and market commentaries, even if sent to all or a large group of clients, and even if not geared at all to individualized trading recommendations.

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marketing materials may characterize the financial adviser's relationship with the customer as one-on-one [sic], personalized, and based on the client's best interest, footnotes and legal boilerplate disclaim the requisite mutual agreement, arrangement, or understanding that the advice is individualized or should serve as a primary basis for investment decisions.

[35] 80 FR 21938.

Classifying such materials as fiduciary advice will curtail the availability of key educational and informative resources that help investors in making informed investment decisions.

For all of the foregoing reasons, SIFMA urges the Department to delete "specifically directed to" from the regulation. At best, it is highly confusing. At worst, it makes general research, a sales call, or a television or newspaper advertisement proof of a fiduciary relationship.

The Carve-outs

There are seven specific carve-outs from the proposed rule's "investment advice" definition. SIFMA believes that they need to be broadened. Our concerns are as follows.

1. The Exclusion From Use of the Carve-outs

First, the carve-outs do not appear to be available at all to any service provider who has affirmatively represented or acknowledged that he or she is a plan fiduciary SIFMA agrees that a person should not be able to agree to act as a fiduciary and then seek to avoid the fiduciary status to which he or she agreed,. But, the language in the proposed regulation makes the carve-outs unavailable is a far broader set of circumstances. We urge the Department to clarify the language in the carve-outs to reflect the very basic concept under ERISA's fiduciary rules: that a person is a fiduciary with respect to particular recommendations made with respect to particular assets of a particular account, and not a fiduciary "in general" of an entire plan. The way the Department has written this section, a none of the carve-outs would be available to a directed trustee because the directed trustee will acknowledge in its trust agreement, that it acts as a fiduciary in safekeeping assets.

A client may have several accounts, or several IRAs, and only in certain of these accounts, and perhaps only with respect to certain assets, has he engaged the financial professional to provide investment advice. The exclusion is overbroad and assumes that once a person is a fiduciary for any set of assets in any manner, no matter how limited, you are a fiduciary for all accounts, all assets, all relationships, and all communications. That is simply not the law.

The definition of fiduciary in the statute is quite clear: a person is a fiduciary "to the extent" that the statutory tests are met. This same, statutorily mandated qualification needs to be reflected in the carve-outs..

Section (a)(2)(i) of the proposal provides:

> (2) Such person, either directly or indirectly (*e.g.*, through or together with any affiliate),--
> (i) Represents or acknowledges that it is acting as a fiduciary within the meaning of the Act with respect to the advice described in paragraph (a)(1) of this section; or . . . .

As noted above, SIFMA requests that it be revised to provide:

> "(2) Such person –
> (i) Represents or acknowledges that it is acting as a fiduciary within the meaning of the Act with respect to advice described in paragraph (a)(1) of this section that is or will be provided with respect to a particular account in connection with a particular recommendation of an investment transaction or a series of recommendations regarding such a transaction or series of transactions."

The carve-out section describes this definition as applying to persons in general, not persons in connection with particular recommendations with respect to particular assets of a particular plan. The proposal provides:

> (b) Carve-outs--investment advice. Except for persons described in paragraph (a)(2)(i) of this section, the rendering of advice or other communications in conformance with a carve-out set forth in paragraph (b)(1) through (6) of this section shall not cause the person who renders the advice to be treated as a fiduciary under paragraph (a) of this

section.

Thus, this language should be revised to read as follows:

> "Except for advice described in paragraph (a)(1) of this section with respect to which the person has represented or acknowledged that it is acting as a fiduciary as described in paragraph (a)(2)(i) of this section with respect to a particular account (or particular assets in an account) and a particular transaction, the rendering of advice or other communications in conformance with a carve-out set forth in paragraph (b)(1) through (6) of this section shall not cause the person who renders the advice to be treated as a fiduciary under paragraph (a) of this section."

2. IRAs and Other Retail Accounts

Only two of the six exceptions – the education and financial reports exceptions – cover communications with participants, beneficiaries, and IRA owners. SIFMA members think this limitation is a mistake that has no analytical basis and goes beyond the Department's authority. Incidental advice as part of selling is a concept Congress adopted in 1940 with the Investment Advisors Act. Congress presumably would have noted such a striking difference when it passed ERISA since it was considering securities law amendments at the same time.[36] Selling is selling, regardless of the setting or recipient. If a financial professional makes clear he is selling, then it is inconsistent with that reality to suggest that selling is a fiduciary activity when the target is a retail account. There simply is no legal difference. When the fee for executing a trade is the same whether one gives "advice" incidental to the sale or not, there is no fee for the advice. Similarly, objectively monitoring data or platform information is just that: factual and objective. It doesn't become less so because it is given to an IRA or a plan participant. SIFMA members

[36] The Conferees intend that this legislation with respect to individual retirement accounts is not to limit in any way the application of the Federal securities laws to individual retirement accounts or the application of them of the laws relating to common trusts or investment funds maintained by an institution. As a result, the Securities and Exchange Commission will have the authority to act on the issues arising with respect to individual retirement accounts independently of this legislation. [CITE}

do not agree with the Department that there is no warning, no cautionary language, no disclosure, that would suffice to warn an individual that the financial professional is selling a service, or that the factual information provided is just that: data. Not every conversation will be misconstrued as a recommendation. SIFMA urges the Department to make all of the carve-outs eligible for retail accounts, including plan participants and IRAs and to create a clear carve-out for sales pitches and other sales activities.

3. Mere Selling

We think the regulation needs to clarify that a person or entity seeking to be hired – as a broker, a custodian, a fiduciary, an advisor, a trustee – initially, for a longer engagement, or a new mandate or new account, and in a one-on-one conversation, a response to an RFP or in a newspaper advertisement, is not a fiduciary regardless of what kind of investment suggestions are contained in that sales context. While selling could be covered by a carve-out, it needs to cover selling to all potential clients, and not just plans with 100 or more participants or asset managers with $100 million in employee benefit plan assets. The clearest expression would be a provision in the rule itself, after the definition of the four kinds of advice in section (a), which would read as follows:

> "Provided however, that no person shall be deemed to be providing investment advice by reason of recommending, urging, responding to requests for proposals regarding or otherwise promoting, its own hiring."

Alternatively, there should be a clear carve-out for selling one's own services.

4. The Counterparty Carve-out

SIFMA seeks several clarifications with respect to this carve-out. The first, as noted above, would make this exception applicable to all retirement accounts, and to all intermediaries who sell products to or act on behalf of those accounts. The lack of opportunity for accounts of any size to decide for themselves whether or not they want to work with a fiduciary advisor is a serious shortcoming. Subject to clear warnings that the financial professional is not providing impartial advice and has no duty to do so, we strongly believe that the Department should not decide for every American that he or she cannot have a non-advisory brokerage account where they nevertheless can speak with a financial professional. Some individuals might not choose to select an advisory account to meet their needs.

The second clarification is that this carve-out should cover services, such as brokerage services, futures execution and clearing services, prime brokerage services, custody services, and other appropriate and necessary services provided to plans where the service provider is acting as agent or representative of the plan. As written, the exception is explicitly available only with respect to a sale, purchase, loan or bilateral contract, and not with respect to services provided to accounts. Thus, any incidental advice from a service provider could be deemed to be fiduciary advice if it is specifically directed to the plan, despite the fact that Congress clearly meant incidental advice which bears no additional fee over and above the fee for execution is not fiduciary advice. Such incidental advice could include:

- information provided by a futures commission merchant executing a futures trade for the biggest, most sophisticated plan client,
- information provided by the institutional agency desk at a broker-dealer, again dealing with the most sophisticated institutions,
- any such information from a plan's prime broker,
- all marketing materials or pitches from trustees, brokers, custodians, investment managers, commodities trading advisers,
- generally available research,

- corporate finance recommendations made to a company's corporate financial staff which may later be communicated to plan fiduciaries,
- any sales pitches by collective trust trustees, brokers, or third party administrators to plan fiduciaries.

For virtually all of these service provider communications, the counterparty exception appears to be inapplicable. Similarly, the current language seems to omit communications from exchanges, alternative trading systems and electronic communication networks used in trading.[37]

While the Department has informally indicated in its meetings with the industry that it will fix this carve-out to include services and that the omission was not intended, the lack of coverage of services, including selling one's own services, by this carve-out is worrisome, especially since in the 2010 proposal, the carve-out also failed to cover services and the Department received scores of comments highlighting this point. The Department has said in every setting from the initial proposal forward that the clarification we seek – the coverage of services and selling -- is what it intends. SIFMA hopes the Department will clarify coverage of service providers and selling one's own services in the carve-out. We also hope that the Department will reconsider its current position regarding the ability of American investors to decide for them what kind of relationship they want to have with their financial professionals and will modify the carve-out to cover transactions with IRAs, participants and small plans. Accordingly, SIFMA respectfully requests that the Department circulate revised language on this point for comment prior to finalizing the proposal because of its importance.

Third, the carve-out should apply to referral programs. Many financial institutions have programs that provide compensation to professionals (*e.g.*, lawyers or accountants) for referrals

[37] SIFMA, and several other commenters, made this very same point in response to the 2010 proposal. See page 15 of SIFMA's February 3, 2011 comment.

(as regulated by SEC Rule 206(4)-3). Under these programs, an estate planning lawyer might refer their client to a financial institution for investment services or advice relating to their IRA and other non-retirement assets. Under the proposal, such referrals would likely be considered fiduciary advice because they could be construed to be a recommendation of an investment adviser or manager. Yet the referral would not be subject to the counterparty carve-out because IRAs are not included. These referral programs are beneficial to consumers. Furthermore, these programs are already regulated by the SEC, which requires extensive conflict disclosures to the consumer, but would not be covered by the counterparty carve-out, as currently contemplated.

Fourth, the carve-out should clearly apply to pooled funds. We assume that this was an inadvertent omission and the carve-out applies to asset managers and trustees who manage pooled funds and to the funds they manage, regardless of whether it is managing the assets of a single plan or a pooled fund. Nonetheless, clarity on that point would be helpful.

Fifth, the $100 million asset test should be based on all assets under management, and not merely employee benefit plan assets. Our members know of no managers who keep track of assets under management based on client type, and no other exemptions where the Department has looked at only employee benefit plan assets to qualify a manager. See, *e.g.*, PTE 84-14, and numerous individual exemptions. This test should be satisfied either by the reasonable belief of the service provider or counterparty or by a representation by the plan sponsor. In addition, the $100 million threshold should be revised to use a standard that is commonly understood in the market place. SIFMA urges the Department not to create new definitions for commonly understood market terms for a sophisticated investor when accepted definitions exist that are well understood by brokers and advisors and counterparties. We suggest in our revision below that the asset level be at $50 million. The condition regarding the level of sophistication at $50 million is taken from the INHAM Exemption (PTE 96-23) and from FINRA Rule 4512(c)(3), which defines aninstitutional account as follows:

> (c) For purposes of this Rule, the term "institutional account" shall mean the account of:
> (1) a bank, savings and loan association, insurance company or registered investment company;
> (2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or
> (3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.

Sixth, as noted above, this carve-out should apply to all accounts with additional disclosure for retail accounts, and a more frequent reminder to retail accounts that any information or suggestions are not impartial investment advice. If the Department is unwilling to take that suggestion, SIFMA members believe that the 100 participant test is a mistake.[38] It is operationally difficult from a compliance perspective. How often would the financial professional need to check on the number of participants in the plan? It would not be possible to check on the current number of participants as of the date of every transaction or every recommendation. If the test is intended to reflect less sophisticated plan sponsors, we think the Department should use an asset-based test that aggregates the assets of all plans sponsored by the same employer and its affiliates. Many large and sophisticated employers sponsor many plans, and some of those plans may be quite small. It does not seem reasonable to suggest that the plan sponsor is not sophisticated, when other plans it sponsors have thousands of participants, and the plans contain billions of dollars in assets. SIFMA urges the Department to use a test that focuses on the value of the assets in all employee benefit plans sponsored by the employer and its affiliates so that this carve-out can apply to large, sophisticated employers, regardless of the size of their plans. Again, this test should be satisfied either by the reasonable belief of the service

[38] We note that the 100 person test is very unwieldy since it does not specify the date as of which this determination is made, or the consequence of fluctuations in this number.

provider or counterparty or by a representation by the plan sponsor.

Seventh, the representations need clarification. The timing of the representations is not specified; they should be provided prior to the first transaction and, as noted above, only for retail accounts should they be repeated periodically. Under no circumstances should the representations be provided on a trade by trade basis. The representations that operationally may be required to make this carve-out work will slow all investment transactions and make plans second class citizens in the market place. As written, it is unclear if they need to be given for each transaction or at the beginning of the relationship. Systems will need to be built to reflect whether a current necessary representation is on file. This kind of infinite prescriptive requirement is unnecessary.[39]

SIFMA is also concerned about the 8 month transition rule in this context. Even if this carve-out only applies to those plans that are covered by the proposal, the task of obtaining mutual representations will likely take a minimum of 24 months, if the recent Dodd-Frank experience is any guide. We urge the Department to be realistic, especially here where the carve-out specifically requires representations from the plan fiduciary.

For retail accounts, the following representations should be sufficient.

- The plan fiduciary will not rely on the person to act in the best interests of the plan, to provide impartial advice or to give fiduciary advice and that the plan fiduciary has sufficient expertise to evaluate the merits of the transaction.
- The financial professional discloses that it has its own financial interests in the arrangement or transaction, or may receive a fee as a result of the transaction.

In sum, SIFMA believes that the carve-out should read as follows:

[39] 17 CFR 23.434.

COUNTERPARTIES AND SERVICE PROVIDERS. In such person's capacity as a counterparty, service provider, including exchanges and other similar trading platforms, to a plan or IRA, or representative of either the plan, the IRA or the counterparty or service provider, the person provides advice to a plan or IRA fiduciary who is independent of such person, with respect to an arm's length service arrangement, sale, purchase, loan or bilateral contract between the plan or IRA and person (or with respect to a proposal to enter into such an arrangement, sale, purchase, loan or bilateral contract), each a "transaction" for purposes of this subclause if, prior to or in connection with entering into a transaction, (A) the plan fiduciary represents that it has the requisite sophistication and experience in investment matters, and such person discloses to the fiduciary, participant or beneficiary, as the case may be, that the person has a financial interest in the matter, and that the person is not undertaking to provide impartial financial advice; provided such person has not acknowledged in writing that it is acting as a fiduciary (within the meaning of the Act) with respect to the transaction and the person does not receive a specific separate advisory fee for such recommendation or (B) such person knows or reasonably believes that the plan fiduciary (1) has responsibility for managing at least $50 million in assets (for purposes of this paragraph, when dealing with an individual employee benefit plan, a person may rely on representations from the independent plan fiduciary regarding the value of assets under management or (2) is a bank, savings and loan association, insurance company, an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state or foreign securities commission (or any agency or office performing like functions).

5. Swap Transactions

SIFMA seeks three clarifications with respect to this carve-out. The first, as noted above, would make this exception applicable to all accounts. There is no reason why a small plan or a very sophisticated IRA owner should not be able to engage in a swap under appropriate circumstances, assuming that the account owner is an eligible contract participant. The second is that it should cover the services inherent in swap transactions, such as, but not limited to, swap clearing arrangements. Third, the carve-out needs to cover pooled funds that hold plan assets, which is a significant omission. These latter two changes are critical to conform this carve-out to the relief the Department recently gave in Advisory Opinion 2013-01A. While the Department has indicated that it did not intend to cut back on that relief, the carve-out is clearly inadequate to cover swap clearing arrangements.

The carve-out should read as follows:

> **SWAP TRANSACTIONS** – The person is a counterparty, service provider or representative thereof or of the plan in connection with a swap or security-based swap if, the plan or plan asset vehicle is represented by a fiduciary independent of the person; the person is a swap clearing firm or other service provider in relation to a swap, swap dealer, security-based swap dealer, major swap participant, or major security-based swap participant; the person (if a swap dealer, security-based swap dealer, clearing firm or other similar service provider), is not acting as an advisor to the plan or plan asset vehicle in connection with the transaction; and in advance of providing any recommendations with respect to a transaction or a series of potential transactions, the person obtains a written representation from the independent plan fiduciary, that the fiduciary will not rely on recommendations provided by the person.

6. Employees of the Plan Sponsor

Under the proposed rule, advice given to plan fiduciaries by the sponsor's employees will not be fiduciary investment advice, unless the employee receives compensation for it beyond the employee's regular pay. We think this is a sensible carve-out. However, it leaves out certain very normal situations that are not at all abusive: the employee providing the advice for the plan sponsor may be an employee of an affiliate of the plan sponsor and he or she may be providing the advice for the plan fiduciary but not directly to the plan fiduciary. The proposal should be clarified accordingly.

7. Platform Providers

SIFMA seeks three clarifications with respect to this carve-out. The first, as noted above, would make this exception applicable to all accounts, including plan participants and IRAs. It is a serious omission, and not at all in the interest of IRAs, to preclude a mutual fund complex or broker dealer or other financial institution from narrowing the offerings available to IRAs so as to make the choices more manageable for the investor, without recommending particular options from the remaining list of funds. There are more than eight thousand mutual funds and ETFs available in the market; it is unfair and burdensome to tell IRA owners that they are on their own.[40] The Department's sincere effort to protect IRAs may well be leading to their abandonment in the financial markets. In addition, if IRA and self-directed brokerage account platforms are not included in the carve-out, it could be impossible for financial institutions to avoid fiduciary status for IRAs and self-directed brokerage accounts even if they offer a non-fiduciary "self-directed/execution only" IRA accounts (i.e., if any limits are placed on the available universe of investment options, a platform may be created).

SIFMA members do not think that such a path is good policy or in the interest of American retirement investors.

Second, the carve-out should apply to the marketing and provision of brokerage window services and factual information provided to participants through such brokerage windows. Third, the carve-out should explicitly apply to call centers. So long as the information provided to plan participants and IRA owners does not vary from caller to caller, there is no reason why the Department would want to make call centers useless to participants and IRAs. SIFMA concurs with the Department's requirement that the platform provider "discloses in writing to the plan fiduciary, plan participant or IRA that [it] is not undertaking to provide impartial investment

[40] ICI, April 2015.

advice or to give advice in a fiduciary capacity." SIFMA believes that the required disclosure should be provided to all users, and should be prominently displayed on the website and in written materials. It may also be appropriate for the disclosure to be provided with account statements periodically but not more frequently than annually.

8. Objective Advice on the Selection and Monitoring of Investment Alternatives

SIFMA reiterates its comments above for this carve-out. It should apply to IRAs and plan participants. Moreover, it should not be restricted to platform providers. Many service providers and consultants provide objective data to help IRA owners, plan participants and plan sponsors monitor their investment alternatives. There is no reason why this carve-out should not apply to anyone who provides this information. The carve-out should cover situations where the provider merely "identifies investment alternatives that satisfy objective criteria specified by the plan fiduciary, participant or IRA" or "provides objective financial data and comparisons with independent benchmarks to the plan fiduciary, participant or IRA." It should surely cover lists of potential funds to consider, fund screeners or other internet tools that allow individuals to filter through thousands of investment options, especially when the list is being provided to all clients, and not individualized to particular IRA owners or plan participants.

SIFMA suggests that the carve-out require that the platform provider "discloses in writing to the plan fiduciary, plan participant or IRA that it is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity."

The Department has repeatedly cited studies that find that individuals need access to clearly presented factual information that is not overwhelming. Many studies have shown that participants who have one-on-one education and assistance can digest and understand this data better.[41] SIFMA believes that the Department understands the confusion engendered by a bewildering number of choices for IRAs. We are quite certain that the Department does not want to make investing one's retirement savings harder, or more confusing, or more time-consuming. The Department should rely on the safeguards described in this comment which would permit retail investors to navigate the markets without a paralysis imposed by a Department regulation.

9. Financial reports and valuations

As noted earlier in this comment, SIFMA strongly believes that the Department should reserve the valuation prong of the definition of fiduciary advice until it is prepared to adopt a complete cohesive definition and to justify its inclusion as a fiduciary act when the statute and the legislative history provide no support for that construction. SIFMA strongly believes that the Department should not deal with this area in a piecemeal fashion.

This is particularly true because of the flaws in the way the carve-out is drafted. The carve-out fails to cover bond prices given to a plan or participant, or any other values given to a plan before a trade in the public markets. The carve-out covers valuations of securities provided for regulatory purposes but fails to cover the monthly account statements sent by custodians, brokers and insurance agents every month, as well as online account information and other similar reports. The carve-out will make every fund administrator, third party vendor of pricing information and custodian a fiduciary by providing the pricing for buying shares or units or partnership interests. We do not believe that the Department has thought through the

[41] See Montmarquette, C., and Viennot-Briot, N. (2012). Econometric Models on the Value of Advice of a Financial Advisor. CIRANO. http://www.cirano.qc.ca/pdf/publication/2012RP-17.pdf, which concludes that advised households save at roughly twice the rate of non-advised households and advised investors exhibit behaviors that leave them better prepared for retirement.

ramifications of this section and the narrowness of the carve-out, all the while giving ESOP valuations, its real area of interest, a free pass. SIFMA again urges the Department to reserve the valuation section of the definition and reserve this carve-out.

10. Investment Education

This exception would replace 29 C.F.R. § 2509.96-1 (also known as "Interpretive Bulletin 96-1"), which excludes general financial, investment and retirement information from the scope of investment advice. While it does cover IRAs, SIFMA members are very concerned about its treatment of distribution advice. The preamble descriptions and the operative language are inconsistent and confusing. And there is no question that a safe harbor that is inconsistent and confusing will not be used, for fear of fiduciary liability. Under the proposed rule, in the context of plan information, an educator can discuss varying forms of distribution, including rollovers. However, when providing general information, it cannot discuss distribution options under the plan or specific alternatives or services offered outside the plan, but in that very same subsection, at paragraph (H), it can discuss "General methods and strategies for managing assets in retirement (*e.g.*, systematic withdrawal payments, annuitization, guaranteed minimum withdrawal benefits), including those offered outside the plan or IRA." It seems very unclear to our members how the lead in language to subsection (ii) relates to paragraph (H) thereunder. Similarly, subsection (iv) seems to allow a discussion of distribution options: "questionnaires, worksheets, software and similar materials which allow a plan fiduciary, participant or beneficiary, or IRA owners to evaluate distribution options"; however, paragraph (E) thereunder provides that the interactive material *not* identify any distribution option. This language needs to be reworked.

This carve-out would require a financial professional providing holistic education to omit information which is both appropriate and arguably indispensable to a participant's understanding of his or her choices. The prohibition suggests that the Department, contrary to its clear support of actions that preserve individuals' retirement savings, would, by barring discussions of these options, fail to discourage a participant from liquidating and spending his savings. It would leave participants adrift on required minimum distributions, the complicated rules on inherited IRAs and the question of beneficiaries on their own IRA. The carve-out requires the material to be factual and objective. SIFMA members do not understand the Department’s concern that these prescriptive requirements are not enough, and all conversations about distribution options needs to be eliminated. Because of the heightened emphasis in the definition of advice on distributions, this carve-out should specifically permit distribution education and rollover education. It is critical that participants in plans be provided information that supports the public policy objective of keeping retirement assets in retirement vehicles so that the assets will be available in the retirement phase of life. SIFMA strongly urges the Department not to limit discussion of distributions in education.

The education carve-out has another problem as well. Even though the current regulations require presentations to state that other investments with similar characteristics may be available, the DOL has decided that participants and IRA owners cannot understand that examples are not, *per se*, recommendations, no matter how strongly they are warned.

> “Thus, for example, we would not treat an asset allocation model as mere education if it called for a certain percentage of the investor’s assets to be invested in large cap mutual funds, and accompanied that proposed allocation with the identity of a specific fund or provider.” See 80 FR 21945.

Virtually every study that the Department points to suggests that participants need assistance with financial decision-making. Giving asset classes without allowing examples will not help participants. They will be paralyzed by their choices, and unless they choose to pay for advice from a financial professional, their choices will be uninformed and haphazard, if not entirely incorrect, driven by confusion in the least volatile markets and panic in the most volatile markets. SIFMA believes there must be middle ground here, so that some examples can be given, under circumstances where the disclosure is clear and unambiguous. It is simply not reasonable to believe that participants will be able to grasp abstract descriptions of investment categories with no examples at all. Education that leaves participants lost, and forced to navigate the internet for additional information is a failure. SIFMA urges the Department to allow examples to be given, so long as at least three examples for each asset class are provided, unless there are fewer than three alternatives available in an asset class, in which event all options should be provided as examples.

SIFMA also urges the Department to make two changes to the proposal for rollovers. The first is to carve-out recommendations related to the selling of rollovers, unless there is a prior, explicit understanding that the recommendations are part of an agreement to render fiduciary advice. This carve-out should require, as a condition, that the call center or financial professional make clear that the conversation is a sales call or education, and is not intended as fiduciary or impartial advice. This second carve-out should make clear that so long as the factors contained in FINRA's 2013 rollover release (FINRA Regulatory Notice 13-45) are fairly presented, the conversation should not be deemed fiduciary advice.

In FINRA Regulatory Notice 13-45, FINRA explained that participants generally have four options when they separate from service: leave their account balance in their current plan, roll over their account balance to their new employer's plan, if permitted, roll over their account balance to an IRA, or simply take a distribution, pay the applicable taxes, and use the money for a non-retirement purpose. FINRA noted that the statistics on rollovers tell a graphic story: many participants are more comfortable with their assets in an IRA they control than in their former employer's plan.[42] SIFMA supports an interpretative bulletin or other rulemaking, or a change to the education carve-out in this rule, that makes clear that education on rollovers is not fiduciary advice. SIFMA respectfully suggests a new subsection to the education carve-out which would require the financial professional or call center representative to address each of the following factors taken directly from the FINRA Regulatory Notice in a non-biased fashion:[43]

> (b)(6)(v) Rollover Education. Oral or written information which does not include recommendations or advice but merely lays out the following considerations, each of which must be mentioned without biased emphasis:
>
> > **(A) Investment Options**—An IRA often enables an investor to select from a broader range of investment options than a plan. The importance of this factor will depend in part on how satisfied the investor is with the options available under the plan under consideration. For example, an investor who is satisfied by the low-cost institutional funds available in some plans may not regard an IRA's broader array of investments as an important factor.
> >
> > **(B) Fees and Expenses**—Both plans and IRAs typically involve (i) investment-related expenses and (ii) plan or account fees. Investment-related expenses may include sales loads, commissions, the expenses of any mutual funds in which assets are invested and investment advisory fees. Plan fees typically include plan administrative fees (*e.g.,* recordkeeping, compliance, trustee fees) and fees for services such as access to a customer service representative. In some cases, employers pay for some or all of the plan's administrative expenses. An IRA's account fees may include, for example, administrative, account set-up and custodial fees.

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[42] IRAs account for about 28 percent of all U.S. retirement assets, which totaled $19.5 trillion at the end of 2012. Of this amount, IRA assets were $5.4 trillion, compared with $5.1 trillion in defined contribution plans and $9 trillion in other retirement plans. Approximately 98 percent of IRAs with $25,000 or less are brokerage accounts. Rollovers from employer-sponsored retirement plans are the largest source of contributions to IRAs. A June 2013 Employee Benefits Research Institute report states that in 2011, assets rolled over into IRAs were almost 13 times the amount of direct contributions. This is not a new trend; ICI data indicates that from 1996 to 2008 more than 90 percent of funds flowing into traditional IRAs came from rollovers, primarily from plans. In 2013, 49 percent of the traditional IRAs held by U.S. households included rollover funds.

[43] A revised carve-out for education is attached hereto as an appendix.

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(C) Services—An investor may wish to consider the different levels of service available under each option. Some plans, for example, provide access to investment advice, planning tools, telephone help lines, educational materials and workshops. Similarly, IRA providers offer different levels of service, which may include full brokerage service, investment advice, distribution planning and access to securities execution online.

(D) Penalty-Free Withdrawals—If an employee leaves her job between age 55 and 59½, she may be able to take penalty-free withdrawals from a plan. In contrast, penalty-free withdrawals generally may not be made from an IRA until age 59½.

(E) Protection from Creditors and Legal Judgments—Generally speaking, plan assets have unlimited protection from creditors under federal law, while IRA assets are protected in bankruptcy proceedings only. State laws vary in the protection of IRA assets in lawsuits.

(F) Required Minimum Distributions—Once an individual reaches age 70½, the rules for both plans and IRAs require the periodic withdrawal of certain minimum amounts, known as the required minimum distribution. If a person is still working at age 70½, however, he generally is not required to make required minimum distributions from his current employer's plan. This may be advantageous for the increasing population of Americans who plan to work into their 70s.

(G) Employer Stock—An investor who holds significantly appreciated employer stock in a plan should consider the negative tax consequences of rolling the stock to an IRA. If employer stock is transferred in-kind to an IRA, stock appreciation will be taxed as ordinary income upon distribution. The tax advantages of retaining employer stock in a non-qualified account should be balanced with the possibility that the investor may be excessively concentrated in employer stock. It can be risky to have too much employer stock in one's retirement account; for some investors, it may be advisable to liquidate the holdings and roll over the value to an IRA, even if it means losing long-term capital gains treatment on the stock's appreciation.

The Department may have other required content to suggest and SIFMA would look forward to engaging in a constructive conversation about how all perspectives on rollovers can be fairly presented to a participant without the provider of the information becoming a fiduciary. But we strongly disagree with the Department's current, highly restrictive approach and ask that the Department carefully consider the implications of and possible alternatives to its proposed framework.

The DOL has specifically declined to provide a separate carve-out for call centers. At the very least, this exception should make clear that call centers can use the education carve-out.

12. **Networking Arrangements and Institutional Referrals**

We understand the Department intends the fiduciary definition to capture individualized recommendations and advice as to the selection of investment managers and advisers. However, the Department's proposed language would apply to all recommendations or referrals without limitation. There is no carve-out for referrals to investment managers or other investment advice fiduciaries. This broad definition, especially when coupled with "the specifically directed to" language discussed above, will preclude information and access that is beneficial to retirement investors. The ability of non-fiduciary financial professionals and service providers to recognize and encourage potential opportunities for retirement savings is beneficial to investors and furthers the Department's goal of increasing the adequacy and preservation of retirement savings. For instance, retail bank employees that are not qualified to discuss investments often refer customers to an affiliated adviser within the bank or an affiliated broker-dealer in order to discuss the benefits of retirement savings. SIFMA members do not believe it is in the best interest of retirement investors to chill these referrals and networking arrangements, especially where such referrals would increase investors' access to, and consideration of, retirement savings and where the referred adviser will be acting in the best interest of the customer. Investors are able to distinguish referrals of affiliated services from trusted fiduciary advice. Fiduciary status should extend to those persons that offer advice as to the advisability of an adviser based on the needs of the plan or investor (assuming other requirements for fiduciary status are met), but not to referrals to such advisers where no recommendation or advice is given as to the advisability of engaging any particular adviser. In these circumstances, fiduciary status should be placed with the advice provider, not the introducer.

In addition, we do not believe fiduciary obligations should extend to arms-length referrals where neither side assumes that the counterparty to the plan is acting as an impartial trusted adviser, but the seller is making representations about the value and benefits of a proposed service. SIFMA urges the Department to provide clarification that the counterparty exception or another exception from the fiduciary definition would be available for service providers when selling the services of an affiliate or third-party adviser, such as a networking arrangement under Regulation R or a solicitor arrangement under Rule 206(4)-3 of the Investment Advisers Act of 1940. The Department has not identified any risk of harm under these circumstances where the communications are non-individualized and fully transparent. This is especially true where a referral will satisfy all the conditions set forth in the counterparty exception or where a plan fiduciary has the expertise to evaluate the transaction and to determine whether the transaction is prudent and in the best interest of the plan participants.

A carve-out from the fiduciary definition should be created to provide as follows:

> **NETWORKING AGREEMENTS AND INSTITUTIONAL REFERRALS** – (A) In such person's capacity as a counterparty, service provider to a plan or IRA, representative or affiliate of the counterparty or service provider, or solicitor of the counterparty or service provider, the person provides a recommendation of a person who is going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (a)(1)(i) through (a)(1)(ii) or for asset management, provided such person has not acknowledged in writing that it is acting as a fiduciary (within the meaning of the Act) with

respect to the recommendation, the person only receives a nominal one-time cash payment from the recommended fiduciary in connection with such recommendation, and the person does not receive a specific separate advisory fee for such recommendation; (B) In such person's capacity as a counterparty, service provider to a plan or IRA, representative or affiliate of the counterparty or service provider, or solicitor of the counterparty or service provider, the person provides advice to a plan fiduciary who is independent of such person and who exercises authority or control with respect to the management or disposition of the plan's assets, with respect to an arm's length service arrangement, sale, purchase, loan or bilateral contract between the plan and a third-party adviser who is going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (a)(1)(i) through (a)(1)(ii) or for asset management, each a "transaction" for purposes of this subclause, if, prior to entering into a relationship that may lead to a transaction, the plan fiduciary represents that it has the requisite sophistication and experience in investment matters, and such person discloses to the fiduciary, participant or beneficiary, as the case may be, that the person has a financial interest in the matter, and that the person is not undertaking to provide impartial financial advice; provided such person has not acknowledged in writing that it is acting as a fiduciary (within the meaning of the Act) with respect to the transaction.

SIFMA reiterates its comments above that this carve-out should apply to IRAs and plan participants as well.

Subsection (d) of 29 CFR 2510.3-21

SIFMA urges the Department to modernize the safe harbor in 2510.3-21(d). The entire basis of the Department's new rule is that times have changed and the rule needs to take into consideration the effects of current plan and market conditions. That being said, the safe harbor should permit trade orders to be given to foreign broker dealers who are registered under broker-dealer laws in their countries. In addition, it should cover transactions in fixed income securities, options, and currency that are not executed on an agency basis. This regulation is not simply about participant directed plans: it covers plans of all sizes and types, and this subsection, which is intended to make sure that limited timing or trade venue decisions does not make one into a fiduciary, needs to cover any market broker or dealer, and not just those in the United States. Accordingly, we suggest the following clarification:

> (d) Execution of securities transactions. (1) A person who is a broker or dealer registered under the Securities Exchange Act of 1934, a reporting dealer who makes primary markets in securities of the United States Government or of an agency of the United States Government and reports daily to the Federal Reserve Bank of New York its positions with respect to such securities and borrowings thereon, or a bank supervised by the United States or a State, *or a bank or broker dealer covered under the laws of a foreign jurisdiction*, shall not be deemed to be a fiduciary, within the meaning of section 3(21)(A) of the Act or section 4975(e)(3)(B) of the Code, with respect to an employee benefit plan or IRA solely because such person executes transactions for the purchase or sale of securities *or currency on behalf of such plan or involving such plan* in the ordinary course of its business as a broker, dealer, or bank, pursuant to instructions of a fiduciary with respect to such plan or IRA, if:
>
> (i) Neither the fiduciary nor any affiliate of such fiduciary is such broker, dealer, or bank; and
>
> (ii) The instructions specify:
>
> (A) The security *or currency* to be purchased or sold;
>
> (B) A price range within which such security *or currency* is to be purchased or sold, *or that the security or currency is to be executed at the current market price,* or, if such security is issued by an open-end investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1, et seq.), a price which is determined in accordance with Rule 22c1 under the Investment Company Act of 1940 (17 CFR270.22c1);
>
> (C) A time span during which such security *or currency* may be purchased or sold (not to exceed five business days); and
>
> (D) The minimum or maximum quantity of such security *or currency* which may be purchased or sold within such price range, or, in the case of a security issued by an open-end investment company registered under the Investment Company Act of 1940, the minimum or maximum quantity of such security which may be purchased or sold, or the value of such security in dollar amount which may be purchased or sold, at the price referred to in paragraph (d)(1)(ii)(B) of this section.

Definitions

SIFMA has the following comments on certain of the definitions used in the proposed regulation.

(1) The term "Recommendation"

The proposed rule defines the term "recommendation" to mean "a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action." The preamble indicates that the DOL based this definition on FINRA Notice to Members 01-23, which sets forth guidelines for identifying communications that require compliance with the "suitability" rule for securities brokerage transactions (FINRA Rule 2111), and several other FINRA notices (RN 11-02, 12-25, and 12-55)[44]. A later FINRA notice, quoted with approval in the preamble to the proposal, states as follows: "An important factor in this regard is whether – given its content, context and manner of presentation – a particular communication from a firm or associated person to a customer reasonably would be viewed as a suggestion that the customer take action or refrain from taking action regarding a security or investment strategy."

The Department should fully adopt FINRA Notice to Members 01-23, which provides extremely valuable guidance for broker-dealers to distinguish between online tools that are educational and do not provide recommendations, and online tools that provided individualized recommendations. The former types of tools are prevalent and extremely valuable to self-directed investors to make informed investment decisions without paying a fee for advice. The industry has been following this guidance for fourteen years and, especially given that DOL has adopted FINRA's definition of "recommendation" based on an interactive tools or other

[44] 80 FR 21938.

communication's content, context and presentation, DOL should remain consistent with this longstanding approach. Otherwise investors may lose access to such tools in their retirement accounts even though they will remain available to them in their taxable accounts.

SIFMA strongly supports the use of FINRA's guidance on what constitutes a "recommendation" to be used for purposes of the DOL proposal but it should also include the context in which that guidance is provided. Broker dealers that are FINRA members have many years of experience with this guidance and have incorporated it into their policies procedures, supervisory systems and controls, and training. This is a good example of the need to take a coordinated approach to the DOL proposed rule.

SIFMA agrees with the Department that the provision of information, investment ideas, alternatives and suggestions that fall far short of a "call to action" or a "specific endorsement" should not be fiduciary advice in the absence of an agreement or a mutual understanding or mutual arrangement. In addition, the definition needs to provide that the term does not include communications that merely suggest actions or courses of actions for consideration without a recommendation that is a call to action for the individual to engage in the action or course of action. However, as noted above, this definition needs to be read in connection with subsection (a)(2) and the changes suggested therein, to delete the term "specifically directed to" and to include the concept of mutual understanding and some level of reliance or importance as well as some level of qualitative recommendation and not a mere listing of possibilities to consider without such a recommendation. SIFMA strongly disagrees with the substitution of a standard which merely requires that the advice be targeted to an individual, and even where a person clearly warns the recipient that he is not providing individualized advice, an advertisement on television noting the availability of one-on-one to advice, may foil that clear warning.

We suggest that the definition read as follows:

Recommendation means a communication that, based on its content, context, and presentation, would reasonably be viewed as a call to action or specific endorsement that the advice recipient engage in or refrain from taking a particular course of action. Recommendation does not include communications that merely suggest actions or course of actions for consideration with no call to action to engage in the action or course of action. A communication that would not be a recommendation within the meaning of applicable FINRA rules will not be deemed a recommendation under this section.

(2) The term "Compensation"

In addition, the proposed regulation defines "fee or other compensation, direct or indirect" to mean "any fee or compensation for the advice received by the person (or by an affiliate) from any source and any fee or compensation incident to the transaction in which the investment advice has been rendered or will be rendered." The term specifically includes brokerage fees, mutual funds and insurance sales commissions but sensibly leaves out revenue sharing, which is not shared with individual financial professionals and is generally paid without reference to particular transactions. This definition needs to make clear that revenue sharing that is paid regardless of whether the advice is taken by the participant or plan fiduciary is not compensation for purposes of the regulation.

We are also concerned with the forward looking part of the definition. As written, it covers "compensation incident to the transaction in which the investment advice has been rendered or will be rendered", leaving open whether the test could be met for compensation that is received regardless of whether the advice is taken, such as revenue sharing or training allowances and leaving open how far into the future compensation could be received. The future tense appears to be an attempt to codify the Department's position that a sales pitch, considered by the recipient in any way, that is followed by acceptance and a fee, can turn that sales pitch into fiduciary advice. SIFMA urges the Department to make clear that an advisor's recommendations under the rule which do not result in compensation for that advisor within a reasonable period of time is not compensation that meets the requirements of the definition.

(3) The term "IRA"

The proposed rule defines IRAs as "any trust, account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code." The definition is too broad. SIFMA members see no reason why the regulation should impose these fiduciary standards on savings accounts accumulated for very different reasons: fairly immediate health cost needs or education expenses. The kinds of issues that one considers in making the relatively short term investment decisions for these vehicles is so different from long term retirement savings that these sections should be reserved and dealt with separately.

Transitions

The preamble, but not the rule itself, provides that the final rule will be effective 60 days after publication of the final rule in the Federal Register. However, the requirements of the final rule would become applicable eight months after such publication. All exemptions would be effective on the applicability date as well. The Department seeks comment on whether certain provisions, such as the data collection requirements, should have a further delayed applicability date. We are not certain we understand the difference between an applicability date and an effective date. Neither term is defined in the proposed rule. Neither term is defined in the preamble. What does the effective date mean, if the rule and the exemptions are not effective on that date? Will courts agree that a rule's effective date is not really its effective date? If a person provides individualized advice after the effective date but before the applicability date, is he not a fiduciary? Is the applicability date the first date that liability attaches? If the individualized advice is given before the applicability date, and after the effective date, can the person receive differentiated compensation until the applicability date? Under what exemption? SIFMA would appreciate a clearer explanation of the Department's intentions with these terms.

Regardless of what these terms mean, they are simply inadequate. Sixty days or eight months is not nearly enough time to train all employees, build new systems, create compliance procedures, change compensation systems, block principal trades, block securities that do not meet the definition of "Asset" in the BIC exemption, revise confirmations, re-document all accounts, negotiate new fees, find and secure bonding policies and fiduciary insurance policies, talk to clients about assets they may no longer buy, and how to sell the investments they already have. Congress provided more than two years for the clearing requirements in Dodd-Frank which were far less sweeping than these changes. And when ERISA was enacted, Congress fully understood that financial professionals would need significant time to meet with their clients, review the required changes in their relationship, renegotiate fees, re-document the relationship, revise internal systems to contain required information and to block prohibited trades, create a website, determine how to create a system that provides liquidity and assesses credit risk, by CUSIP, on a daily basis to meet the requirements of the principal transaction exemption, design new confirms, new marketing materials, new educational materials, create supervisory procedures and compliance training, recode all accounts – the list is extraordinarily long and 8 months is very short. ERISA required far less in terms of systems development, new documentation, creation of charts, websites, and asset blocking systems. In 1974, Congress gave broker-dealers almost 10 years to phase in the prohibited transaction provisions relating to purchases and sales and almost three years to change services arrangements.[45] The Department's transition period is simply inadequate. Even if the final rule is published by January 1, 2016, financial professionals will have only 8 months to reach out to about 50 million accounts, have the important conversations with these plan fiduciaries and retirement investors about how their accounts, fees and client relationship will change, and how the rule will prevent those accounts from holding assets that

[45] See Section 413 of ERISA and ERISA Conference Report page 325, et. seq.

they currently hold or might want to hold in the future. Plans, participants and IRAs will be enormously pressured to review their arrangements or take their accounts to other institutions. Simply put, the transition period is too short. If the rule is to be effective within 8 months, at the very least the Department should propose a temporary exemption that permits all transactions permissible under current law to continue for 18 months, so long as clients receive clear and specific disclosure that the financial professional is required to put the client's interest before his own, and that he may have a conflict of interest with respect to the fees he receives in connection with his advice.

A Best Interest Standard

SIFMA believes there are less disruptive and more comprehensive ways to implement a best interest standard for additional protection for individual investors who maintain securities investments. Our members long ago endorsed a best interest or uniform fiduciary standard of care for all retail investors, including the retirement sector, when providing personalized investment advice about securities. SIFMA has encouraged the SEC, which has broad jurisdiction and authority in this space, to take action to establish a uniform fiduciary standard across all retail securities accounts receiving personalized investment advice.

The Dodd-Frank Act granted the SEC the authority to review and set the standard of care for broker-dealers with respect to retail investors through a Congressional mandate. While the SEC has not yet moved forward with a proposed rule, the rules and precedents governing broker-dealers' conduct with respect to retail investors, both in retirement and non-retirement accounts, have been migrating in recent years toward a best interests standard of care. For example, FINRA, under the supervision and oversight of the SEC, has been increasingly refining its definition of suitability under Rule 2111 and most recently through FINRA Notice 13-45, referenced earlier, to require brokers to put clients' best interests ahead of their own.

To further assist the SEC and FINRA and to maintain forward progress towards formalizing a best interest standard across all retail investor securities accounts, SIFMA, on June 3, 2015, proposed a "Best Interests of the Customer Standard for Broker-Dealers",[46] which is designed to lay the groundwork for an investor-focused, comprehensive regulatory solution that works for investors and broker-dealers alike.

SIFMA believes that an optimal "best interests of the customer" legal standard for broker-dealers should do the following:

1. Apply across all investment recommendations made to individual retail customers in all brokerage accounts (not be limited to just IRA accounts);
2. Serve as a benchmark for, be consistent with, and integrate seamlessly into, the SEC uniform fiduciary standard that ultimately emerges under Dodd-Frank § 913;
3. Provide interim, strong, substantive, "best interests" protections for retail customers; and
4. Follow the traditional securities regulatory approach of establishing a rules-based heightened standard, including robust disclosure, coupled with robust examination, oversight, and enforcement by the SEC, FINRA and state securities regulators, as well as a private right of action for investors, as exists today.

SIFMA believes that our proposal outlines the broad contours of how a best interests standard for broker dealers might be developed as part of the path forward on this most important investor protection issue. Any approach by the DOL for retirement accounts must be entirely consistent with the views and rulings of the securities regulators, or the costs of compliance will increase unreasonably as institutions attempt to reconcile inconsistent interpretations of these requirements – how to define markups and markdowns, when disclosure must be provided,

[46] See http://www.sifma.org/newsroom/2015/sifma_proposes_best_interests_standard_for_broker-dealers.

required content on confirms, scope of required records --leading to confusion on the part of financial professionals, compliance professionals and clients. Investor confusion and market disruption are a certain result if the government does not get this right.

SIFMA and its members appreciate the opportunity to comment and look forward to meeting with the Department to discuss our concerns. For further discussion, please contact the undersigned at 202-962-7329.

Sincerely,

Lisa J. Bleier
Managing Director, Federal Government Relations
and Associate General Counsel

Revisions of Investment Education Carve-out

(6) Investment education. The person furnishes or makes available any of the following categories of investment-related information and materials described in paragraphs (b)(6)(i) through (iv) of this section to a plan, plan fiduciary, participant or beneficiary, eligible employee, IRA or IRA owner irrespective of who provides or makes available the information and materials (*e.g.*, plan sponsor, fiduciary or service provider), the frequency with which the information and materials are provided, the form in which the information and materials are provided (*e.g.*, on an individual or group basis, in writing or orally, or via call center, video or computer software), or whether an identified category of information and materials is furnished or made available alone or in combination with other categories of information and materials identified in paragraphs (b)(6)(i) through (iv), provided that the information and materials do not include (standing alone or in combination with other materials) recommendations with respect to specific investment products or specific plan or IRA alternatives, or recommendations on investment, management, or value of a particular security or securities, or other property.

(i) Plan information. Information and materials that, without reference to the appropriateness of any individual investment alternative or any individual benefit distribution option for the plan or IRA, or a particular eligible employee, participant or beneficiary or IRA owner, describe the terms or operation of the plan or IRA, inform a plan fiduciary, eligible employee, participant, beneficiary, or IRA owner about the benefits of plan or IRA participation, the benefits of increasing plan or IRA contributions, the impact of preretirement withdrawals on retirement income, retirement income needs, varying forms of distributions, including rollovers, annuitization and other forms of lifetime income payment options (*e.g.*, immediate annuity, deferred annuity, or incremental purchase of deferred annuity), advantages, disadvantages and risks of different forms of distributions, or describe investment objectives and philosophies, risk and return characteristics, historical return information or related prospectuses of investment alternatives under the plan or IRA.

(ii) General financial, investment and retirement information. Information and materials on financial, investment and retirement matters that do not recommend specific investment products, specific plan or IRA alternatives or distribution options available to the plan or IRA or to eligible employees, participants, beneficiaries and IRA owners, or specific alternatives or services offered outside the plan or IRA, unless at least three examples are provided but which inform the plan fiduciary, participant or beneficiary, or IRA owner about--

(A) General financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment;

(B) Historic differences in rates of return between different asset classes (*e.g.*, equities, bonds, or cash) based on standard market indices;

(C) Effects of inflation;

(D) Estimating future retirement income needs;

(E) Determining investment time horizons;

(F) Assessing risk tolerance;
(G) Retirement-related risks (*e.g.*, longevity risks, market/interest rates, inflation, health care and other expenses); and
(H) General methods and strategies for managing assets in retirement (*e.g.*, systematic withdrawal payments, annuitization, guaranteed minimum withdrawal benefits), including those offered outside the plan or IRA.
(iii) Asset allocation models. Information and materials (*e.g.*, pie charts, graphs, or case studies) that provide a plan fiduciary, participant or beneficiary, or IRA owner with models of asset allocation portfolios of hypothetical individuals with different time horizons (which may extend beyond an individual's retirement date) and risk profiles, where--
(A) Such models are based on generally accepted investments theories that take into account the historic returns of different asset classes (*e.g.*, equities, bonds, or cash) over defined periods of time;
(B) All material facts and assumptions on which such models are based (*e.g.*, retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) accompany the models;
(C) Such models do not recommend any specific investment product or specific alternative available under the plan or IRA unless three examples are provided; and
(D) The asset allocation models are accompanied by a statement indicating that, in applying particular asset allocation models to their individual situations, eligible employees, participants, beneficiaries, or IRA owners should consider their other assets, income, and investments (*e.g.*, equity in a home, Social Security benefits, individual retirement plan investments, savings accounts and interests in other qualified and non-qualified plans) in addition to their interests in the plan or IRA, to the extent those items are not taken into account in the model or estimate.
(iv) Interactive investment materials. Questionnaires, worksheets, software, and similar materials which provide a plan fiduciary, eligible employee, participant or beneficiary, or IRA owners the means to estimate future retirement income needs and assess the impact of different asset allocations on retirement income; questionnaires, worksheets, software and similar materials which allow a plan fiduciary, eligible employee, participant or beneficiary, or IRA owners to evaluate distribution options, products or vehicles by providing information under paragraphs (b)(6)(i) and (ii) of this section; questionnaires, worksheets, software, and similar materials that provide a plan fiduciary, participant or beneficiary, or IRA owner the means to estimate a retirement income stream that could be generated by an actual or hypothetical account balance, where--
(A) Such materials are based on generally accepted investment theories that take into account the historic returns of different asset classes (*e.g.*, equities, bonds, or cash) over defined periods of time;
(B) There is an objective correlation between the asset allocations generated by the materials and the information and data supplied by the participant, beneficiary or IRA owner;

(C) There is an objective correlation between the income stream generated by the materials and the information and data supplied by the eligible employee, participant, beneficiary or IRA owner;

(D) All material facts and assumptions (*e.g.*, retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, rates of return and other features and rates specific to income annuities or systematic withdrawal plan) that may affect a participant's, eligible employee's, beneficiary's or IRA owner's assessment of the different asset allocations or different income streams accompany the materials or are specified by the eligible employee, participant, beneficiary or IRA owner;

(E) The materials do not recommend any specific investment alternative available or distribution option available under the plan or IRA, unless at least three examples are provided or unless such alternative or option is specified by the participant, beneficiary or IRA owner; and

(F) The materials either take into account other assets, income and investments (*e.g.*, equity in a home, Social Security benefits, individual retirement account/annuity investments, savings accounts, and interests in other qualified and non-qualified plans) or are accompanied by a statement indicating that, in applying particular asset allocations to their individual situations, or in assessing the adequacy of an estimated income stream, eligible employees, participants, beneficiaries or IRA owners should consider their other assets, income, and investments in addition to their interests in the plan or IRA.

(v) The information and materials described in paragraphs (b)(6)(i) through (iv) of this section represent examples of the type of information and materials that may be furnished to participants, beneficiaries and IRA owners without such information and materials constituting investment advice. Determinations as to whether the provision of any information, materials or educational services not described herein constitutes the rendering of investment advice must be made by reference to the criteria set forth in paragraph (a) of this section.

(vi) Rollover Education. Oral or written information which does not include recommendations or advice but merely lays out the following considerations, each of which must be mentioned without biased emphasis:

> **(A) Investment Options**—An IRA often enables an investor to select from a broader range of investment options than a plan. The importance of this factor will depend in part on how satisfied the investor is with the options available under the plan under consideration. For example, an investor who is satisfied by the low-cost institutional funds available in some plans may not regard an IRA's broader array of investments as an important factor.
>
> **(B) Fees and Expenses**—Both plans and IRAs typically involve (i) investment-related expenses and (ii) plan or account fees. Investment-related expenses may include sales loads, commissions, the expenses of any mutual funds in which assets are invested and investment advisory fees. Plan fees typically include plan administrative fees (*e.g.,* recordkeeping, compliance, trustee fees) and fees for

services such as access to a customer service representative. In some cases, employers pay for some or all of the plan's administrative expenses. An IRA's account fees may include, for example, administrative, account set-up and custodial fees.

(C) Services—An investor may wish to consider the different levels of service available under each option. Some plans, for example, provide access to investment advice, planning tools, telephone help lines, educational materials and workshops. Similarly, IRA providers offer different levels of service, which may include full brokerage service, investment advice, distribution planning and access to securities execution online.

(D) Penalty-Free Withdrawals—If an employee leaves her job between age 55 and 59½, she may be able to take penalty-free withdrawals from a plan. In contrast, penalty-free withdrawals generally may not be made from an IRA until age 59½.

(E) Protection from Creditors and Legal Judgments—Generally speaking, plan assets have unlimited protection from creditors under federal law, while IRA assets are protected in bankruptcy proceedings only. State laws vary in the protection of IRA assets in lawsuits.

(F) Required Minimum Distributions—Once an individual reaches age 70½, the rules for both plans and IRAs require the periodic withdrawal of certain minimum amounts, known as the required minimum distribution. If a person is still working at age 70½, however, he generally is not required to make required minimum distributions from his current employer's plan. This may be advantageous for the increasing population of Americans who plan to work into their 70s.

(G) Employer Stock—An investor who holds significantly appreciated employer stock in a plan should consider the negative tax consequences of rolling the stock to an IRA. If employer stock is transferred in-kind to an IRA, stock appreciation will be taxed as ordinary income upon distribution. The tax advantages of retaining employer stock in a non-qualified account should be balanced with the possibility that the investor may be excessively concentrated in employer stock. It can be risky to have too much employer stock in one's retirement account; for some investors, it may be advisable to liquidate the holdings and roll over the value to an IRA, even if it means losing long-term capital gains treatment on the stock's appreciation.

APPENDIX III

Letter from the Securities Industry and Financial Markets Association re: ZRIM: 1210-ZA25; PTE Application D-11712 (the "SIFMA BIC Letter")

July 20, 2015

By U.S. Mail and Email: e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11712
Suite 400
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: ZRIN: 1210-ZA25; PTE Application D-11712

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to provide comments regarding the Department of Labor's ("Department") Proposed Best Interest Contract Exemption[2] ("BIC Exemption") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). We appreciate the opportunity to comment and hope that our comments are helpful to the Department as it assesses whether the exemption, as written, can be accommodated into the broker-dealer model that exists today, or whether, as written, it will result in the loss of professional investment advice for small retirement accounts.[3] We respectfully request an opportunity to testify at the hearing on the proposed exemption.

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960 (April 20, 2015).

[3] 80 Fed. Reg. at 21961.

Attached hereto are SIFMA's submissions for the related rulemakings being undertaken by the Department. These attachments are an integral part of this submission.[4]

Although the preamble states that the proposed BIC Exemption "seeks to preserve beneficial business models by taking a standards-based approach that will broadly permit firms to continue to rely on common fee practices," the exemption as currently proposed raises significant and in many respects insurmountable obstacles for broker-dealers, including the ability to offer commission-based advice. For example, the contract requirements of the proposed exemption do not comport with the manner in which financial professionals enter into relationships with retail customers. SIFMA further believes that the written disclosures required under the proposed exemption will not only overwhelm customers with more information than they can possibly digest, but also seriously impede customer transactions and cause timing and opportunity losses for smaller retirement accounts.

Moreover, complying with the terms and conditions of the proposed exemption will impose significant additional costs on broker-dealers and other providers of financial services. That will make it extremely difficult, if not impossible, for smaller retirement accounts to receive financial advice from the professionals who currently serve them. As a result, many of these smaller retirement accounts may be terminated or maintained such that the investor receives no assistance and the broker is no more than an order taker. To the extent that the investment education currently provided by financial professionals ceases to be available, the result will be accelerated leakage of retirement savings out of tax-advantaged accounts, less people saving for retirement and widespread confusion on the part of retirement investors, none of which is in the best interest of these investors.

[4] See Appendices numbered 1-8.

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SIFMA shares the Department's interest in ensuring that investors receive appropriate, informed assistance with decisions concerning retirement. However, SIFMA respectfully believes that this proposed exemption, and the package of proposals accompanying it, are not the proper way of proceeding. SIFMA also does not believe that the Department may use a new definition of "fiduciary," in combination with its exemptive authority, as a means of establishing a new regulatory and enforcement program for financial professionals, ERISA plans, and non-ERISA plans such as IRAs. SIFMA expresses this objection with regard to the BIC Exemption, and the other, related exemptive rules that have been proposed.

Comments on specific provision can be found on the pages indicated below:

Section I: Scope of the Proposed Best Interest Contract Exemption

SIFMA respectfully believes that the Department's new "fiduciary" definition, and this proposed exemption, exceed the Department's statutory authority. SIFMA offers the comments and recommended changes in this letter to assist the Department in improving this exemptive rule in the event the Department resolves to adopt this package of proposals in final form, despite the deep concerns they present. Nothing in these comments should be understood to mean that SIFMA concurs with the construction of ERISA and the Code underlying the Department's proposals, or with the policy views regarding the financial services industry that the Department has articulated in presenting its proposals.

Advice Recipients Covered by the BIC Exemption.

The proposed BIC Exemption permits an adviser to receive compensation for services provided to a "Retirement Investor" in connection with a purchase, sale or holding of an "Asset" by a plan, a plan participant or an IRA. "Retirement Investor" is defined to include a plan participant or beneficiary with the ability to self-direct his or her account or take a distribution, an IRA owner, or a plan sponsor of a plan with fewer than 100 participants that is not participant-directed. We urge the Department to include advice to sponsors of participant directed plans with fewer than 100 participants on the composition of the menu of investment options available under such plans. Without such relief, sponsors of such plans would have to enter into a fixed fee arrangement with an adviser to obtain advice regarding menu selection, which many small employers would be unwilling to do. We also note that the Department has omitted Keogh plans from the list of retirement investors, which we assume was inadvertent.

As a result of the Department's decision to limit the availability of the BIC exemption to the "retail" retirement marketplace, no financial professional can receive any third party fees on behalf of any plan with more than 100 participants. We urge the Department to permit receipt of mutual fund third party payments in connection with plans with more than 100 participants under PTE 86-128 (amended consistent with SIFMA's comment letter addressing the Department's proposed amendments to PTE 86-128), with full disclosure in the manner that has worked successfully under that exemption for the last 30 years.

We also believe that the 100 participant ceiling in the BIC exemption will be operationally unworkable from a compliance perspective. For example, how often would the financial professional need to confirm that the number of participants in the plan is at or below 100? It would not be possible to confirm the number of participants prior to every transaction or every recommendation. If the 100 participant cap is intended to protect less sophisticated plan sponsors, we suggest as an alternative that the Department use an asset based test in Section (b)(1)(i)(B) of the proposed regulation[5] that aggregates the assets of all plans sponsored by the employer and its affiliates. Many large employers sponsor multiple plans, some of which may be quite small. In such cases, the plan sponsor is not likely unsophisticated or in need of the protection of the BIC Exemption. Such employers can take advantage of other exemptions for any small plans that they sponsor and should not be forced into the BIC Exemption. If the Department determines to keep the 100 participant test, we urge the Department to amend the proposed exemption to provide that the test must be met as of the latest Form 5500 filed by the plan sponsor and publicly available from the Department at the time the account is opened.

Transactions Covered by the BIC Exemption.

The exemption covers only the receipt of compensation in connection with the *purchase, holding or sale* of a specified list of "Assets." We believe it also needs to cover the receipt of

[5] *See Definition of the Term "Fiduciary": Conflict of Interest Rule—Retirement Investment Advice*, 80 Fed. Reg. 21928, 21957 (Apr. 20, 2015).

compensation in connection with extensions of credit, since by its terms, the exemption covers debt instruments, bank deposits and certificates of deposit.[6]

We are troubled by the narrow scope of the permitted "Assets" and urge the Department to reconsider its approach to this concept. The term "Asset" is defined to include *only*: bank deposits; certificates of deposit; shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs, or exchange-traded funds; corporate bonds offered pursuant to a registration statement under the Securities Act of 1933; agency debt securities as defined in FINRA Rule 6710(l) or its successor; US Treasury securities as defined in FINRA Rule 6710(p) or its successor; insurance and annuity contracts; guaranteed investment contracts; and equity securities within the meaning of 17 C.F.R. § 230.405 that are exchange-traded securities within the meaning of 17 C.F.R. § 242.600.[7] The term "Asset" is expressly defined to exclude "any equity security that is a security future or a put, call, straddle, or other option or privilege of buying an equity security from or selling an equity security to another without being bound to do so."

The investments excluded from the Department's proposed list of permissible "Assets" include such transparent and liquid securities as municipal bonds, federal agency and government sponsored enterprise guaranteed mortgage-backed securities, foreign bonds, foreign equities, and foreign currency. It also omits other common investments such as over the counter equities, structured products (other than U.S. corporate bonds), hedge funds, private equity and other

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[6] The BIC Exemption also provides no relief for principal transactions, which effectively denies relief under the exemption for the acquisition of shares of unit investments trusts. Although unit investment trusts are organized as registered investment companies, they are typically sold out of inventory. In a separate comment letter, SIFMA is recommending that the proposed exemption for principal transactions in debt securities be expanded in such a way that it would provide relief for the acquisition of unit investment trust shares.

[7] These "exchange" definitions make clear that only equities traded on a US exchange are covered under the exemption.

alternative investments, options, and futures contracts. In enacting ERISA, Congress chose not to prohibit these types of investments, and the Department has historically declined to create a "legal list" of investments for plan fiduciaries.[8]

The creation of an enumerated list of permissible asset types for small plans and IRAs is a marked departure from the Department's practice over the last 40 years. For the first time, the Department is proposing to create a "legal list" that substitutes its judgment for that of the plan fiduciary, IRA owner or plan participant. We question whether the Department has the legal authority to specify what retirement accounts can invest in. Had Congress wanted to place investment restrictions, it could have done so, as it did in IRC § 408(m) for IRA accounts. Because there are no such prohibitions in ERISA, we do not believe that the Department has the requisite authority to impose them now. We also question the Department's ability to expand the list of prohibited investments for IRAs given the language in IRC § 408(m) which does not include any of the securities prohibited under this proposed exemption.

We also believe that the "legal list" is fundamentally inconsistent with a fiduciary standard. An adviser may in good faith believe that an investment not on the list of "Assets" is in the best interest of the plan, plan participant or IRA owner. If an adviser so believes and fails to act on his or her belief, will adherence to the list be a defense? Limiting the ability of advisers to take action that they truly believe would be in the best interest of IRA owners, plans and their participants would substitute the Department's judgment for that of advisers, IRA owners, plans and their participants, and seems counter to the Department's stated goals.

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[8] *See* Investment of Plan Assets under the "Prudence" Rule, 44 Fed. Reg. 31369 (June 1, 1979) ("the Department does not consider it appropriate to include in the regulation any list of investments, classes of investment, or investment techniques that might be permissible under the prudence rule"). We note that exchange traded funds did not exist in 1979 and thus could not have made any such list at the time.

Furthermore, limiting the types of permissible assets would create major operational challenges. As outlined in the Deloitte report submitted with this comment letter, SIFMA member firms would have to bifurcate accounts to accommodate products that would not be permissible under the exemption. Significant oversight would be required to ensure that advised retirement accounts are holding only permissible assets and that retirement investors are being advised only with respect to such assets. For pre-existing retirement accounts, SIFMA member firms will be barred from providing much needed advice to the account owners concerning the holding or sale of any assets that are not on the Department's proposed list. These negative consequences are discussed in greater detail below in SIFMA's comments regarding Section VII of the proposed exemption.

Although the Department suggests plans and IRAs can obtain exposure to impermissible assets through mutual funds, mutual funds does not have the risk, reward or fee structure of those assets (*e.g.*, sovereign bonds or foreign securities). It is not reasonable to suggest that a mutual fund is a substitute for an asset that the Department has excluded. We urge the Department to replace the term "Asset" in Section I(a) with the phrase "securities or other property." Given the impartial conduct standard required by the BIC Exemption, there should be no limit on the types of assets covered by the exemption. As proposed, the BIC Exemption purports to require brokers to act in the client's best interest, but then trumps the broker's judgment on what is or is not a suitable investment. Moreover, as the investment world constantly evolves, the sort of static list proposed in the BIC Exemption could impede investments in new vehicles that have the same level of transparency and liquidity cited by the Department as primary criteria in selecting "Assets." We believe that any such limitation is inappropriate.

The BIC Exemption also makes no provision for the receipt of compensation for two specific activities that the Department has included in the proposed definition of fiduciary investment advice: rollover advice and manager advice. Under the proposal, one becomes a fiduciary by recommending that a plan participant roll his or her account balance over to an IRA or by recommending a manager, but BIC Exemption provides no relief for the receipt of fees in connection with the rollover or the manager selection process.

In addition to substituting the phrase “securities or other property” for the term “Asset,” SIFMA urges the Department to provide explicit relief for compensation received in connection with a recommendation to take a distribution of benefits or rollover into a plan or an IRA, as well as in connection with a recommendation concerning the selection of investment managers or advisers. We believe that these omissions must have been inadvertent, since it does not seem reasonable to make a person a fiduciary for a particular type of advice but provide no exemption for any compensation that may flow from that recommendation.

Because the proposed BIC Exemption is tailored to the recommendation of an “Asset,” it is unworkable for recommendations of investment managers or advisers, including recommendations of separate managed account strategies or wrap fee programs (collectively, “advice programs”). These advice programs are for discretionary management services that, when provided for retirement accounts, are already subject to the full protections of ERISA today. A separate, modified BIC Exemption must be adopted that is more tailored and relevant to the recommendations of these advice programs. To address potential conflicts, such an exemption could incorporate the same impartial conduct standards and other requirements as contained in the BIC Exemption (subject to the necessary clarifications and modifications discussed below in this letter). To avoid encumbering unnecessarily the pre-investment conversation, and to leverage existing requirements and practices under the Advisers Act for discretionary management services, the exemption should allow the contractual requirements to be incorporated into an advice program agreement. It should be possible for that agreement to be executed after the adviser recommends the advice program, but prior to any actual investment through the advice program. For example, a required clause could state that an advice program recommendation was made in the best interest of the client. In lieu of the BIC Exemption disclosures, which are asset-based and therefore inapposite to the recommendation of advice programs, the Department should require 29 C.F.R. § 2550.408b-2 disclosures that could be incorporated into the advisory program's ADV Part 2 disclosure brochure that is already delivered to clients under the Advisers Act. The concept of leveraging § 2550.408b-2 disclosures is discussed in more detail below.

Section II: Contracts, Impartial Conduct and Other Requirements

Contract Requirement

The BIC Exemption requires that a contract be entered into *before* any recommendation is made to a retirement investor. There are several reasons why this requirement is simply incompatible with the markets and relationships it is intended to regulate. As a threshold matter, it is completely at odds with the manner in which brokers typically enter into relationships with retail customers. Given the uncertain scope of the term "recommendation" and the risk of non-compliance with the exemption, this proposed condition may leave brokers no choice but to ask retirement investors to enter into written contracts before any meaningful conversations have taken place. That could make retirement investors so uncomfortable that they simply decide not to proceed any further. Requiring a contract *before* any recommendation is made would also preclude reliance on the BIC Exemption for certain types of advice (such as rollover recommendations), because participants are not likely enter into a contract until they have considered the advice and made a decision.

There are other operational incompatibilities as well. The practical reality of the marketplace is that contracts are generally entered into between the financial institution and the IRA owner, plan fiduciary or participant acting on behalf of the IRA, plan or participant account. Advisers do not sign these contracts, and it would not be feasible for them to do so. Advisers are merely agents of the financial institution and they may leave that institution at any time. Having advisers sign the agreements would require the execution of a new contract whenever an adviser leaves the firm or an account is reassigned to another adviser. Likewise, if the adviser is not available, a recommendation could not be made by anyone else since the contract would be non-transferrable between advisers. Similarly, where an IRA or small plan account is serviced by a team of advisers, all of the advisers would have to sign the agreement, and a new contract would be required whenever an adviser leaves the team, or a new adviser joins the team.

Requiring advisers to sign a written contract would also create problems for financial institutions that have call centers and a rotating team of employees who may be permitted to provide advice. The Department declined to provide a "carve out" for call centers in the proposed definition of fiduciary advice. Can IRAs be allowed to use the call center if *no one* in the call center has signed the contract? If call center staff are fiduciaries, does each staff person in the call center have to sign the contract if an IRA owner could get a different person every time the IRA owner calls? These are just two examples of why this requirement is impractical.

Furthermore, there are close to fifty million IRAs and plans with *current* brokerage contracts. To amend, reprice, and resign all of those current contracts in the eight month period between the effective date and the applicability date would be an impossible undertaking. The Department has noted the impracticality of obtaining signatures on revised contracts in more than twenty prohibited transaction exemptions permitting deemed consent or negative consent. We respectfully request that any contract requirement be replaced by a written undertaking on the part of the financial institution; if the plan fiduciary, participant or IRA owner continues the relationship after being provided with the written undertaking, he or she will be deemed to have consented to it. At a minimum, the BIC Exemption should be revised to make clear that either negative consent or an electronic signature is sufficient, and that the written undertaking can be delivered either by mail or by electronic means.

Finally, we note that the proposed exemption for principal transactions targets the plan or IRA account as the counterparty to the agreement by requiring that the retirement investor enter into the contract "acting on behalf of the Plan, participant or beneficiary account, or IRA." This language makes clear that any advice provided by the adviser is being provided only with respect to the retirement account covered by the agreement. Although we have commented separately that the contract requirement of the proposed principal transaction exemption should likewise be replaced by an undertaking, we think treating the retirement account as the counterparty is more workable than the approach taken in the proposed BIC Exemption, which views the retirement investor as the counterparty.

Voluntary Assumption of Fiduciary Status

The BIC Exemption requires the adviser and the financial institution to affirmatively state that they are "fiduciaries under ERISA or the Code, or both, with respect to any investment recommendations to the Retirement Investor." The "Retirement Investor," as that term is defined in the exemption, will be a person or entity who may have more than one account with the adviser or the financial institution or both. At the very least, this language should be revised to clarify that the affirmative statement applies only with respect to recommendations provided with respect to the specific retirement account covered by the undertaking.

The required acknowledgement of fiduciary status creates other complications as well. For example, the preamble states that the requirement to adhere to a best interest standard "does not mandate an ongoing or long-term advisory relationship."[9] Section (c) of the proposed regulation[10] appears to limit the scope of any fiduciary duty to those assets for which a person exercises discretionary authority or renders investment advice. However, the Department should

[9] 80 Fed. Reg. at 21969.

[10] *See Definition of the Term "Fiduciary": Conflict of Interest Rule—Retirement Investment Advice*, 80 Fed. Reg. at 21959.

make clear in the BIC Exemption that advisers and financial institutions can limit any acknowledgment of fiduciary status and the requirements of the exemption to the *specific* assets for which investment advice has in fact been rendered, and if the investment advice is non-discretionary, that they can also limit the scope of any fiduciary obligation so that it does not extend to ongoing monitoring of that asset position. To do otherwise would require a financial institution to provide an additional investment advisory service (account monitoring) that neither the financial institution nor the plan, participant, or IRA owner may want or be willing to pay for. The Department should not imply that the adviser and/or financial institution will be acting in a fiduciary capacity *any* time they discuss investments for an account that holds an asset that was subject to non-discretionary investment advice. To do so would in fact preclude the adviser and financial institution from relying on the carve-outs to fiduciary status, including the ability to provide investment education, for any trade executed in the account.

In conjunction with the BIC Exemption's narrow definition of "Asset," the acknowledgement of fiduciary status must not result in self-directed IRA owners and plan participants being denied the ability to invest in assets of their choice. If a client with an advised IRA instructs the custodian to acquire a non-recommended investment that is excluded from the list of permissible "Assets," the broker should be able to execute the trade for a commission because the broker did not provide investment advice on that asset. The Department should make this clear. Otherwise, broker-dealers may be unwilling to risk dual-role accounts, where recommendations are made as to some but not all investments. This is a very common model for some broker-dealers whose advisers may provide occasional advice but not all the time and not with respect to all assets in the account, and it is consistent with Section (c) of the proposed regulation. If broker-dealers are instead forced to restrict advisory accounts to the acquisition, holding or sales of "Assets" as defined in the BIC Exemption, the result will be to deny clients the ability to invest their accounts in the assets of their choice. This does not seem to be the Department's intent, and in the final adoption the Department should make this clear.

Even if the above situation is addressed, dividing IRAs into advised and non-advised IRAs will create its own set of problems, not unlike the situation where a client has both a personal brokerage account and a plan or an IRA account. Assume that the broker recommends an investment for the client's personal account that would not be on the BIC Exemption's list of permitted "Assets," and that the client then instructs the broker to purchase the same investment for the IRA. The broker has not made a recommendation for the IRA and should be permitted to execute the transaction in the non-advised IRA as a non-fiduciary broker. However, the broker may risk being sued for a prohibited transaction by following the client's instruction with respect to the IRA. If the broker does not follow the client's instruction, the broker risks losing the client's business.

These types of risks are likely to drive many broker-dealers away from commission-based compensation arrangements entirely, contrary to the Department's stated goal of "flexibly accommodate[ing] a wide variety of business practices" through use of the BIC Exemption. [11] The broad undertaking of fiduciary responsibility, the prevalence of individuals having multiple accounts with the same financial institution and broker, and the severely constrained list of permitted "Assets" make the BIC Exemption an ineffective solution for the modern investment marketplace.

Impartial Conduct Standards

The BIC Exemption requires that the adviser and the financial institution affirmatively agree to comply with, and then in fact comply with, impartial conduct standards. The impartial conduct standards require the adviser to provide advice that is "in the Best Interest of the Retirement Investor (*i.e.*, advice that reflects the care, skill, prudence and diligence under the circumstances

[11] 80 Fed. Reg. at 21961.

then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party)." The Department has thus taken ERISA's prudence standard and turned it into a prohibited transaction applicable to both plans and IRAs.

Congress saw no reason to impose a prudence standard for IRAs and believed that a violation of the prudence standard for ERISA plans should be remedied through litigation in federal court. Nonetheless, the proposal purports to condition relief under Section 4975 of the Code on the *contractual* assumption of a prudence standard that would be enforceable by IRA owners in state court through class action litigation or in arbitration on an individual claim basis. We do not believe that Congress intended a breach of the duty of prudence to violate the prohibited transaction provisions of ERISA and the Code.

We also do not believe the Department has a basis to apply its best interest standard to ERISA plans. The Department acknowledges in the preamble that the best interest standard "is based on longstanding concepts derived from ERISA and the law of trusts"; in particular, the duties of prudence and loyalty imposed by ERISA § 404(a). Requiring advisers to ERISA plans or plan participants to agree to, and comply with, a best interest standard separate and apart from their existing ERISA fiduciary duty is redundant and unnecessary to achieve the Department's stated goals. For ERISA plans, requiring advisers and financial institutions to adhere to a best interest standard as a condition for relief under the BIC Exemption ramps up the consequences of any fiduciary breach by imposing an excise tax on a prudence violation. We believe that is both inappropriate and contrary to the statutory framework and Congress's intent.

In our view, the Department lacks statutory authority to require compliance with a prudence rule as a condition of a prohibited transaction exemption. Congress has issued more than 20 statutory exemptions. Not one of those exemptions has imposed a vague "reasonable person" standard or a subjective "misleading disclosure" standard as a condition punishable by transaction reversal and an excise tax, regardless of whether there is a loss on the trade and regardless of whether the disclosure is entirely correct but simply unclear. Nor has any exemption previously issued by the Department contained such vague and subjective conditions. These conditions simply are not administrable and therefore do not meet the standards for issuance of an exemption under ERISA § 408(a). If the Department insists on retaining compliance with a non-misleading disclosure condition in the exemption, we suggest instead that the Department explicitly adopt FINRA guidance relating to Rule 2210 regarding the term "misleading."[12] In addition, we ask that the provision be clarified to require only that the financial institution and any adviser acting for the financial institution reasonably believe that the statements are not misleading. Because the failure to comply with a prohibited transaction exemption has such dire consequences, we do not believe that an inadvertent, immaterial statement taken in the wrong way by a client should result in reversal of the transaction, a guarantee of losses and the imposition of an excise tax.

We also question the language purporting to require advisers and financial institutions to prove that advice was given "without regard to the financial *or other interests of* the … Related Entity or *any other party*." We have several concerns with respect to this formulation. First, we believe the requirement that advice be "without regard" for the financial interests of the adviser sets up a standard that an adviser will fail any time a plaintiff can prove that the adviser did not recommend the investment that paid him the least. In guidance regarding the suitability rule, FINRA uses a much more common sense approach that does not contain this flaw: that the adviser provide recommendations that are in the best interest of his client and put his client's interest before his own.[13] We urge the Department to use this formulation.

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[12] *See, e.g.*, FINRA Frequently Asked Questions regarding Rule 2210, *currently available at* www.finra.org/industry/finra-rule-2210-questions-and-answers.

[13] *See, e.g,* FINRA Regulatory Notice 12-25, Q1 at p.3 (May 2012) (citing FINRA rules that adhere to this formulation).

In addition, the proposed exemption in the language quoted above refers to "other interests" of "any other party," with no apparent limitation. We do not know what these "other interests" and "other parties" are intended to address; nor does the preamble explain them. We request that this language be deleted from the definition of "best interests" in the exemption.

The impartial conduct standards also prohibit the adviser, financial institution and their affiliates and related parties from receiving unreasonable compensation "in relation to the total services they provide to the Retirement Investor." This new formulation of reasonable compensation is unexplained. Nor does the Department attempt to justify the differences between this formulation and Congress's view of reasonable compensation, which does not require all compensation received by a financial institution to be justified by a particular set of services to a particular account. We believe that this language is troublesome and we urge the Department to use the language it has used since the enactment of ERISA and as recently as 2012, when it entirely revised its regulations under ERISA § 408(b)(2).[14]

The impartial conduct standards also prohibit misleading statements about the recommended asset, fees, material conflicts of interest and other matters pertinent to the retirement investor's investment decisions. While SIFMA generally agrees that misleading statements about such matters should be prohibited, we do not believe that such statements should be remedied by a prohibited transaction excise tax and rescission of related trades. We also note that the definition of "Material Conflicts of Interest" in Section VIII(h) of the proposed exemption provides no

[14] *See* 29 C.F.R. § 2550.408b-2(d) ("Section 2550.408c-2 of these regulations contains provisions relating to what constitutes reasonable compensation for the provision of services."); 29 C.F.R. § 2550.408c-2(b)(1) ("In general, whether compensation is 'reasonable' under sections 408(b)(2) and (c)(2) depends on the particular facts and circumstances of each case.").

explanation of the term "Material."[15] The proposed definition in Section VIII(h) is so broad that it will be virtually impossible for financial institutions to enumerate every conceivable existing or potential conflict of interest. A materiality standard should be added to the proposed exemption by amending the definition of "Material Conflict of Interest" to state as follows: "A 'Material Conflict of Interest' exists when an Adviser or Financial Institution has a financial interest that, from the perspective of a reasonable person, could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor regarding an Asset."

Warranties

The proposed BIC Exemption requires that the adviser and the financial institution warrant that: (i) they and their affiliates will comply with all applicable federal and state laws regarding investment advice and securities transactions; (ii) the financial institution has adopted written policies and procedures reasonably designed to mitigate the impact of material conflicts of interest and "ensure" that its advisers adhere to the impartial conduct standards; (iii) in formulating its policies and procedures, the financial institution specifically identified material conflicts of interest and has adopted measures to prevent material conflicts from causing violations of the impartial conduct standards; and (iv) the financial institution and its affiliates and related entities do not use "quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives to the extent that they would tend to encourage individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor." Although differential compensation encouraging the adviser to act in a manner that is not in the client's best interest would breach that warranty, differential compensation received by the financial institution itself would be permitted.

[15] The term "Material Conflicts of Interest" appears throughout the proposed exemption, and our comment on that term should be deemed restated each time the term appears. The repeated use of the term makes it even more important that the definition in Section VIII(h) be clarified.

These warranties are extremely troublesome, particularly in light of the resulting exposure to class action litigation. SIFMA requests that the first warranty be modified to warrant that the advisor, the financial institution and their affiliates have adopted policies that are *reasonably designed* to achieve compliance with all applicable law, not that they "will comply" with all applicable law. This is the regulatory standard that FINRA uses, and which the SEC approved.[16] We hope that the Department will recognize that this warranty would be provided in the context of the safeguards established by the SEC and FINRA and not require an absolute, strict liability declaration.

SIFMA also requests clarification regarding the second and third warranties. The Department should make clear that the second warranty requires the financial institution to warrant that it has adopted written policies and procedure that are *reasonably designed* to ensure that its advisers adhere to the impartial conduct standards, not that policies and procedures "ensure" such adherence. Similarly, the third warranty should be modified to warrant that the financial institution has adopted measures that are *reasonably designed to mitigate* material conflicts of interest, not that the financial institution has adopted measures "to prevent" such conflicts from causing violations of the impartial conduct standards. The financial institution cannot possibly adopt measures that will "prevent" material conflicts of interest.

SIFMA urges the Department to eliminate the fourth warranty regarding compensation practices entirely. Contrary to the Department's statement that the BIC Exemption "will broadly permit firms to continue to rely on common fee practices,"[17] we believe that this warranty will require a

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[16] Rule 3110(a) provides that: "Each member shall establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with the applicable securities laws and regulations, and with applicable FINRA rules."

[17] 80 Fed. Reg. at 21961.

substantial, if not a complete, overhaul of broker compensation arrangements. Indeed, as far as we can tell, it will require the elimination of commission-based advice. Although the preamble indicates that the failure to comply with the mandated warranties would not result in a loss of the exemption, any breach of these warranties in the IRA setting, including the warranty regarding compensation policies and procedures, would be actionable under state contract law.[18] Thus, any warranty that differentiated commissions, sales loads, trail commissions,12b-1 fees and other payments from third parties do not "tend to encourage" violations of the best interest standard would expose financial institutions to the risk of class action litigation. To avoid that risk, financial institutions would be forced to eliminate differential and third party compensation arrangements with advisers (including attendance at training or other seminars to which advisers may be invited), as well as any bonus or incentive programs for advisers, in the provision of investment products and services to small plans and IRAs.

The preamble suggests several methods of satisfying the "policies and procedures" warranty, including the use of computer models to generate advice delivered by advisers, asset-based compensation, fee offsets, compensation systems based on the financial institution's determination of what products take more time or effort to sell, and compensation arrangements that are designed to align the interests of the adviser with the interests of the investor. None of these examples would reasonably permit the continuation of commission-based advice. Thus, contrary to what the Department says in the preamble, commission-based advice would be eliminated in brokerage accounts for IRAs, and an important choice for retirement investors about how to pay for advice would be gone.

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[18] *See* 80 Fed. Reg. at 21970 ("Failure to comply with the [policies and procedures] warranty could result in contractual liability for breach of warranty."); *id*. at 21972 ("The Department intends that all the contractual obligations (the Impartial Conduct Standards *and the warranties*) will be actionable by IRA owners.") (emphasis added).

Given their resulting exposure to class actions for breach of warranty, SIFMA believes that its members will either terminate their relationships with smaller plans and IRAs or offer only fee-based compensation arrangements. As the head of FINRA noted quite recently:

> … I have practical concerns with the Labor proposal in a number of areas. First, the warranty and contractual mechanism employed by Labor used to address their limited IRA enforcement jurisdiction, appears to me to be problematic. In one sweeping step, this moves enforcement of these provisions to civil class action lawsuits or arbitrations where the legal focus must be on a contractual interpretation. I am not certain how a judicial arbiter would analyze whether a recommendation was in the best interests of the customer "without regard to the financial or other interests" of the service provider. I'm not sure, but I suspect, a judicial arbiter might draw a sharp line prohibiting most products with higher financial incentives no matter how sound the recommendation might be. Similarly, I'm not sure how a judicial arbiter would evaluate which compensation practices "tend to encourage" violations of the exemption. It would appear likely, however, that firms would be required to demonstrate, at least, that any higher compensation was directly related to the time and expertise necessary to provide advice on the product, as specifically suggested by DOL. To say the least, making that case is not a simple proof standard.
>
> This all leads to my second concern that there is insufficient workable guidance provided either to the firm or the judicial arbiter on how to manage conflicts in most firms' present business models other than moving to pure asset-based fees, or a completely fee-neutral environment...I fear that the uncertainties stemming from contractual analysis and the shortage of useful guidance will lead many firms to close their IRA business entirely or substantially constrain the clients that they will serve. Put another way, the subjective language of the PTE, coupled

> with a shortage of realistic guidance, may lead to few providers of these critical investor services.[19]

We believe that these concerns are well founded. Full and prominent disclosure, brought to the client's attention with some frequency, will do far more to shed light on fee differences, and educate clients regarding these differences, than arbitrarily banning fee differences in a business model that treats agency transaction compensation, principal transaction spreads, mutual fund fees and insurance company commissions differently. It is a not a "principles based" change to require this kind of massive overhaul in the way all brokers are compensated. In 2010, the Department suggested that it wanted a change in the law to make its enforcement program easier. We are very concerned that this exemption has the same aim, but at a huge cost to the financial services industry and those saving for retirement. We strongly urge the Department to reconsider this requirement.

If the Department determines to proceed with this approach, we ask the Department to delay the differential compensation rules for thirty six months. As the Department is well aware, the compensation paid to brokers differs *within asset types* and *across asset types*. It is simply unrealistic to require a change of this magnitude in eight months. Financial professionals with IRA or other plan clients would have to be excluded from firm-wide bonus pools that reflect the profitability of the entire firm, including retirement clients. Financial professionals also would have to be excluded from training programs if such programs are sponsored or supported by a mutual fund complex or similar provider of investment offerings. Changes like this will take years to plan and implement. Financial institutions cannot renegotiate the contractual arrangements with third parties and venders to alter the pay practices of every adviser within the eight month period provided in the proposed exemption. Delaying the differential compensation

[19] http://www.finra.org/newsroom/speeches/052715-remarks-2015-finra-annual-conference

rules by thirty six months should give financial institutions the time to redesign their programs, review all bonus and incentive programs, set new policies and procedures, retrain all necessary compliance, audit and risk teams, and put in new systems to accommodate these rules.

Contract Disclosures

Under the proposed BIC Exemption, the written contract must disclose all material conflicts of interest, and inform the investor of the right to obtain complete information about all fees associated with the assets in which the plan or IRA is invested, including "all of the direct and indirect fees paid [sic] *payable to* the Adviser, Financial Institution, and any Affiliates." (Emphasis added). It must also disclose the existence of proprietary investment products, any fees that the adviser will receive from third parties in connection with the purchase, holding or sale of any asset, and the address of the website required by the exemption. Failure to include any of these disclosures would preclude reliance on the exemption, and advisers and financial institutions will be exposed class action lawsuits challenging the completeness of any such disclosures.

Again, the use of the prohibited transaction framework here is troublesome. For example, many indirect fees cannot be attributed to specific transactions or customers due to the nature of the compensation arrangements utilized by investment providers and do not affect the customer's bottom line. For example, a mutual fund company may agree to pay a broker a flat fee that is unaffected by sales volume. The payment would be made regardless of whether the broker provides services to retirement investors and the payment may be insignificant when attributed to individual investors. Yet the smallest omission would require reversal of the transaction and payment of an excise tax, even where the omission had no effect on the transaction.

We urge the Department to incorporate the materiality standard described above in the definition of "Material Conflicts of Interest." Otherwise, even the most inconsequential omission would require reversal of the transaction and payment of an excise tax and expose advisers and financial institutions to class action litigation. For purposes of assessing the disclosures, we recommend, and assume that the Department intends, that the terms "direct" and "indirect" have the same meanings ascribed to them in the recent amendments to the regulation under ERISA § 408(b)(2).

Prohibited Contract Provisions

As an initial matter, we note that the Department does not have the authority to create a new private right of action, which is what is done with the BIC requirement. Beyond this, SIFMA has concerns with a number of the contractual prohibitions in the BIC Exemption. The Exemption provides that the written contract may not limit the liability of the adviser or the financial institution for violations of the contract, nor may it waive or limit the retirement investor's right to participate in class actions against the adviser and the financial institution. The Department states in the preamble that "[t]he right of a Retirement Investor to bring a class-action claim in court (and the corresponding limitation on fiduciaries' ability to mandate class-action arbitration) is consistent with FINRA's position that its arbitral forum is not the correct venue for class-action claims." The Department also states, however, that "this section would not affect the ability of a Financial Institution or Adviser, and a Retirement Investor, to enter into a pre-dispute binding arbitration agreement with respect to individual contract claims."

We believe that the BIC Exemption should allow advisers and financial institutions to exclude liability for actions and omissions outside of their control. If an adviser recommends a transaction, the investor approves it, but the transaction fails or is cancelled for lack of funding by the client, then the *client* should be responsible for the failure to settle the trade and any compensation received by the adviser should not be at risk under the BIC Exemption. Similarly, the acts or omissions of a third party, such as a custodial error in recording assets or trades, or impossibility due to an occurrence outside the control of the financial institution (a force majeure) should not cause liability on the part of a broker.

We also ask the Department to confirm in any final rule that, consistent with existing law, the contract with the retirement investor may exclude liability for punitive and consequential damages. In addition, we ask the Department to clarify that the contract may require the use of FINRA's securities dispute resolution forum as the venue for arbitrating claims under the contract. Finally, we urge the Department to eliminate the proposed prohibition of provisions waiving the right to bring a class or other representative action in court. The Department has no authority to prohibit such agreements under the Federal Arbitration Act.

Section III: Disclosure Requirements

As a general matter, SIFMA agrees that appropriate cost disclosure may enhance a retirement investor's ability to assess prospective transactions, whether in a plan or in an IRA. However, SIFMA is very disappointed that the Department chose not to rely on the detailed disclosures required by the 2012 amendments to its regulation under ERISA § 408(b)(2).[20] SIFMA's members opposed many of the requirements of that disclosure regime, largely on the ground that the costs of implementing the new requirements would greatly outweigh any benefits to be gained from them. But the entire industry complied with those requirements just three years ago. Now, after SIFMA's members have spent millions of dollars building the systems necessary to implement that disclosure regime, the Department is proposing to require a new disclosure framework, different from the first, which would be far more costly to design and implement.

Rather than continue down this path, SIFMA suggests that the Department incorporate the fee disclosure requirements of 29 C.F.R. § 2550.408b-2(c) into the BIC Exemption. Following

[20] *See* Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure, 77 Fed. Reg. 6632 (Feb. 3, 2012).

adoption, the Department could take the appropriate time to judge whether those disclosures provide plan fiduciaries, participants and IRA owners with sufficient information to assess conflicts of interest, and then determine based on actual experience with those disclosures whether it is still necessary to mandate the additional disclosures set forth in the proposal. This would allow SIFMA's members to rely on the systems already in place to make disclosures to IRA owners. With this approach the Department should make clear that it is permissible for financial institutions that are operating under the Advisers Act (*e.g.*, when recommending discretionary investment management services or advice programs as discussed above) to include the 408b-2 disclosures in their Form ADV disclosure brochures, as this will be more manageable for both advisers and their clients.

SIFMA offers the following additional comments with respect to the disclosure requirements of Section III of the proposed BIC Exemption:

Cost Disclosure at Time of Purchase

Under the proposed BIC Exemption, whenever an adviser executes a purchase of an asset for a retirement investor, the investor must be given a chart showing the "total cost" of the acquired asset over periods of one, five, and ten years. "Total cost" includes the acquisition cost (*e.g.*, loads, commissions, mark-ups on assets bought from dealers, and account opening fees), ongoing fees and expenses of pooled investment funds (*e.g.*, annualized mutual fund expenses), and costs of disposition (*e.g.*, surrender fees and back-end loads). The Department states that its proposal is designed to direct attention to fee information "in a time frame that would enable the Retirement Investor to discuss other (possibly less costly) alternatives with the Adviser prior to executing the transaction" and invites comment on all aspects of the provision of data both at the time of the transaction and annually.

We believe that this chart is unworkable. Providing an investment's "total cost" over one, five and ten year periods will require return assumptions, which no financial professional will be prepared to speculate about. The SEC and FINRA have for years taken the position that projected return information is unreliable and misleading to investors. Indeed, a communication to a retirement investor that purports to predict or project performance would violate FINRA Rule 2210(d)(1)(F). The Department lacks any special expertise in this area and should not attempt to override the judgment of the agencies that have that expertise,

We firmly believe that this disclosure requirement should be eliminated. Differing assumptions across firms to calculate future performance of products could mislead retirement investors. Forward-looking cost estimates, based on future performance speculation, is simply unsubstantiated speculation. Will the 1-, 5- and 10-year data be deemed to satisfy the requirement if they are calculated using FINRA rules? To the extent that an investment is not subject to FINRA's oversight (*e.g.*, GIPS standards or state insurance regulations), what assumptions would advisers be required to make in order to comply? Do the 1, 5 and 10 year calculations apply to stocks and bonds and bank deposits, and if so, how? No financial professional could operationalize these requirements and they should be dropped.

The chart would also slow trading to the disadvantage of retirement investors alone. While the financial professional creates the chart, provides it by mail or electronically, and waits for the retirement investor to see and approve it, the market moves, pricing changes, and valuable opportunities are lost. By focusing on cost to the exclusion of other investment characteristics such as historical performance, the chart also provides a distorted picture of the relative merits of a particular investment. In short, we believe that the chart envisioned by the Department would help no one, and at worst, would seriously undermine the financial institution's duty of best execution.

Practical issues surrounding the timing and mode of delivery of this chart provide yet another reason why it should be eliminated. How long would the adviser have to wait after mailing, emailing or other means of delivery to the investor before the adviser could reasonably assume the investor has reviewed the information? If the disclosure is provided in a compliant form, will the investor be precluded from later claiming that the adviser failed to explain the information sufficiently or that the investor did not find the disclosure to be adequate to assess a course of action? In all cases, an investor must instruct the adviser to make a trade only after having the full disclosure in hand. Will the adviser be required to furnish the disclosure, even if by postal mail, before the transaction can be placed? If so, the disclosure requirement might actually impede best execution or affect the advisability of the particular transaction.

Furthermore, many substantive elements of the disclosure make no sense given the narrow definition of permissible "Assets." We are confused by the reference to mark-ups in the costs of acquisition. Mark-ups are charged only on principal transactions, which are not covered by the exemption. Even if a fixed income security is sold on an agency basis, the adviser would have no way of knowing what the mark-up is, since it is charged by an unrelated dealer that has no legal duty to disclose the mark-up. If mark-up includes spread revenue on annuities, then the proposed disclosure requirement is inconsistent with the disclosures required by 29 C.F.R. § 2550.404a-5. The reference to account opening fees is also puzzling. Accounts do not seem to be covered as an Asset. What is contemplated by the required disclosure of mark-downs on assets sold to dealers? That information will not be available to the financial professional or the financial institution; if required, the third party dealer will not engage in the trade.

Various types of accounts impose fees at the time of opening, and some may have fees if the account is materially changed – such as transitioning an account from a pure investment vehicle to an annuitized account without liquidating any investments. Unless the definition of "Asset" under the BIC Exemption is revised to include a rollover account, the fees associated with opening a rollover account are not costs of acquiring an "Asset." More importantly, while we recognize that the Department's goal is to provide the investor with a sound basis to assess costs, we do not believe that including this type of account fee in the disclosure makes sense in the overall context of the regulation. Similarly, fees imposed to close an account do not have a connection to any "Asset." In our view, these disclosure items need to be rethought and better tailored to reflect the narrow list of assets permitted under this exemption.

Annual Fee and Compensation Disclosure

Under the BIC Exemption, within 45 days after the end of each year, the adviser must give the retirement investor a list of each asset purchased, sold, or held for his account during the preceding year, as well as a statement of all fees and expenses paid by the investor, directly or indirectly, during the year with respect to each asset. A statement of the total compensation received by the adviser and financial institution directly or indirectly from any party, as a result of each asset purchased, sold or held for the investor's account during the year also must be included.

We believe that this requirement should be eliminated. Requiring annual disclosure of all fees and expenses paid by the investor during the year would be duplicative of disclosures made at the time of sale (*e.g.*, through prospectuses and trade confirmations) and would only impose unnecessary costs on financial institutions that would ultimately be passed on to retirement investors. It would also be extremely difficult for advisers and financial institutions to identify all of the indirect compensation that they may receive. As stated previously, many indirect fees cannot be attributed to specific transactions or customers due to the nature of the compensation arrangements utilized by investment providers. By the same token, the amount of any indirect compensation attributable to a specific transaction or customer may be insignificant, and the failure to disclose even an immaterial amount of indirect compensation could result in a complete loss of the exemption.

If the Department insists on retaining this annual disclosure requirement, it should be expressly limited to assets *for which investment advice was provided* during the preceding year. We assume that is the Department's intent, and request that the Department make that limitation clear. We also respectfully request that the timing of the annual disclosure be revised to match the timing requirements for the annual Form 5500. We do not believe any meaningful purpose is served by requiring the disclosure within forty-five days after each year end. Further, our members believe that this time frame is not reasonable and should, at the very least, be extended to ninety days. Also, for fees and expenses paid by the investor, estimates should permitted, as they are in the Department's current regulation under ERISA § 408(b)(2) – for example, fees for pooled investment vehicles are estimated based on the average annual fee rates of those vehicles. The Department should also permit estimates for indirect compensation and require only that material amounts be disclosed.

Web Disclosure

The BIC Exemption requires the financial institution to maintain a web page that lists all "direct or indirect material compensation" payable to the adviser for services in connection with each asset (or, if uniform across a class of assets, the class of assets) that an investor is able to purchase, hold or sell through the adviser and that has been purchased, held or sold in the last 365 days, along with the source of the compensation and how it varies within and among assets. The information also must be accessible in a machine readable format. This presumably requires the detailing of every insurance company separate account, every collective trust by unit class, every mutual fund by share class, every annuity contract and every GIC.

SIFMA views the web page disclosure requirement as overly broad, very impractical, and extremely costly and cumbersome to build, administer and maintain. SIFMA's members have had the experience of modeling disclosure for plans and participants in the last five years. They do not believe that such an undertaking would achieve the Department's stated goal of providing "a broad base of information about the various pricing and compensation structures adopted by Financial Institutions and Advisers."[21] In addition, although the Department states that a related goal is to provide information that enables "financial information companies" to analyze and compare fee and compensation practices of advisers and financial institutions, this is a massive undertaking, requiring daily review for product and fee changes, and would cost millions of dollars for every single financial institution. We simply do not see how establishing a publicly available web page would serve the interests of the public and it certainly could not be cost justified. Even if the Department's goal is to condense information that would then be aggregated and disseminated by "financial service companies," the varying degrees of payments that could be attributed across the many types of institutions would be meaningless. In addition to these steep challenges, the information would not have any use for members of the public, even for participants of plans that invest in privately managed accounts.

We urge the Department to abandon the proposed web page disclosure requirement as a condition for relief under the BIC Exemption. This requirement, coming so close on the heels of the massive section 408(b)(2) project, is simply impossible to justify. On its own, it will result in brokers refusing to use the exemption, which in turn will result in more leakage of retirement savings from tax-advantaged accounts and widespread confusion on the part of retirement investors, neither of which is in their interest.

Section IV: Range of Investment Options

Under the BIC Exemption, the financial institution must offer and the adviser must make available a range of assets that is broad enough for the adviser to make recommendations with respect to every asset class necessary to serve the retirement investor's best interests. The

[21] 80 Fed. Reg. at 21973.

exemption permits the financial institution to offer only proprietary products, only those that generate third party fees or only those of a particular asset class or product type, if it makes a written finding that the limitations do not prevent the adviser from providing advice that is in the investor's best interest, if the compensation received for the services provided to the investor is reasonable, and if the investor is given written notice of the limitations placed on assets that may be offered to the investor. The adviser must notify the investor if the adviser does not in fact recommend a sufficiently broad range of assets to meet the investor's needs.

The precise language in Section IV(a) of the exemption states that the financial institution and adviser must offer "a range of Assets that is broad enough to enable the Adviser to make recommendations with respect to all of the asset classes reasonably necessary to serve the Best Interests of the Retirement Investor in light of its investment objectives, risk tolerance, and specific financial circumstances." The Department should make clear that the term "asset classes" refers to the broad categories of equity, debt and cash instruments, rather than subcategories or other classifications that are less easily categorized. Any other intended meaning would be unworkable and lead to confusion.

The Department's use of the phrase "range of Assets" in Section IV(a) is also confusing. Could a financial institution that offers only mutual funds have a "range of Assets" that is broad enough to satisfy the requirements of Section IV(a)? What about a financial institution that offers bank deposits, CDs and money market funds? How would the requirement of a "broad enough" array of "Assets" apply in cases where a financial institution specializes in a limited range of asset classes? Could a specialist in fixed income satisfy the broad "range of Assets" requirement of Section IV(a) if the specialist recommends a broad range of corporate bonds, agency debt and U.S. Treasury securities that meet the definition of an "Asset" under the BIC Exemption, or would the specialist have to advise on an entire range of asset classes? Could such a fixed income specialist satisfy the broad "range of Assets" requirement in Section IV(a) with respect to some retirement investors but not others? The Department acknowledges that some firms "specialize in particular asset classes or product types" and suggests that such firms may still be able to use the exemption;[22] however, it is unclear how the "range of Assets" requirement could be satisfied outside the context of mutual funds. We urge the Department to limit this requirement to recommendations to purchase, hold or sell mutual funds.

Section IV(b) focuses on financial firms that exclusively offer specialized and/or proprietary products, which may or may not cross an array of asset classes. Many of the above questions about Section IV(a) reflect confusion about the interplay between Sections IV(a) and (b). We believe that Section IV(b)'s "Section (a) notwithstanding" language should be clarified to delineate the scope of the general rule and the exceptions and conditions.

We are also unclear about how the conditions of Section IV(b) would be applied in operation. The conditions of Section IV(b) specify that the firm and adviser must satisfy the best interest, impartial conduct and reasonable compensation standards contemplated by the proposal and notify the retirement investor of the limitations placed on the Assets offered to the investor. These requirements of Section IV(b) raise a number of questions.

- To the extent that a financial institution offers a limited range of investment options, does Section IV(b)(1) require the financial institution to make a separate written finding for each retirement investor that the limitations on Assets available for purchase do not prevent the advisor from acting in the best interest of the retirement investor or otherwise adhering to the impartial conduct standards? Can this requirement be satisfied by a written finding that applies to all of the financial institution's retirement investor clients?

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[22] *See* 80 Fed. Reg. at 21975.

- How would the adviser address questions from a client in a case where Section IV(b)(4) requires the adviser to provide notice that it is not recommending a sufficiently broad range of investment options to meet that client's needs? For example, assume a financial institution's business model is to sell only funds with agreements for compensation, and it and the adviser make the finding required under (b)(1). Further narrowing the range of investments, the individual adviser advises only on bond funds regardless of whether other advisers may recommend a broader range. Does Section IV(b)(4) require the adviser to provide the investor with a notice stating literally that "the Adviser does not recommend a sufficiently broad range of Assets to meet the Retirement Investor's needs"? Section IV(b)(4) should be revised to make clear that the notice can be phrased in less pejorative terms that are more tailored to fit the circumstances – *e.g.*, "Please understand that the adviser provides recommendations only on bond funds and that the adviser's recommendations are not intended to encompass the entire range of assets that might be necessary to meet your needs."

In addition to the questions noted above, it is unclear whether the notice required by Sections IV(b)(3) must be repeated every time a recommendation is made, updated or changed. Similarly, under what circumstances would a change in the limitations on Assets offered to retirement investors render a notice provided under IV(b)(3) insufficiently specific? For example, what if the financial institution changes the amount or percentage of revenue sharing it expects to receive? Would it be sufficient in all such cases to state in a notice that the firm expects to receive payment from the investment providers whose products are being offered, or is more specific disclosure required as to the relative amounts of such compensation?

The requirements of Section IV(b)(1), (3) and (4) are vague and confusing. We urge the Department to eliminate these sections, or repropose them with more clarity and objective requirements. Failure to meet this exemption requires reversal of the transactions done under it, and payment of a significant excise tax. It is quite unfair to impose a vague, internally inconsistent, and ill-defined requirement with these severe penalties.

Finally, we request that Section IV(b)(2) be deleted. That condition requires that any compensation be "reasonable in relation to the value of the specific services provided to the Retirement Investor in exchange for the payments and not in excess of the services' fair market value." Because the impartial conduct standards already prohibit the receipt of compensation in excess of what is reasonable, Section IV(b)(2) should be unnecessary.

To the extent that Section IV(b)(2) purports to establish a different standard of "reasonable compensation," we believe that it is too prescriptive and narrow to be workable. A standard requiring that compensation be no more than "fair market value" for the specific services provided to plan investors and individual investors alike would be extremely difficult to apply. How would a financial institution prove reasonableness in relation to the specific services provided to the retirement investor if the firm has only omnibus expenses that are based on services and profitability across a large retirement plan book of business? Would it be reasonable to allow an adviser to recommend one mutual fund over another where the adviser knows that the recommended fund's investment manager pays the adviser's firm more than another fund manager? Would the firm be prepared to show that the adviser's only economic benefit would be greater fees paid to his firm, or would the firm be better advised to recommend only funds with the lowest third party payments? Third party fees vary widely. If a financial institution accepts a low fee from one fund, would all other fund fees in excess of that level be unreasonable on the ground that the benefit to the firm is indirectly compensating the individual adviser?

In short, the "reasonable compensation" standard articulated in Section IV(b)(2) is unreasonable, and appears to be drafted as an impossibility: unless a financial professional can trace every dollar to a particular service to a particular account in connection with a particular transaction and demonstrate that others charge the same way, he is destined to fail. We suggest that this has never been the law, nor even the Department's position with respect to the reasonable compensation requirements of the statutory exemption for services.

Sections V and IX: Disclosure to the Department, Recordkeeping and Data Requests

Section IX of the BIC Exemption requires financial institutions to maintain information at the financial institution level by quarter, concerning investment inflows, outflows and holdings for each asset purchased, sold or held under the exemption, including: the identity and quantity of each asset purchased, held or sold; the aggregate dollar amount invested or received and the cost to the investor for each asset purchased or sold; the cost incurred by the investor for each asset held; all revenue received by the financial institution or its affiliate in connection with the purchase, holding or sale of each asset, disaggregated by source; the identify of each revenue source and the reason for the payment. In addition, financial institutions must maintain information at the investor level concerning the identity of the adviser, the beginning- and end-of-quarter value of each investor's portfolio, and each external cash flow to or from the investor's portfolio during the quarter.

Section V(b) of the BIC Exemption further requires that this data be maintained for a period of six years from the date of the transaction for which relief is sought under the exemption and that it be made available to the Department upon request *within six months from the date of the request*. In addition, Section V(c) requires the financial institution to maintain for a period of six years records demonstrating that the conditions of the exemption have been satisfied. Such records must be made available to the Department, the Internal Revenue Service (IRS), any retirement investor and any contributing employer or employee organization whose members are covered by a plan that engaged in a transaction under the exemption.

The preamble states that the purpose of the Section V(b) data request requirement is to "assist the

Department in evaluating the effectiveness of the exemption." The effect of that requirement, however, would be to invalidate past and future compensation covered under the exemption if the Department's data request cannot be met within the six month period. Creating a system that would be able to respond to such a data request will be extremely costly and time consuming. The cost implications of these data request requirements are described in greater detail in the Deloitte report submitted with this comment letter. We do not believe that these costs are justified by the benefit the Department suggests would be obtained. We urge the Department to eliminate the data request requirements of Sections V(b) and IX entirely.

If the Department decides to move forward with the data request requirements of Sections V(b) and IX, it should extend the effective date of these requirements by at least thirty-six months to give the industry adequate time to develop the systems necessary to capture the data and perform the calculations contemplated by the requirements. We also ask the Department to eliminate the Section IX(e) public disclosure provision. We believe it is entirely inappropriate to disclose portfolio return information alongside the identity of the individual advisor in a public filing. It appears that the entire purpose of this disclosure is to embarrass or otherwise call out advisors whose clients have lower returns, regardless of whether the clients' returns are determined by their own choice of strategies, and not by their advisor's skill or expertise. It is a blunt instrument, without any differentiation between asset classes, age or risk tolerance of the investor, or any other parameter that would actually be relevant to a comparison.

In addition, we ask that the data request requirement in Section V(b) be modified to parallel the exception in the proposed recordkeeping requirement of Section V(c) for records that are lost or destroyed due to circumstances beyond the control of the financial institution. We also request clarification that, to the extent a financial institution cannot rely on the exemption due to a failure to maintain or provide information that complies with a data request under Section V(b), that the inability to rely on the exemption will apply only prospectively from the date the BIC Exemption becomes unavailable to that institution, and that there will be no retroactive consequences.

In contrast, we believe that the comprehensive disclosure framework administered by the SEC and FINRA is far more targeted and nuanced in an appropriate manner. Particularly in light of the privacy risks highlighted by the widely-publicized hacking of confidential personal information concerning millions of federal employees, we believe that sensitive information about individual investors should either be excluded from the data request requirements of Sections V(b) and IX, or at the very least subject to a right on the part of the investor to "opt out" of having their sensitive financial information scrutinized, or even inadvertently disclosed, by federal regulators. At the very least, we believe this section should require all retirement investors to be warned that every transaction they engage in will be reported to the federal government.

Section VII: Exemption for Pre-Existing Transactions

The supplemental relief for pre-existing transactions would provide relief from the prohibitions of ERISA §§ 406(a)(1)(D) and 406(b) and Code §§ 4975(c)(1)(D), (E) and (F) for the receipt by advisers of prohibited compensation in connection with transactions that were entered into prior to the applicability date of the proposed regulation. The supplemental relief for pre-existing transactions applies to the receipt of compensation for services in connection with the purchase, holding or sale of an "Asset" by IRAs, participant accounts and *all* ERISA plans, regardless of size and whether or not the plan is participant-directed. The supplemental relief would cover advisers who did not consider themselves fiduciaries prior to the applicability date, as well as advisers who considered themselves fiduciaries but relied on an exemption that has since been amended. The proposed conditions for supplemental relief would require that the compensation be received under an arrangement that was entered into prior to the applicability date. The proposed conditions also would require that the adviser not provide any "additional advice" regarding the purchase, holding or sale of the asset after the applicability date. The proposed conditions would also exclude transition relief for any compensation received in connection with a purchase or sale that was a non-exempt prohibited transaction when it occurred.

SIFMA does not believe that it would be in the best interests of retirement investors to deny transition relief for advice to hold or sell or otherwise dispose of assets already held in such accounts. Not providing advice to a retirement investor on assets that the advisor previously recommended will only confuse the investor. Advisers should be able to continue to receive compensation for any asset in the retirement investor's account prior to the effective date of the rule as long as the adviser does in fact continue to give advice to the investor. That is a common sense approach and is in the retirement investor's best interest.

We also would ask that any acquisitions or dispositions that are effected after the applicability date of the regulation pursuant to any standing or automatic investment instructions effected before the applicability date (*e.g.*, investment instructions to rebalance back to the original investment allocation) be afforded protection under the BIC Exemption. These modifications would allow investors and advisers to continue on previously agreed courses of action, with the relief to end immediately upon any new recommendation or transaction that otherwise would trigger the contractual and other requirements of the BIC Exemption.

We believe that investors are best served by transition guidance that enables them to dispose of assets that they or their advisers no longer wish to own. The adoption of a new set of rules should not make it more cumbersome to advise, recommend or process an order to liquidate a pre-existing position, particularly given the time it will undoubtedly take to bring pre-existing accounts into compliance with the new rules. Rather, the disposition of a pre-existing position for cash should be grandfathered under existing rules, although any recommendation to re-invest that cash would, appropriately, be subject to the new fiduciary definition. Any other approach would be, at best, confusing to explain and apply, and at worst, inhibit communications between advisers and clients about poorly performing assets. In the event there is no relief for advice regarding pre-existing holdings, however, we recommend that prohibited transaction relief for such advice be conditioned only on compliance with the "best interests" standard proposed by FINRA. In this way, firms will be able to limit sales or other dispositions of assets that may generate extra compensation for the adviser, such as a back-end load or surrender charge.

We believe that it is equally important to extend transition relief to acquisitions of investments that are part of an automatic savings and investment program. For example, if a plan participant elects automatic salary deferrals into the plan after receiving advice from an adviser prior to the applicability date, we do not believe it serves the interests of anyone involved to require that such advice be revisited and, most likely, given again subject to the fiduciary standard, with or without the BIC Exemption. It would create an enormous burden for financial firms, and it is difficult to understand how it would benefit the participant. If, of course, the adviser recommends any increase in the investment amount, or changes the recommended asset mix after the applicability date, the new fiduciary framework would apply. Similarly, standing asset allocation (and rebalancing) instructions and automatic dividend reinvestment should not be an inadvertent compliance trap, so long as it is not changed or advised to be changed. Mutual fund and annuity "dollar-cost averaging," where an individual purchases a highly liquid interest, usually a money market fund, and has the money fund account automatically fund other investments at pre-set intervals, also should be unaffected if the dollar-cost averaging advice and investment program were set before the applicability date.

SIFMA is also concerned that the narrow definition of the term "Asset" could have serious adverse consequences if the exemption for pre-existing transactions is adopted in its proposed form. As we understand the proposed transition relief in Section VII, if a pre-existing holding is not an "Asset" within the meaning of the BIC Exemption, Section VII will provide no relief for any compensation received with respect to that holding going forward, and Section I likewise will provide no relief for any advice or recommendations with respect to that holding going forward. Denying transition relief for compensation received with respect to pre-existing holdings that are not "Assets" not only defeats legitimate expectations of the contracting parties, but will create a huge compliance burden from the instant the rules become applicable. Advisers and financial institutions will have to determine promptly which pre-existing accounts hold investments that meet the definition of an "Asset," which hold investments that do not meet that definition, and which hold both types of investments. For any pre-existing accounts that hold investments that are *not* "Assets," advisers and financial institutions will have to immediately suspend the receipt of any compensation attributable to such assets and cease to provide any advice or recommendations with respect to such non-"Assets" going forward. For accounts that hold both "Assets" and non-"Assets," segregating any ongoing compensation associated with "Assets" covered by the transition rule will present its own technical challenges, and advisers and financial institutions may have no choice from a compliance perspective but to split the "Assets" and non-"Assets" into separate accounts. Such splitting into separate accounts would not only increase recordkeeping and other costs, but also make it more difficult for the account owner to monitor his accounts with the financial institution.

Furthermore, because of the time it would take to identify every account holding non-"Assets," advisers and financial institutions may have to place all of their retirement accounts into a "no advice" category until all of these issues can be sorted out. The process of identifying all pre-existing account holdings that are not "Assets" will be extremely costly and time consuming, and the account owners themselves are likely to be bewildered and upset by the entire experience. We do not believe this is workable and we urge the Department to broaden the scope of transition relief.

The transition relief also suffers from the concerns we have previously raised regarding multiple accounts, such as an IRA and a non-retirement account, and the limited scope of the "Asset" definition. We will not reiterate all of those concerns in this section of our comments, but we wish to point out that, apart from the fiduciary requirements and proposed exemptions, there is no history in account construction or composition that differentiated among assets as the Department now proposes. Therefore, while the issues we raised above certainly apply in the context of future accounts, assets and recommended transactions, the complications are multiplied where financial firms are maintaining multiple pre-existing accounts for clients. It will be next to impossible to succinctly explain to clients or advisers how the rule regarding "Assets" is to be applied, particularly with long-standing investment accounts.

The Request for Comment on a Low Fee Streamlined Exemption

The preamble to the proposed exemption seeks comments on whether the Department should issue a separate class exemption, with fewer conditions, for advice concerning low-fee index funds. Examples mentioned in the preamble are "a long-term recommendation to buy and hold a low-priced (often passively managed) target date fund that is consistent with the investor's future risk appetite trajectory" and "a medium-term recommendation to buy and hold (for 5 or perhaps 10 years) an inexpensive, risk-matched balanced fund or combination of funds, and afterward to review the investor's circumstances and formulate a new recommendation."

This contemplated exemption appears, similar to the "Asset" definition, to indicate a policy preference by the Department for passively managed target date funds. Neither ERISA nor the Code authorizes the Department to implement such policy changes. Further, we disagree with this approach because there is no good evidence that passively managed investments are "safer" than actively managed investments. An investment in an S&P 500 index fund reflects an affirmative decision to invest in large U.S. equities (and incidental futures used to smooth rebalancing transactions, or large inflows and outflows). The fund's investment strategy is quite simple to explain, but its underlying assets are subject to all of the market volatility and to some extent sector volatility that underlie all equity investing. We do not believe that any element of such vehicles, in and of itself, lends itself to a different fiduciary analysis, and we reiterate our view that the Department's desire to simplify the investment advice for retirement investors should not result in the Department lending favored status to any particular investment type. We recommend even-handed treatment of investments in the BIC Exemption and in the fiduciary regulation overall absent specific features that demand special precautions.

Section VIII: Definitions

Many of SIFMA's questions and comments regarding the proposed definitions in the BIC Exemption are addressed as they arise in the proposal itself. What follows is a list of additional comments and questions concerning the definitions, not specific to any particular functional part of the exemption.

Adviser – Under the proposed fiduciary regulation, there is no carve out for call centers or their personnel. SIFMA has separately commented on that proposal. For purposes of the BIC Exemption, call center employees may be compensated in a way that puts them in a position that requires relief. However, to meet the definition of an "Advisor" under Section VIII(a) of the BIC Exemption, call center employees would have to "[s]atisfy the applicable federal and state regulatory and licensing requirements of insurance, banking, and securities laws with respect to the transaction." We are concerned that this language may require call center employees to register with the SEC as "advisers" under the Investment Advisers Act of 1940 ("Advisers Act"). Unless the Department decides to include a specific carve out in the fiduciary regulation for call centers, we urge the Department to clarify that call center employees do not have to register as "advisers" under the Advisers Act to qualify for relief under the BIC Exemption.

The Department, in the proposed fiduciary regulation, has cited its extensive coordination with securities regulators. We are hopeful that the SEC and the Department are aligned on the "Adviser" definition, and that invoking the relief provided by the BIC Exemption will not, by itself, trigger a separate registration requirement with the SEC under the Advisers Act to the extent there was no other need to register under that statutory framework.

Affiliate – We urge the Department to revise this definition to provide greater consistency with the federal securities laws, particularly with respect to the individuals covered in paragraph VIII(b)(2). The ERISA and Code definitions cited in that section will introduce an additional compliance hurdle to the extent those definitions do not align with the common definitions applied in the securities law context.[23] We recommend using the existing framework of broker-dealers' compliance programs, which are predicated not only on an "affiliate" definition but also on an "associated person" definition.

Best Interest – The proposed best interest standard requires advisers and financial institutions to prove that their recommendation was made "without regard to the financial *or other interests* of the Adviser, Financial Institution or any Affiliate, Related Entity *or other party*." We recommend that this clause be replaced with the phrase "and place the interests of the Retirement Investor ahead of their own." At a minimum, for the reasons explained in our comments on the impartial conduct standards, we urge the Department to delete the phrases "other interests" and "or other party" from the current formulation of the standard.

Financial Institution – Section VIII(e)(2) defines the term "Financial Institution" to include a bank or similar financial institution supervised by the United States or a state, or a savings association, "but only if the advice resulting in the compensation is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by federal or state banking authorities." We see no reason to

[23] Rule 12b-2 under the Securities Exchange Act of 1934 defines "Affiliate" as a "person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." That Rule contains a separate definition for an "associate": "(1) any corporation or organization ...of which [a] person is an officer or partner or is, directly or indirectly, the beneficial owner of 10 percent or more of any class of equity securities, (2) any trust ..., and (3) any relative or spouse of such person, or any relative of such spouse, who has the same home as such person or who is a director or officer of the registrant or any of its parents or subsidiaries."

limit this definition to advice provided through a bank's trust department. Advice to IRA owners may emanate from any department of a bank and all areas are subject to federal or state supervision.[24] Accordingly, we request that the entire "but only if" clause be dropped.

Independent – As written, the definition of "independent" would disqualify any company that provides services to the financial institution, such as its accounting firm, lawyers, cleaning services, food services, security services, parking services, window washing services, etc. To the extent any of those companies sponsors a plan, the plan sponsor would not be "independent," regardless of how small the amount of income received from the financial institution. Historically, the Department has recognized this fact in virtually every exemption it has granted and we assume its failure to do so here was inadvertent. Accordingly, we suggest that subsection (2) of the definition of "independent" in Section VIII(f) should be replaced with the following: "Receives less than 5% of its gross income from the Adviser, Financial Institution or Affiliate." In addition, subsection (3) should be revised to make clear that an IRA owner will not be deemed to fail the independence requirement simply because he or she is an employee of the financial institution.

Individual Retirement Account – We believe that health savings accounts (HSAs) should not be included in the definition. HSAs by their terms are not intended for retirement income but rather health care expenses. To be clear, we argue the same is true for other tax favored savings vehicles that are not intended to provide retirement security, such as college or other educational savings accounts that may be offered through broker-dealers.

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[24] The bank regulators at the federal level include the Office of the Comptroller of the Currency, the Consumer Financial Protection Board and the Securities and Exchange Commission.

Material Conflict of Interest – This definition should be revised to incorporate the standard of materiality described above in our comments concerning the impartial conduct standards. Without more, the Department's proposed definition could be interpreted to cover even the most remote financial interest that could possibly affect one's best judgment, regardless of whether the effect of the financial interest would be material.

Proprietary Product – Section VIII(j) defines a "proprietary product" as one that is "managed by" the financial institution or any of its affiliates. However, investment products are generally considered "proprietary" to a firm when they are issued or sponsored by the firm or an affiliate. We recommend a definition more in line with these concepts and believe that the term "managed by" is not a meaningful indicator of "proprietary" status.

SIFMA and its members appreciate the opportunity to comment and look forward to meeting with the Department to discuss our concerns. For further discussion, please contact the undersigned at 202-962-7329.

Sincerely,

Lisa J. Bleier

Lisa J. Bleier
Managing Director, Federal Government Relations
and Associate General Counsel

APPENDIX IV

Comment on the Department of Labor Proposal and Regulatory Impact Analysis

Comment on the Department of Labor Proposal and Regulatory Impact Analysis

July 17, 2015

Executive Summary

NERA Economic Consulting has been retained by SIFMA to review and comment on the U.S. Department of Labor's ("DOL") proposed conflict of interest rule and definition of the term "fiduciary" under ERISA (the "proposal"), and associated Regulatory Impact Analysis ("RIA"). The estimates in the above documents form the basis of the Department of Labor's argument that the proposed conflict of interest rule would provide a net "benefit" to the public.

To study these costs associated with the DOL proposal, NERA also collected account-level data from a number of financial institutions in order to construct a representative sample of retirement accounts. Our dataset includes tens of thousands of IRA accounts, observed over a period from 2012 through the first quarter of 2015.

Briefly, our findings are as follows:

- The DOL proposal may effectively make the commission-based brokerage model unworkable for investment accounts covered by ERISA due to the operational complexity and costs of compliance that would be required under the Best Interest Contract Exemption. Using our account-level data, we find that:
    - Some commission-based accounts would become significantly more expensive when converted to a fee-based account under the DOL proposal.
    - Investors can and do select the fee model (commission vs. fee) that best suits their own needs and trading behavior.
    - A large number of accounts do not meet the minimum account balance to qualify for an advisory account.

- There is no evidence that commission-based accounts underperform fee-based accounts.

- In 2011, the DOL estimated that consumers who invest without professional advice make investment errors that collectively cost them $114 billion per year. Applying the DOL's own logic to the present proposal, combined with the likelihood that a large number of investors will lose access to advice, will result in aggregate costs that may exceed the DOL's own estimates of the benefits of the proposal.

- The RIA produces many different numbers representing different underlying assumptions, resulting in industry cost estimates that vary wildly from about $2 bil./year to $50 bil./year. The range of numbers is so wide it suggests no scientific confidence in their own methodology.

- The academic research cited in the RIA is misapplied.

  - While the academic literature focuses on mutual funds, it is applied more widely to other assets such as variable annuities in order to come up with the asset base of $1.7 trillion in retirement assets.

  - The most frequently cited paper in the RIA takes results from a statistical analysis on certain types of funds and misapplies those results to all funds. This likely exaggerates the importance of the findings cited by the DOL.

  - The academic literature cited in the RIA does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts. Therefore, any findings based on this research are inappropriate as a basis for the DOL proposal.

- Overall the DOL's misapplied use of the academic literature and erroneous conclusions on investor behaviors render their regulatory impact analysis unreliable and incomplete.

Contents

I. COSTS OF IMPEDING THE COMMISSION-BASED INVESTMENT MODEL

The Department of Labor's ("DOL") proposed conflict of interest rule and definition of the term "fiduciary" under ERISA (the "proposal"), and associated Regulatory Impact Analysis ("RIA")[1,2] have led many to conclude that the proposal would effectively make the commission-based brokerage model unworkable for investment accounts covered by ERISA and similar sections of the IRS code due to the operational complexity and costs of compliance that would be required under the Best Interest Contract exemption. In this section, we use account-level data to pursue the question of how this result would affect existing holders of commission-based accounts.

There are at least two immediate consequences to the proposed rule change. The first is that some commission-based accounts would become more expensive, in the sense that average fees would increase, particularly for investors who trade infrequently. Second, advisory or "fee-based" accounts currently have minimum balance requirements. These account balance requirements are in place to ensure that the firm serving the client can at least break even on the operating costs associated with administering advisory accounts. Using account-level data, we can estimate the percentage of consumers currently in commission-based accounts who would not meet the minimum account balance requirements and therefore lose access to professional investment advice under the DOL proposal.

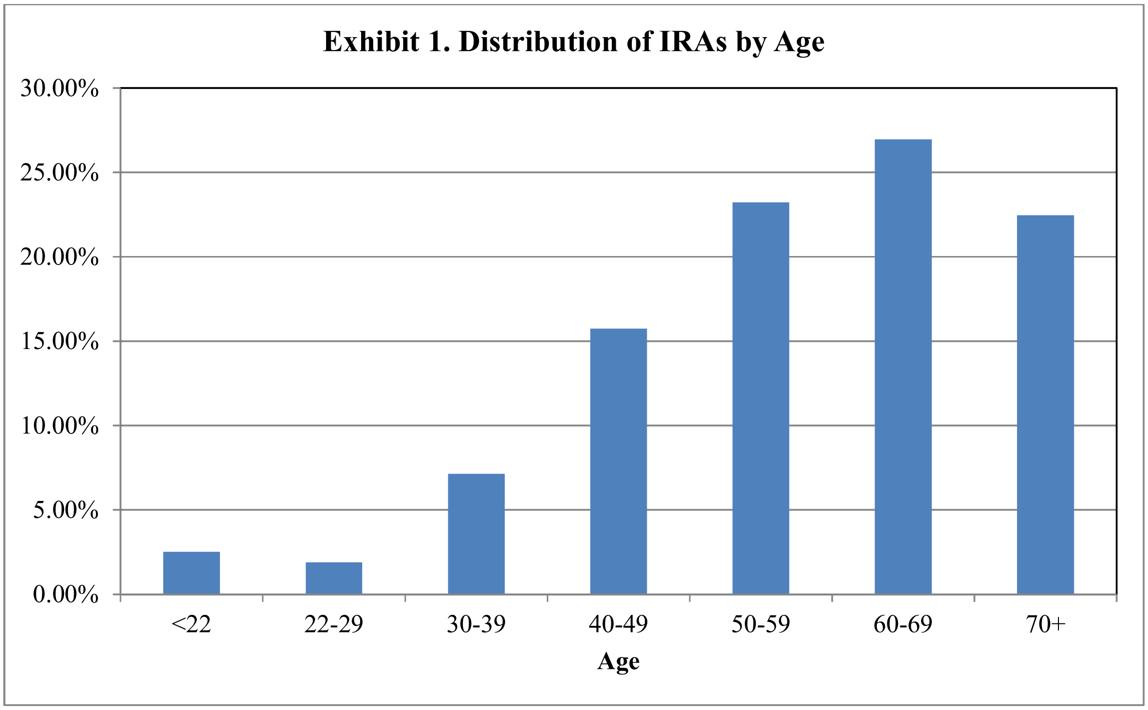
We begin with a discussion and summary of the account-level data that NERA has collected for this study.

A. Summary of Data

The RIA itself recognizes (p. 101) "the absence of comprehensive data" with which to conduct a complete analysis of the proposal. To address that void, we collected account-level

[1] 29 CFR 2509 and 2510, DOL, Definition of the Term "Fiduciary"; Conflict of Interest Rule-- Retirement Investment Advice; Proposed Rule in Federal Register Volume 80, Number 75 (Monday, April 20, 2015), Pages 21927-21960.
[2] "Fiduciary Investment Advice Regulatory Impact Analysis", Department of Labor, Available on-line at www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

data from a number of financial institutions in order to construct a representative sample of retirement accounts. Our dataset includes over 63,000 IRA accounts, with data ranging from 2012 through the first quarter of 2015. The investors in our dataset are distributed across a wide range of age groups, with the bulk of IRAs held by investors aged 50 or older, as shown in Exhibit 1.

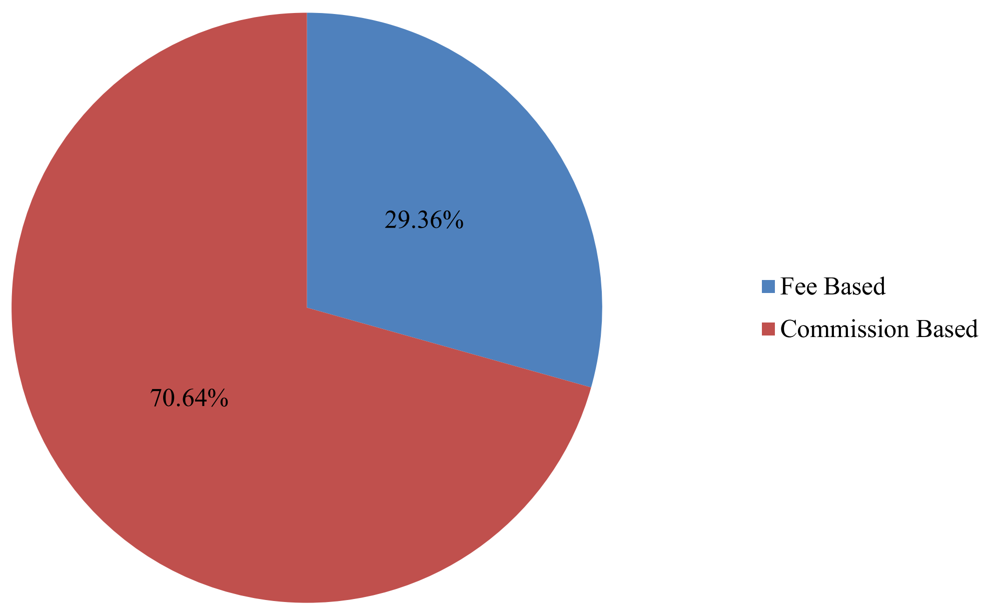


The data we collected from the participating firms contains various types of account-level data fields, including: balances, fees, activity, and positions. In order to conduct an analysis, we merged the data from the various firms into one combined dataset.

Fees

Based on data received from participating firms, we classify IRAs into two broad fee-type categories: fee-based and commission-based accounts. Fee-based accounts are charged a fixed fee as a percentage of assets whereas commission-based accounts are charged fees based on trading and other activity. As shown in Exhibit 2, approximately 70.6 percent of our accounts are commission-based; the rest are fee-based.

Exhibit 2. IRA Account Structure



Fees include all proceeds paid by the account-holder directly to the firm, such as management fees and trading commissions.[3] They exclude, however, fees paid to third-parties such as mutual fund managers.

The median account balance in our sample is \$57,072, with the 25th and 75th percentiles falling at \$17,511 and \$166,794 respectively.[4] These summary statistics are shown in Table 1 below.

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[3] Fees exclude revenue that the firm may receive indirectly from the account-holder, such as markup/markdown revenue or 12b-1 fees. Recognizing that such indirect revenues are not included in our fee data, we construct returns which are net of *all* fees, both direct and indirect. These net returns are presented in section I.E.

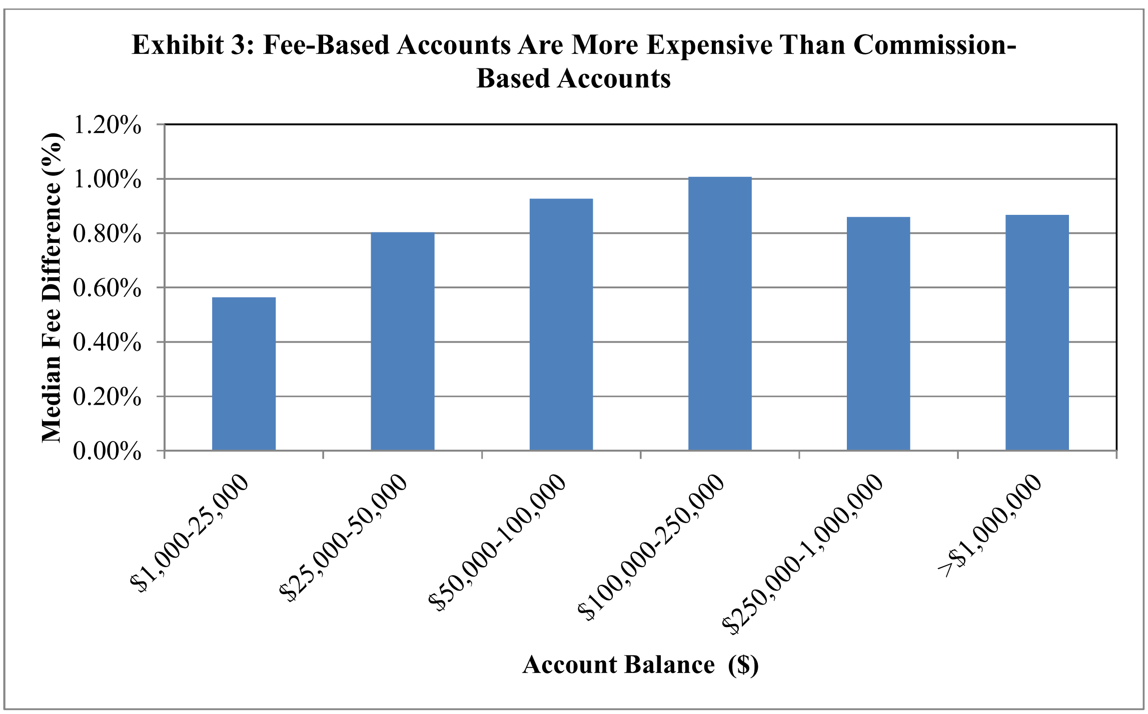
[4] In our analyses, we exclude accounts with balances below \$1,000.

Table 1. Account Balances

	Account Balance ($)
Mean	174,034
Median	57,072
25th Percentile	17,511
75th Percentile	166,794

B. Some Accounts Would Become More Expensive under the DOL Proposal

Our account-level dataset allows us to identify a large number of accounts as having a fee structure which is either fee-based, or commission-based. In Exhibit 3, we present the difference between median fee-based and commission-based account fees, as a percentage of account balance, for various levels of account balance. The chart shows that this difference is always greater than zero; in other words, holders of fee-based accounts pay higher fees, in percentage terms, for all levels of account balance.



The differences tend to be in the range of about 57 basis points (bps) for relatively small accounts (those with balances below $25,000) up to about 1 percent for accounts with balances from $100,000 to $250,000. This suggests that investors would pay more if moved to fee-based accounts. Indeed, the magnitude of the increased cost is on par with the 1 percent "cost of conflicted advice" claimed in the White House/CEA memo that preceded the DOL proposal. The numerical results are reported in Table 2, below.

Table 2. Fees by Balance and Account Type

	Median		
Balance Range	**Fee Based**	**Commission Based**	**Difference**
$1,000-25,000	1.24%	0.67%	0.57%
$25,000-50,000	1.16%	0.36%	0.80%
$50,000-100,000	1.20%	0.27%	0.93%
$100,000-250,000	1.25%	0.24%	1.01%
$250,000-1,000,000	1.09%	0.22%	0.86%
Greater than $1,000,000	0.99%	0.12%	0.87%

C. Account-Level Data Suggests that Investors Select the Fee Model that Best Suits Their Own Needs and Trading Behavior

In the data, one of the most striking behavioral distinctions between fee-based and commission-based accounts is that the former tend to trade more frequently. We also calculated investors' aggregate trading activity by looking at both the number and dollar amount of purchases and sales in each account.[5] We measure trading activity in two ways: number of trades and account turnover. Number of trades counts each discrete purchase and sale during the time period. Account turnover takes the minimum of the total dollar amount purchased and the total dollar amount sold as a percentage of the average dollar balance during the year. Summary statistics of trading activity are presented below in Table 3.

[5] Where we could not break out dividends from new investments, trades may include dividend reinvestments.

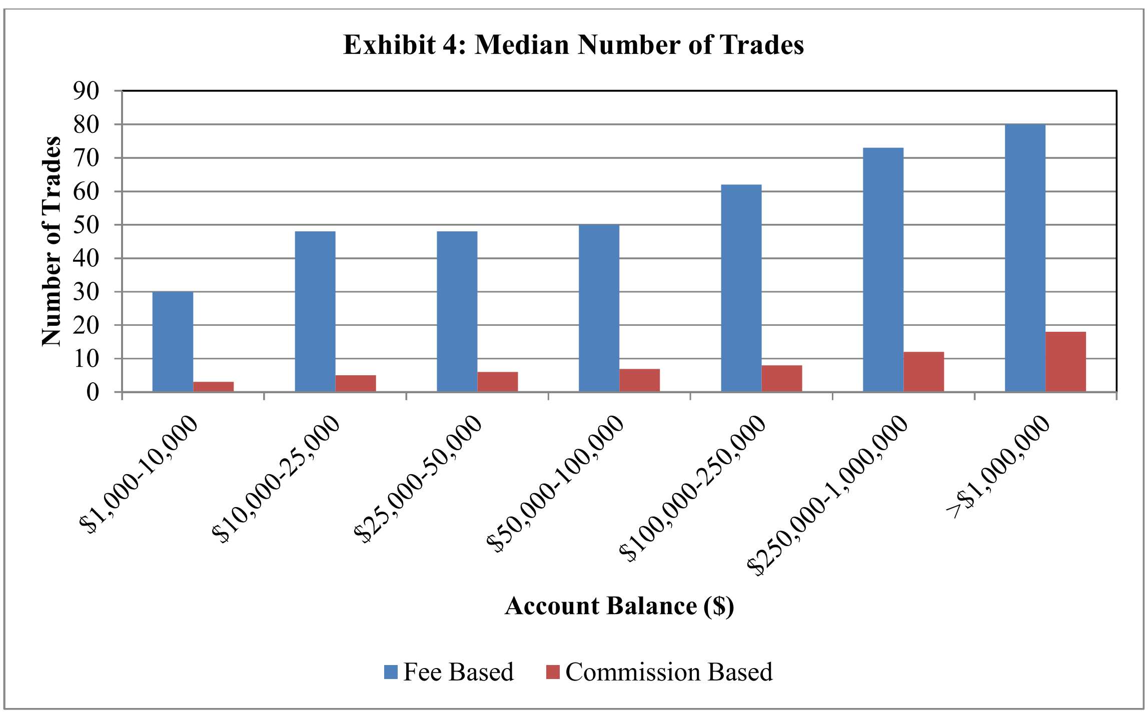
Table 3. Trading Activity

	Number of Trades	Account Turnover
Mean	54	34.11%
Median	16	14.79%
25th Percentile	4	4.84%
75th Percentile	56	39.31%

Exhibit 4 below shows the number of trades, or transaction frequency, of fee-based and commission-based accounts in 2014 for various account balance levels.

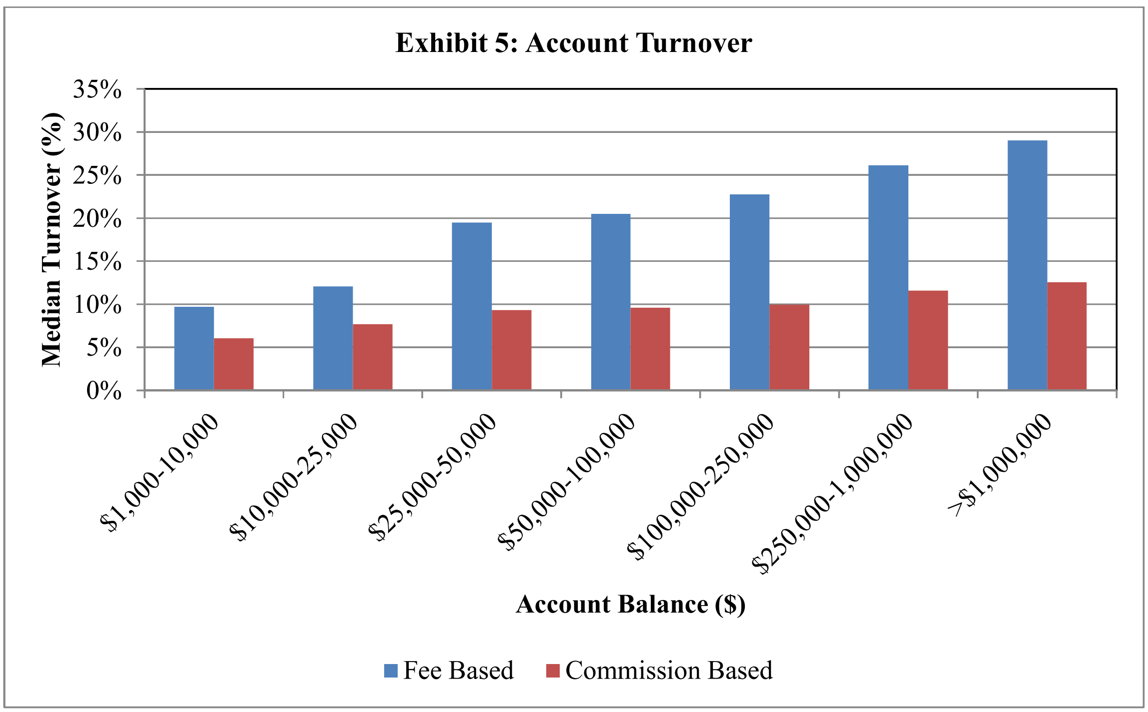
In 2014, the median trade frequency in commission-based accounts was just 6 trades. By comparison, in fee-based accounts the median trade frequency was 57 trades, with larger accounts generally trading more frequently than smaller ones.

Thus, the data are consistent with the idea that investors who expect to trade often rationally choose fee-based accounts whereas those that do not trade often are likely to choose commission-based accounts.



Additionally, it is worth noting that the data does not seem to show "churning," the needless buying and selling of securities. We see the median commission-based account had traded 6 times in 2014. Such trading is more consistent with a buy-and-hold strategy than churning.

The interpretation of the account-level data as being consistent with investors who trade infrequently self-selecting into commission-based accounts is further supported by account turnover. The median dollar-value of transactions, as a fraction of account balance, is show in Exhibit 5 below, for various levels of account balance.



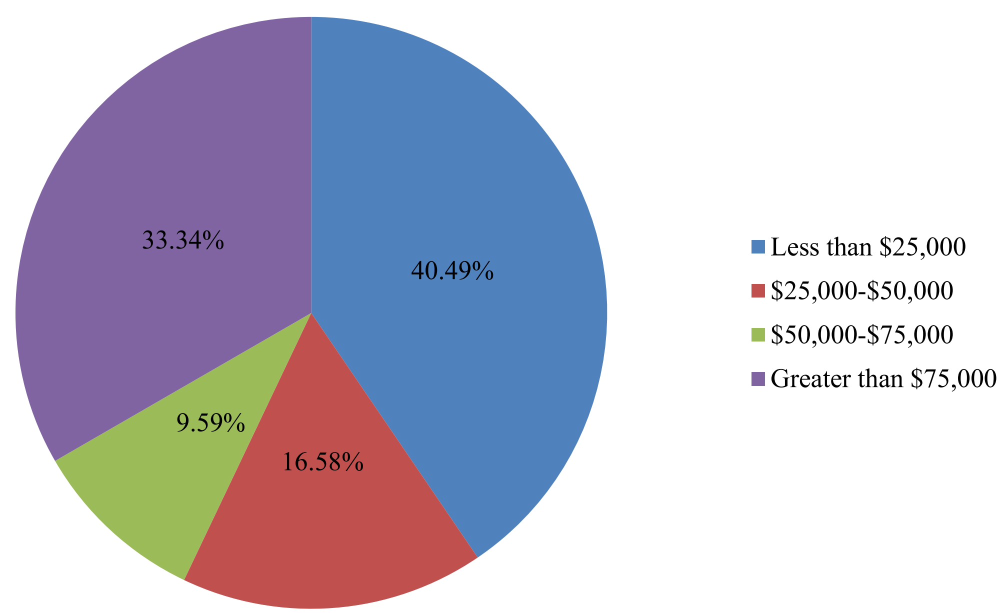
The median commission-based account across all balances only turns over 8.9 percent of its assets annually. For fee-based accounts the median turnover is 22.1 percent.

D. Some Account Balances Are Too Small for RIA Accounts

As mentioned above, a primary concern with the DOL proposal is that it would make commission-based accounts unworkable. If this turns out to be the case, investors will have to move to fee-based accounts or lose access to professional investment advice entirely.
Using our account-level data, we can estimate the number of investors who currently have commission-based accounts with balances below the minimum required account balance for advisory accounts.[6]

The results are shown in Exhibit 6. Using the conservative minimum account balance of $25,000, over 40% of commission-based accounts in our dataset would not be able to open fee-based accounts. Using a $50,000 threshold, over 57% of accounts would not meet minimum balance requirements for a fee-based account. If the effective threshold is $75,000, two-thirds of account holders would be left without any professional investment advice.

Exhibit 6: Commission-Based Accounts by Account Balance



[6] An important limitation in our data is that we have collected account-level data, which may not coincide with household-level data. We may therefore be understating the ability of some households to combine separate IRA accounts held within the same household to achieve the minimum balance requirement. This limitation also likely explains the existence of fee-based accounts smaller than $10,000 in our dataset.

E. Commission-Based Accounts Do Not Underperform

We calculate returns on a quarterly basis by calculating the change in account balance, adjusting for net flows during the quarter.[7] Since fees are deducted from account balances, either directly or indirectly, returns calculated based on account balances are net of fees.

We find that the median annualized return across all accounts in our sample, over the period from June 30, 2012 to March 31, 2015, is 10.3 percent.

In terms of differential fee structures, if investors in commission-based account are subject to the "cost of conflicted advice", then we would expect to see an underperformance in terms of the returns they earn. Indeed, this is explicitly the argument made in the DOL proposal.

Over the time periods for which we have data, commission-based and fee-based accounts exhibit similar performance, when calculated net of fees. The median differences in returns are shown, quarter by quarter, in Table 4. As the data show, the difference in return is sometimes positive and sometimes negative but small in magnitude. Moreover, the difference in returns is not statistically significant.

Table 4. Fee-Based Returns Less Commission-Based Returns

Date Range	**Difference in Median Quarterly Return**
06/30/12-09/30/12	-0.14%
09/30/12-12/31/12	0.63%
12/31/12-03/31/13	-1.96%
03/31/13-06/30/13	-0.91%
06/30/13-09/30/13	0.62%
09/30/13-12/31/13	-0.08%
12/31/13-03/31/14	-0.44%
03/31/14-06/30/14	-0.18%
06/30/14-09/30/14	-1.04%
09/30/14-12/31/14	0.04%
12/31/14-03/31/15	0.33%
Average	**-0.28%**

[7] Net flows include cash and other transfers to and from the account that are not investment-related (i.e.: withdrawals and contributions). Net flows were constructed to exclude fees, dividends, and interest, to the extent it was possible to identify these payments in the underlying transaction data. To eliminate the potential impact of outliers on our findings, we removed the top and bottom 1 percent of returns from our calculations (where such outliers may reflect the timing of transactions in our data, and not be reflective of actual returns).

Overall, from June 30, 2012 to March 31, 2015, the average difference (where again the difference is the fee-based return minus the commission-based return) is -0.28 percent. Thus, there is no support in this data for the contention that commission-based accounts underperform.[8] An alternative interpretation of the finding that returns are roughly equal across the two fee structures is that investors self-select into account types that are appropriate for them and that this leads to equilibrium.

II. COST OF LOSING ACCESS TO ADVICE

In order to conduct a proper cost-benefit analysis, it is important to consider all of the costs associated the proposed rule. Indeed, the DOL Regulatory Impact Analysis itself states (p.99-100) that:

"A full accounting of a rule's social welfare effects would encompass all of the rule's direct and indirect effects as would be manifest in general market equilibrium. Likewise, that full accounting would consider pure social welfare costs – that is, reductions in economic efficiency – which are not the same as simple compliance costs."

The RIA goes on to recognize that (p. 100): *"The quantitative focus of this analysis, however, is on the proposal's most direct, and directly targeted, effects: gains to retirement investors, and compliance costs to advisers and others."*

But the DOL fails to measure one important cost—the cost of the loss of advice to investors. In this section we partly address this shortcoming by explicitly considering the costs that would be incurred by those consumers who completely lose access to professional investment advice as a result of the DOL proposal.

In prior studies, the DOL itself acknowledged this cost. An October 2011 DOL cost-benefit analysis published in the Federal Register on the "final rule" relating to the provision of investment advice under ERISA included estimates of the costs to consumers of not having access to advice.[9] In that document, the DOL estimated that participant-directed retirement

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[8] The sign of the difference might be read to mean that commission-based accounts outperform fee-based accounts in our dataset, but in fact the difference is not statistically different than zero in any of the quarters in our sample period.

[9] 29 CFR 2550, DOL, Investment Advice – Participants and Beneficiaries, Final Rule, October 2011.

savings account holders make investment mistakes in the absence of professional advice valued at an aggregate of “more than $114 billion in 2010” (p.66151).

Moreover, the 2011 DOL cost-benefit analysis estimated the effects of a change in public policy on investors’ access to professional investment advice. In particular, the DOL estimated that the enactment of the Pension Protection Act of 2006 (P.L. 109-280, the “PPA”) increased access to advice, and hence reduced aggregate investing errors by $7 billion to $18 billion per year. These are extremely large numbers, and hence clearly indicate the DOL’s own estimation of the importance to investors of access to professional advice.

A. Estimates of Number of Investors Who Will Lose Access to Advice

As discussed in section I.A above, our account-level data allows us to identify a large number of accounts as having a fee structure which is either fee-based, or commission-based, by account balance. For example, we noted above that 40.49 percent of the accounts that are currently commission-based have balances below $25,000 in our sample.

If the DOL proposal were to make commission-based accounts unworkable for broker-dealers, these accounts could no longer be maintained. Moreover, many commission-based accounts have small balances and so would be below the minimum account balance for advisory accounts. These investors will be left on their own with no access to professional investment advice.

If we were to take at face value the DOL’s methodology in the 2011 cost-benefit analysis discussed above, and assume a minimum-balance threshold of $25,000, the new fiduciary standard would cause a loss of access to professional advice for 40.49 percent of commission-based retirement account holders. It would take a relatively small number of such accounts to lose advice for this to result in an aggregate cost that exceeds the $17 billion in purported benefits claimed in the White House/CEA memo.

Moreover, this is based on a conservative estimate of the minimum balance, at only $25,000. Even at this level, the aggregate cost could easily be on par with the DOL’s own estimates of the “cost of conflicted advice”.

Hence, using the DOL’s own approach, the costs of the proposal likely exceed its benefits once we account for other costs such as the cost of compliance.

B. Implications of Losing Access to Advice: Individual Investors Make Systematic Errors When Investing on Their Own

In this section we first review the extensive academic and professional literature on the value to investors of having access to professional investment advice. The discussion begins with a survey of the potential pitfalls faced by many individuals who invest on their own. We then discuss the established literature that documents ways in which the use of professional advisors tends to lead to fewer such investment errors.

Additionally, it is worth noting that below, in section III.D, we discuss an earlier 2011 cost-benefit analysis on the Pension Protection Act of 2006 in which the DOL itself recognized the implications of investors losing access to professional investment advice. The conclusions of that DOL study are similar to the academic findings discussed in this section.

1. The disposition effect and mental heuristics

Ever since the seminal work of Kahneman and Tversky (1979, 1992), it has been widely accepted that individual investors are prone to making systematic mistakes in the way they evaluate and treat investment decisions in the presence of uncertainty.[10] Indeed, Kahneman was awarded the Nobel Prize in Economics for this work in 2002. This research agenda was typically accompanied by experimental data, but not backed up with actual accounts and transactions of individual investors.

In the 1990's, however, Odean (1998) built upon the earlier literature by analyzing the trading records of ten thousand accounts at a large nationwide discount brokerage firm. The dataset he collected covered the period 1987 through 1993.[11] The data includes an account identifier, trade dates, the security traded, a buy-sell indicator, the quantity traded, the commission paid and the principle amount. The study compared the selling price for each stock sold to its average price to determine whether that stock is sold for a gain or loss. One of the primary findings of the paper was that investors demonstrate a strong preference for realizing winners rather than losers. This phenomenon is now widely known as the "disposition effect" for individual investors.

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[10] Kahneman, D and A. Tversky (1979), "Prospect Theory: An Analysis of Decision under Risk," *Econometrica* **47** (2): 263 and Tversky, A and D. Kahneman (1992), "Advances in prospect theory: cumulative representation of uncertainty," *Journal of Risk and Uncertainty* **5** (4): 297–323.

[11] Odean, T. (1998), "Are Investors Reluctant to Realize Their Losses?" *Journal of Finance,* 53, 1775-1798.

Since Odean (1998), the disposition effect has been confirmed by numerous studies. Goetzmann and Massa (2004) construct a variable based on investor trades that acts as a proxy for the representation of disposition-prone investors in the market and test how it relates to stock returns. [12] The authors report a strong negative correlation between the disposition effect and stock returns. Grinblatt and Han (2005) also study the disposition effect, and in particular the tendency of investors to hold on to their losing stocks.[13] They attribute this behavior to prospect theory, or the tendency to under weigh outcomes that are merely probable in comparison to outcomes that are obtained with certainty, and to a psychological phenomenon known as "mental accounting". The authors find that the tendency for households to fully sell winning stocks is weaker for wealthy investors with diversified portfolios of individual stocks.

Franzini (2006) uses a database of mutual funds holdings to construct a measure of reference prices for individual stock and confirms the existence of the disposition effect.[14] Moreover, the author suggests that the disposition effect can induce under-reaction by individual investors to news, leading to return predictability and post-announcement price drift. In particular, bad news travels slowly among stocks trading at large capital losses, in turn leading to a negative price drift, and good news travels slowly among stocks trading at large capital gains.

Nor is this literature limited to academic circles. The Morgan Stanley Consulting Group (2014), for example, studied the various behavior biases that can impair the performance of individual investors in managing their own portfolios.[15] The authors point to "psychological blindspots" that negatively influence investors such as overconfidence, mental accounting, anchoring biases, framing biases and loss aversion. Their research suggests that a financial advisor can mitigate the effects of these problems because they have a clearer understanding of the investment process.

2. Mental heuristics disproportionately affect people with fewer savings

As argued above, the academic literature has documented evidence that individual investors display irrational and costly investing behavior in the form of the disposition effect.

[12] Goetzmann, W. and M. Massa (2004), "Disposition Matters: Volume, Volatility and Price Impact of Behavioural Bias," *Centre for Economic Policy Research*, Paper No. 4814.
[13] Grinblatt, Mark and Bing Han (2005), "*Prospect theory, mental accounting and momentum," Journal of Financial Economics,* 78, 311-339.
[14] Frazini, Andrea (2006), "The Disposition Effect and Underreaction to News," *The Journal of Finance*, 61, No. 4
[15] Morgan *Stanley Consulting Group,* "The Value of Advice," (2014), available on-line at www.morganstanleyfa.com/public/projectfiles/thevalueofadvice.pdf

Beyond this general observation, there is also a strand of research that shows that these flaws tend to disproportionately affect people with lower levels of wealth.

Grinblatt and Keloharju (2000) employ the central register of shareholdings for Finnish stocks in the Finnish Central Securities Depository (FCSD), a comprehensive data source which covers 97 percent of the total market capitalization of Finnish stocks beginning in 1995.[16] The data set reports institutional holdings and stock trades on a daily basis. The authors find that generally the more sophisticated the investor and the greater the wealth invested in stocks, the less contrarian (buying losing stock and selling winning stock) is the investment strategy. The degree of contrarianism appears to be inversely related to a ranking of the sophistication of investor types.

Dhar and Zhu (2002) analyze the trading records of a major discount brokerage house and confirm the existence of the disposition effect.[17] The paper finds empirical evidence that wealthier and individual investors in professional occupations exhibit less disposition effect. Trading experience also tends to reduce the disposition effect.

Calver, Campbell and Sodini (2009) study a dataset containing the disaggregated wealth of all households in Sweden between 1999 and 2002. The authors find that contrary to rational expectations, households are more likely to fully sell directly held stocks if those stocks have performed well and more likely to exit direct stockholding if their stock portfolios have performed well.[18] This paper examines changes in household behavior over time, specifically decisions to scale up or down the share of risky assets in the total portfolio, to enter or exit risky financial markets, to full sell individual risky assets and to scale up or down the share of individual assets in the risky portfolio. By doing so, the authors develop an adjustment model with different target risky shares across households. The authors find that wealthy, educated investors with better diversified portfolios tend to rebalance more actively. Specifically, the authors point to wealth and portfolio diversification as more relevant than income in predicting the strength of the disposition effect

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16 Grinblatt, Mark and Matti Keloharju (2000), "The investment behavior and performance of various investor types: a study of Finalnd's unique data set*" Journal of Financial Economics*, 55, 43-67.
17 Dhar, Ravi and Ning Zhu (2002), "Up Close and Personal: An Individual Level Analysis of the Disposition Effect," *Yale ICF Working Paper No. 02-20.*
18 Calver, Laurent E. and John Y. Campbell and Paolo Sodini (2009), "Fight or Flight?" *The Quarterly Journal of Economics*, 124, 1.

Cerqueira Leal, Rocha Armada and Duque (2010) use a database of 1,496 trading records of individual investors in the Portuguese stock market from January 1, 1999 to December 31, 2002, consisting of initial position, account movements, events and daily closing stock prices.[19] The authors then calculate the "proportions of gains realized and the proportions of losses realized" based on each investor's portfolio for each day of the sampling period. The authors find that less sophisticated investors (defined by average account value, number of shares traded and number of trades) exhibit a stronger disposition effect.

3. Individual investors churn

Aside from the disposition effect described above, another well-known error that is commonly observed in un-advised, self-directed, individual investors is the tendency to trade too often, or "churn". In a seminal paper, Barber and Odean (2000), analyze the returns earned on common stock investment by 66,465 self-directed households. The net return earned by these households underperforms a value-weighted market index by about 9 basis points per month (or 1.1 percent annually).[20] Those that trade the most earn an annual return rate of 11.4 percent, while the market returns 17.9 percent. The poor performance of the average household can be traced to the costs associated with this high level of trading. The authors find a negative correlation between trading frequency and investment returns.

Similarly, Barber, Lee, Liu and Odean (2007) use a complete trading history of all investors in Taiwan, and document that the aggregate portfolio of individual investors suffers an annual penalty of 3.8 percentage points.[21] These losses virtually all come from aggressive trading. In contrast, institutional investors enjoy an annual performance boost of 1.5 percentage points--even after commission and transaction taxes. Foreign institutional investors garner nearly half of the institutional profits. The author points out that investors who are saving to meet long term goals would benefit from effective guidance regarding best investment practices.

[19] Cerqueira Leal, Cristiana and Manuel J. Rocha Armada, and Joao C. Duque (2010), "Are All Individual Investors Equally Prone to the Disposition Effect All The Time? New Evidence from a Small Market," *Frontiers in Finance and Economics*, 7, No. 2, 38-68.

[20] Barber, M. Brad and Terrance Odean (2000), "Trading is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors" *The Journal of Finance*, 60, No. 2.

[21] Barber, Brad M., Yi-Tsung Lee, Yu-Jane Liu, and Terrance Odean (2007) "Just How Much Do Individual Investors Lose by Trading?" *AFA 2006 Boston Meetings Paper*.

C. Benefits of Financial Advisors

Having established that individual investors are prone to making systematic mistakes in their investing due to behavioral biases, it is natural to ask whether such errors are reduced, on average, by having access to professional advice. The answer, unsurprisingly, tends to be "yes" in the by extensive academic and professional literature.

1. Portfolio allocations that are more diversified and closer to model portfolios

Bluethgen, Gintschel, Hackethal and Mueller (2008) examine a dataset of 12,000 German bank accounts, categorizing bank customers as "advised customers" or "self-directed", and find that financial advice enhances portfolio diversification, and makes investor portfolios more congruent with predefined model portfolios.[22] While the bank in the study derived more revenues from advised clients, the advised clients' portfolios also resembled more closely the optimal portfolios prescribed by financial theory. The authors conclude that financial advisory service has a "significant impact on household investment behavior."

Gerhardt and Hackethal (2009) collect a data set on 65,000 private investors and analyzed the portfolio composition and trading behavior of more than 14,000 persons and note that there are clearly positive effects to working with an advisor.[23] These benefits include: less speculative trading and a more diversified portfolio.

A study commissioned by the Investment Funds Institute of Canada (2010) analyzed a longitudinal database with Canadian households' financial behaviors and attitudes.[24] The study isolated 3200 households and broke the sample into two groups – those who had an advisor in both years and those who did not have an advisor in either year. The authors found that households that received investment advice had substantially higher investable assets that non-advised households, controlling for age and income level. Additionally, investors without advice save less, utilize tax-advantaged savings opportunities less, and invest in securities with less opportunity for future investment growth than their advised counterparts.

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[22] Bluethgen, Ralph, Andreas Gintschel, Andreas Hackethal, and Armin Mueller (2008), "Financial Advice and Individual Investors' Portfolios."

[23] Gerhardt, Ralf and Andreas Hackethal (2009), "The Influence of Financial Advisors on Household portfolios: A study on Private Investors switching to Financial Advice," February 14, 2009.

[24] The Investment Funds Institute of Canada (2010), "The Value of Advice Report," available on-line at www.ific.ca/wp-content/uploads/2010/07/IFIC-Value-of-Advice-Report-2010-July-2010.pdf/4001/

A paper by the Investment Funds Institute of Canada (2012) stresses the importance of the CIRANO 2012 research, as well as citing papers from Australia and the United States.[25] Summarizing the existing literature, the paper notes that research proves that advice has a positive and significant impact on wealth accumulation, leads to better long term investment strategies and benefits the wider macroeconomy.

Kramer (2012) compares portfolios of advised and self-directed Dutch individual investors to investigate whether financial advisers add value to individual investors' portfolios.[26] The author finds that advised portfolios are more diversified and perform better than self-directed portfolios, thus reducing avoidable risk. The author (at least partly) attributes the reduction of idiosyncratic risk observed in advised portfolios to advisory intervention

In a widely-cited paper, Kinniry, Jaconetti, DiJoseph and Zilbering (2014), argue that through suitable asset allocation using broadly diversified funds/ETFs, cost effective implementation, rebalancing, behavioral coaching, asset location, spending strategy, and total-return versus income investing strategies, advisors can potentially add about 3 percent in net returns to investors.[27] For some investors, the value of working with an advisor is peace of mind. The value of an advisor for investors "without the time, willingness, or ability to confidently handle their financial matters" should not be ignored by "the inability to objectively quantify it." The authors argue that value added cannot be analyzed as an annual figure because "the most significant opportunities to add value occur during periods of market duress or euphoria when clients are tempted to abandon their well-thought-out investment plan."

Mardsen, Zick and Mayer (2011) argue that working with an advisor is related to several important financial planning activities including goal setting, calculation of retirement needs, retirement account diversification, use of supplemental retirement accounts, accumulation of emergency funds, positive behavioral responses to the recent economic crisis and retirement confidence.[28]

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[25] The Investment Funds Institute of Canada (2012), "The Value of Advice Report," available on-line at www.ific.ca/wp-content/uploads/2013/02/IFIC-Value-of-Advice-Report-2012.pdf/1650 /

[26] Kramer, Marc M. (2012), "Financial Advice and Individual Investor Portfolio Performance," *Financial Management,* 41, No. 2, 395-428.

[27] Kinniry, Francis M., Jr., Colleen M. Jaconetti, Michael A. DiJoseph, and Yan Zilbering (2014), "Putting a value on your value: Quantifying Vanguard advisor's Alpha," *The Vanguard Group.*

[28] Mardsen, Mitchell, Cathleen D. Zick, and Robert N. Mayer (2011), "The Value of Seeking Financial Advice," *Journal of Family and Economic Issues,* 32, No. 4, 625-643.

Winchester, Huston and Finke (2011) collect data containing 3,022 respondents with at least $50,000 in annual income.[29] These individuals also had equity holdings that they could control or direct during market downturns. The authors used "investor prudence" as the dependent variable and noted whether the individuals rebalanced their portfolio over a market decline. The authors find that investors who use a financial advisor are about one-and-a half times more likely to adhere to long-term investment decisions. Moreover, investors with a written financial plan are almost twice as likely to make optimal long term financial decisions.

2. Advisors help investors stop making investing mistakes

Shapira and Venezia (2001) argue that professionally-managed accounts experienced better roundtrip performance than those administered independently.[30] The authors find that the disposition effect, or the tendency of investors to sell shares whose price has increased, while keeping assets that have dropped in value, is significantly weaker for professional investors. This indicates that professional training and experience reduces judgmental biases, even though it cannot eliminate them. The authors point to this as an advantage in enlisting professional advice.

Maymin and Fisher (2011) used data from a boutique investment management firm, Gertstein Fisher.[31] The data includes all account and household information, client introduction history, notes, and portfolio allocations and performances since 1993. The authors test five predictions by analyzing the contacts actually recorded between clients and the manager in the data set. The authors conclude that the advisor's role in helping investors stay disciplined and on plan in the face of market volatility, including dissuading them from excessive trading, is one that is highly valued by the individual investor.

3. Tax minimization

Horn, Meyer and Hackethal (2009) use transaction data from a German bank from 1999-2008, to study a natural experiment of the introduction of a withholding tax in Germany in order to see how private investors react to changes in taxation.[32] The authors conclude that financial

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[29] Winchester, Danielle D., Sandra J. Huston, and Michael S. Finke (2011), "Investor Prudence and the Role of Financial Advice," *Journal of Financial Service,* 65, No. 4, 43-51.
[30] Shapira, Zur and Itzhak Venezia (2001). *Patterns of Behavior of Professionally Managed and Independent Investors*, Journal of Banking and Finance, 25, No. 8, 1573-587.
[31] Maymin, Philip Z. and Gregg S. Fisher (2011), "Preventing Emotional Investing: An Added Value of an Investment Advisor." *The Journal of Wealth Management,* 13, No. 4.
[32] Horn, Lutz, Steffen Meyer and Andreas Hackethal (2009), "Smart Investing and the Role of Financial Advice – Evidence from a natural Experiment Using Data Around a Tax Law Change," Working Paper Series.

advisors help people make smarter investment decisions because of their financial sophistication and experience in tax-related investment decisions.

Martin and Finke (2012) uses both the 2004 and the 2008 waves of the National Longitudinal Survey of Youth to estimate the impact of financial advice on retirement savings and the change in accumulated retirement wealth between 2004-2008.[33] The authors compare the effectiveness of creating one's own retirement plan versus using a professional advisor. The authors find that the use of a comprehensive financial professional overwhelmingly increases the likelihood that households will go through the process of calculating retirement needs. Respondents who rely on an advisor to help plan for retirement are more likely to own tax-advantaged accounts. Authors conclude that planning, with the help of a comprehensive advisor, improves retirement outcomes.

4. Increased savings

Montmarquette and Nathalie (2015) used Ipsos Reid collected data in the form of a 45-question internet survey from 18,333 Canadian Households.[34] The data were filtered to produce a high quality sample of 3,610 households. After splitting up the data into "advised households" and "non-advised households" the authors used econometric modelling in order to isolate the benefits of advisors in the accumulation of wealth.

Econometric results show that participants retaining the services of a financial advisor for more than 15 years have about 174 percent more financial assets (in other words, 2.73 times the level of assets) than non-advised respondents. The authors conclude that a highly plausible explanation for this finding comes from the greater savings and improved asset selection that is associated with having a financial advisor. Those investors who have advice are more likely to trust financial advisors, associate satisfaction with financial advisors and have confidence in financial advisors.

Similarly, in a KPMG Econtech (2009) paper based on the results of a regression analysis from an economy-wide model, the authors conclude that an individual who has a financial planner is estimated to save $2,457 more in a year compared to similar individuals without

[33] Martin, T. K. and Michael S. Finke (2012), "*Planning for Retirement,"* (December 31, 2012), available at SSRN: papers.ssrn.com/sol3/papers.cfm?abstract_id=2195138

[34] Montmarquette and Nathalie Viennot-Briot (2015), "The Value of Advice," Annals of Economics and Finance, 16-1, 69-94. This paper was also published as Montmarquette and Veinnot-Briot (2012), "Econometric Models on the Value of Advice of a Financial Advisor," at the Centre interuniversitaire de recherché en analyse des des organisations.

financial advisors/planners.[35] Investors with a financial planner have greater savings and investment balances than those who do not.

A study by Standard Life (2012) based on collected data from the UK, reports that the current average pension pot for consumers who have been advised on their retirement planning is £74,554.30, nearly double that of those not seeking advice.[36] Those who have taken advice put nearly a third more a month into their pension plan. On investments, people with an adviser save for longer and contribute more, leading to an average investment value which is over £40,000 higher than the average for those who haven't sought advice.

Lastly, Antunes, Macdonald and Stewart (2014) construct a hypothetical scenario using collected survey data that included age, average savings, average income and the presence of an advisor.[37] After collecting the data, the authors assume that 10 percent of the income of non-advised savers is now saved at the higher rate of those who do receive financial advice in order to capture the increased savings level that is correlated with having an advisor. This paper then applied the percentage difference between this savings rate and the baseline savings rate to the Conference Board of Canada's long term national forecasting model to quantify the economic impact of the increased savings in the long run. On top of positively impacting an investor's savings rate, the presence of an advisor was also shown to boost real GDP, turn consumer expenditures positive and raise the aggregate household savings rate.

5. Economies of scale with respect to the cost of information

In a highly-regarded paper by Stoughton, Wu and Zechner (2010), the authors create a model with three classes of agents: the active portfolio manager, the set of financial advisers and the pool of investors in the economy.[38] The authors first derive an equilibrium assuming that financial advisers are independent and must charge their investors their full costs in order to break even and allow portfolio manager to provide payments to the adviser. Then, the authors run the model to solve for the optimal amount of rebates preferred by the portfolio manager and

[35] "Value Proposition of Financial Advisory Networks" (2009), *KPMG Econtech*. www.fsc.org.au/downloads/uploaded/2009_1105_KPMGEcontech(FinalReport)_7d94.pdf

[36] Standard Life (2012), "Value of Advice Report," available on-line at www.unbiased.co.uk/Value-of-Advice-Report-2012.pdf

[37] Antunes, Pedro, Alicia Macdonald and Matthew Stewart (2014), "Boosting Retirement Readiness and the Economy Through Financial Advice," *The Conference Board of Canada.*

[38] Stoughton, Neal M., Youchang Wu, and Josef Zechner (2010), "Intermediated Investment Management," *Journal of Finance,* 66, No. 3. 947-980.

the impact on management fees, fund sizes and flows. Finally, the paper derives the equilibrium without an adviser and compares all the scenarios. The authors find that financial advisers facilitate the participation of small investors in actively managed portfolios by economizing on information costs.

It is also interesting to note that the DOL itself wrote, in a 2011 cost benefit analysis of the final rule on investment advice under ERISA[39] (p. 66156) that "The Department therefore expects this final rule to produce cost savings by harnessing economies of scale and by reducing compliance burdens." "For example, an adviser employed by an asset manager can share the manager's research instead of buying or producing such research independently."

D. The Cost of Losing Access to Professional Investment Advice

While the 2015 DOL regulatory impact analysis (RIA) ignored the costs of investors losing access to advice, the 2011 SEC staff's 913 study as well as the 2011 DOL cost-benefit analysis, both mentioned above, both discussed the costs of investors not having access to advice.

We note that the DOL's 2010 proposal differs from the current one in some of its details. However, both proposals raise the same troubling implications for current investors in commission-based accounts by increasing the complexity and compliance costs associated with offering that fee structure to customers.

1. Review of the SEC (2011) assessment: costs of imposing a fiduciary standard on brokers

As mentioned above, the SEC staff undertook a study in 2011 designed to evaluate the effectiveness of existing regulatory standards for investment advisers and brokers. The study was mandated under Section 913 of Title IX of the Dodd-Frank Act and analyzed some of the potential costs associated with changes to the current regulatory framework (see p.143-165), including imposition of a fiduciary standard on brokers.

In this section we review the discussion in SEC (2011) regarding the potential costs and expenses to retail customers, and the potential impact on the profitability of their investment

[39] See footnote 10.

decisions, including access to the range of products and services offered by broker-dealers, resulting from imposing on broker-dealers the fiduciary standard associated with the Investment Advisers Act of 1940.

The primary concern mentioned in SEC (2011) is with respect to the cost and availability to retail investors of accounts, products, services, and relationships with broker-dealers, which could inadvertently be eliminated or impeded (for example, through higher costs to brokers being passed on to investors).[40]

In general imposition of a new regulatory standard of conduct on broker-dealers has the potential for additional costs on broker-dealers, which would be passed on to the customers at least in part, according to the standard economic theory of "effective incidence". That theory simply states that it is likely that at least some portion of the regulatory costs imposed by the government is ultimately passed on to the public.[41] In turn, costs passed on to retail investors would have the effect of eroding the profitability of their investments.

The net cost impact on retail customers would likely depend on a complex interplay of various factors, such as investor wealth, investor willingness to pay additional fees, and size of the particular broker-dealers in question as well as the competitive landscape. To take an extreme example, in relation to the UK experience, the FSA found[42] that smaller firms and firms with less revenue were more likely to either exit the market or alter the types of services provided, in response to new government regulations.

The following discussion presents some further detail on specific concerns discussed in SEC (2011).

a. **Brokers may deregister and register as investment advisers and, in the process, convert their brokerage accounts into advisory accounts subject to advisory fees.**

One concern expressed in SEC (2011) associated with the imposition of a fiduciary standard is the possibility that brokers would convert existing accounts from commission-based

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[40] See p. 155-159.

[41] See, for example, Mukherjee, S. (2002), Modern Economic Theory, at p.833.

[42] Oxera, Retail Distribution Review Proposals: Impact on Market Structure and Competition, prepared for the Financial Services Authority, Mar. 2010

accounts to fee-based accounts, in order to respond to new requirements placed on those account. The ultimate cost impact of this would depend on the actual fees and commissions, the relative extent to which the accounts in question had been actively trading, and any increased costs associated with providing advice for a fee.[43]

Additionally, there could also be "fee layering" (whereby fees are charged based both on the value of the assets as well as account fees such as administrative and custodial fees), especially for less actively traded accounts.[44]

An Oliver Wyman/SIFMA 2010 study[45] notes that there are significant cost differences between broker-dealer and advisory accounts, and if a change in the regulatory regime has the effect of pushing more clients toward the higher-cost model then this could be a suboptimal outcome for those investors. They estimate cumulative returns to retail customers with $200,000 in assets would be reduced by $20,000 over the next 20 years in such a scenario.

The 2011 SEC study states on p.162 that: "One possible way that costs could increase is if broker-dealers whose customers want advice and who currently provide the full range of brokerage services…for a single commission (or mark-up) and perhaps minor account level fees, simply converted these accounts to investment adviser status and cease to provide execution services to retail investors who sought advice. If that were the case, custody costs to the retail investors would be higher. Advice costs charged, at least initially upon conversion (and absent the investor researching competitors' prices), would also be higher for those investors who buy and hold, because either an hourly or asset-based fee would likely exceed the current commission or mark-up on a retail trade."

The 2011 SEC study goes on to note: "In sum, to the extent that broker-dealers respond to a new standard by choosing from among a range of business models, such as converting brokerage accounts to advisory accounts, or converting them from commission-based to fee-based accounts, certain costs might be incurred and ultimately passed on to retail investors in the

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[43] See p. 155-159.
[44] See p. 172
[45] Oliver Wyman, Securities Industry and Financial Markets Association, Standard of Care Harmonization: Impact Assessment for SEC, Oct. 2010.

form of higher fees or lost access to services and products. Any increase in costs to retail investors detracts from the profitability of their investments."[46]

b. Broker-dealers may unbundle their services and provide them separately through affiliates or third parties.

The SEC (2011) study notes that broker-dealers might choose to unbundle their services and provide some of the component services through third parties.[47] A brokerage relationship involves various component functions: finding customers; providing advice to those customers; executing orders; clearance and settlement services; custodial services; and recordkeeping services, such as trade confirmations and account statements.

SEC (2011) argues that costs to broker-dealers are likely to depend on whether these services were provided by one firm or whether they were divided among affiliates. For example, a broker can self-clear securities transactions or contract with a third-party clearing broker to clear transactions. A broker can act as custodian for securities itself or contract with a third party such as a bank.

Brokers could decide to divide some or all of these functions. As noted in SEC (2011), to the extent broker-dealers may transfer accounts or personnel to affiliates, this may generate additional administrative costs.

2. The DOL (2011) Federal Register Study

While the most recent 2015 DOL RIA did not provide estimates of the cost to investors of losing professional investment advice, an earlier DOL (EBSA) study in 2011, previously cited, did in fact do so. The 2011 DOL *Federal Register* article published the final rule relating to the provision of professional investment advice to plans and beneficiaries of IRAs, under ERISA.

The 2011 DOL publication explicitly argues that participants in participant-directed retirement savings accounts make mistakes. In particular, the study notes (p.66151) that:

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[46] See p. 162.

[47] See p. 164, 173.

"such mistakes and consequent losses historically can be attributed at least in part to provisions of the Employee Retirement Income Security Act of 1974 that effectively preclude a variety of arrangements whereby financial professionals might otherwise provide retirement plan participants with expert investment advice. Specifically, these 'prohibited transaction' provisions of section 406 of ERISA and section 4975 of the Internal Revenue Code prohibit fiduciaries from dealing with DC plan or IRA assets in ways that advance their own interests."

The DOL estimates this error rate costs an aggregate of "more than $114 billion in 2010" (p.66151). The study goes on to say (p. 66159) that: "The Department is highly confident in its conclusion that investment errors are common and often large, producing large avoidable losses (including foregone earnings) for participants. It is also confident that participants can reduce errors substantially by obtaining and following good advice. While the precise magnitude of the errors and potential reductions therein are uncertain, there is ample evidence that that magnitude is large."

The DOL then argued that the PPA, by permitting a broader array of investment advice under ERISA, decreased the amount of errors made by investors. For example, the study states (p.66152): "the Department believes this final regulation will provide important benefits to society by extending quality, expert investment advice to more participants, leading them to make fewer investment mistakes. The Department believes that participants, after having received such advice, may pay lower fees and expenses, engage in less excessive or poorly timed trading, more adequately diversify their portfolios and thereby assume less uncompensated risk, achieve a more optimal level of compensated risk, and/or pay less excess taxes."

The DOL estimated that the reduction in investment errors due to the expansion of availability of investment advice would amount to between $7 billion and $18 billion annually, or approximately 6 percent to 16 percent of the $114 billion total in investment errors made per year.[48] At the upper range these numbers are as large as the supposed cost of conflicted advice that the DOL Fiduciary Standard is designed to alleviate.

[48] The DOL stated that it based its estimates on the retirement assets in DC plans and Individual Retirement Accounts reported by the Federal Reserve Board's Flow of Funds Accounts (Mar. 2011), at www.federalreserve.gov/releases/z1/Current/. The study also refers the reader to earlier DOL studies including 74 FR No 164 (Aug. 22, 2008), 74 FR No 12 (Jan. 21, 2009), and 75 FR No 40 (Mar. 2, 2010).

The investment mistakes discussed in the 2011 RIA are grounded in the behavioral finance literature, which we have discussed in detail above. For example, the DOL stated (p. 66153) that "in practice many investors do not optimize their investments, at least not in accordance with generally accepted financial theories. Some investors fail to exhibit clear, fixed and rational preferences for risk and return. Some base their decisions on flawed information or reasoning. For example some investors appear to anchor decisions inappropriately to plan features or to mental accounts or frames, or to rely excessively on past performance measures or peer examples. Some investors suffer from overconfidence, myopia, or simple inertia."

The study then goes on to focus on five types of investment mistakes:

a) *Fees and Expenses.* The DOL stated that it believes that (p. 66153) "there is a strong possibility that at least some participants, especially IRA beneficiaries, pay inefficiently high investment prices." However, it is not clear what empirical evidence the DOL used as its basis for this statement.

b) *Poor Trading Strategies.* The study cited churning, failure to rebalance, attempts to time the market, and chasing past returns as examples of strategies that tend to underperform.

c) *Inadequate Diversification.* The DOL claims that DC plan participants sometimes concentrate their assets excessively in stock of their employer, as well as being under-invested in international equity or debt.

d) *Inappropriate Risk.* The study notes that investors may construct portfolios that are too risky or too safe, given their preferences.

e) *Excess Taxes.* The DOL study mused that some households appear to follow sub-optimal strategies with respect to minimizing taxes, such as not placing taxable bonds in tax-deferred accounts. However, the DOL also stated that (p. 66154) "the Department currently has no basis to estimate the magnitude of excess taxes that might derive from participants' investment mistakes."

Despite the rather lengthy description of the above types of investment errors, the DOL did not use data from actual investor-held accounts to estimate the magnitude of the associated losses. Instead, they made a variety of assumptions, summarized as follows:

1) The DOL assumed that approximately 40 percent of DC plan sponsors provided access to investment advice before the PPA.[49] After enactment of the PPA, they assumed this percentage increased to between 56 and 69 percent.

2) They assumed that about 25 percent of plan participants that are offered advice use the advice (both pre-PPA and post-PPA). For IRAs, they assumed that 33 percent used advice pre-PPA, and between 50 percent and 80 percent post-PPA.[50,51]

3) Investors who received advice make mistakes about half as often as those who are unadvised (they also consider other fractions).

Finally, the above assumptions are combined with the previously mentioned assumption that aggregate investment errors cost consumers about $114 billion per year to arrive at the final estimates of between $7 billion to $18 billion per year from having increased access to professional investment advice.

Taking the DOL's methodology and results at face value, by their own calculations the loss of access to advice, by even a small fraction of investors, would result in investment errors so large as to be of the same magnitude as the problem that the DOL is purportedly trying to solve—the "cost of conflicted advice," by the DOL's own reckoning, is on par with the losses that would be incurred by a government policy that curtails the availability of professional investment advice.

III. THE COST OF CONFLICTED INVESTMENT ADVICE

We begin with a review of the claims of harm associated with purportedly conflicted investment advice, as put forth in White House memo entitled "The Effects of Conflicted Investment Advice on Retirement Savings" ("WH/CEA memo") published in February 2015 and the Department of Labor's (DOL) proposed conflict of interest rule and definition of the term

[49] The DOL attributed these numbers at least partly to surveys including Hewitt Associates LLC, *Survey Findings: Hot Topics in Retirement, 2007* (2007); Profit Sharing/401(k) Council of America, *50th Annual Survey of Profit Sharing and 401(k) Plans* (2007); and Deloitte Development LLC, *Annual 401(k) Benchmarking Survey, 2005/2006 Edition* (2006).

[50] These are based on Employee Benefit Research Institute, *2007 Retirement Confidence Survey, Wave XVII,* Posted Questionnaire (Jan. 2007); Hewitt Associates LLC, *Survey Findings: Hot Topics in Retirement, 2007* (2007); Profit Sharing/401(k) Council of America, *50th Annual Survey of Profit Sharing and 401(k) Plans* (2007); and Deloitte Development LLC, *Annual 401(k) Benchmarking Survey, 2005/2006 Edition* (2006).

[51] It is interesting to note that the DOL assumed that "a large majority of IRA beneficiaries who invest in mutual funds purchase them via such professionals."

"fiduciary" under ERISA (the "proposal"), and associated Regulatory Impact Analysis ("RIA").[52,53]

The estimates in these documents form the basis of the Department of Labor's argument that the proposed conflict of interest rule would "benefit" the public. The Regulatory Impact Analysis in particular purports to quantify these benefits in dollar terms. As shown in detail in the next section, however, the RIA fails to do so. The RIA produces many different numbers representing different underlying assumptions, and results in estimates that vary wildly over an incredible set of values. This range of numbers is so wide as to suggest no scientific confidence in the DOL's methodology. As a result, the estimates in the RIA provide little confidence as to the actual benefits, if any, arising from the DOL's proposal.

A. Estimates of the Benefits of the Proposal Vary Wildly in the RIA

In the WH/CEA memo entitled "The Effects of Conflicted Investment Advice on Retirement Savings" published in February 2015, the authors estimated that a baseline aggregate cost to consumers from purportedly conflicted advice is about $17 billion per year. They calculated this number as one percent times the total number of mutual funds and variable annuities in IRAs. The one-percent factor came from their assessment of an average of estimates produced by various academic papers using differing methodologies and datasets.

However, this number does not appear in the subsequent DOL Regulatory Impact Analysis published two months later in April 2015. Instead, the RIA provides many different numbers, all generated by different sets of assumptions.

Table 5 summarizes the various estimates of the cost of purportedly conflicted advice that appeared in the RIA. A review of the table indicates an astounding range of different estimates. On the low end, there is mention in three separate places in the RIA (p. 8, p. 102, and p. 106) of an estimated cost from $20 billion to $22 billion over a ten year horizon. These numbers appear to come from an analysis that assumes the new DOL rules will eliminate 50 percent of

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[52] 29 CFR 2509 and 2510, DOL, Definition of the Term ``Fiduciary''; Conflict of Interest Rule-- Retirement Investment Advice; Proposed Rule in Federal Register Volume 80, Number 75 (Monday, April 20, 2015), Pages 21927-21960.

[53] "Fiduciary Investment Advice Regulatory Impact Analysis", Department of Labor, Available on-line at http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

underperformance due to front-end-load sharing, and that this is the only effect considered. These numbers equate to between $2 billion to $2.2 billion per year (setting aside discount rates and any growth in the asset base over time), which are about 13 percent of the WH/CEA memo's $17 billion per year estimate.

On the high range, the RIA states on p. 7 and p. 98 that the costs of conflicted advice could be "nearly $1 trillion" over a horizon of 20 years. This is consistent with approximately $50b in costs per year (again, setting aside discount rates, compounding of returns and other dynamic assumptions the DOL may have made). The estimate seems to come from an analysis in which it is assumed that investors lose 200 basis points (two percentage points) of annualized return per year due to "conflicted advice," instead of the 100 bps (one percentage point) assumed in the WH/CEA memo. It is not clear where the 200 bps number comes from. Nor is it clear why this number is so large, given that simply doubling the 100 bps number should approximately double the estimate from $17 billion per year to $34 billion per year. Presumably, the DOL increased the number from $34 billion to $50 billion by apparently compounding returns over time, but the RIA does not specify this in enough detail to be certain.

One reason for the incredible range in aggregate estimates is that the RIA numbers vary in terms of the horizon of interest (some are per year, some cover a 10-year horizon, and some cover a 20-year horizon), assumptions made (e.g., some assume a 100 bps reduction in investment performance, and others assume a 200 bps reduction in performance), and the universe of assets that are considered (e.g., some consider all mutual funds held in individual retirement accounts ("IRAs") while others focus only on front-end load mutual funds, and so forth).

Nevertheless, given the variety to the DOL's own numbers, the "benefit" estimates do not provide a credible foundation on which to base significant changes in policy and regulation. The very wide range in the numbers suggests that the DOL itself does not have a good measure of the dollar magnitude of purportedly conflicted advice that they seek to ameliorate.

This range of numbers is so wide as to provide no scientific confidence in the DOL's own methodology, and is inconsistent with a cost-benefit analysis that is concrete enough to form the basis of a change to federal government policy.

An additional problem with the "benefits" of the proposal, as presented by the DOL, is that the academic literature on which they base their argument does not directly apply to the question of how to best define and implement a fiduciary standard under ERISA.

B. The RIA Misapplies the Academic Literature

In this section, we discuss some important ways in which the RIA misapplies the existing academic literature in an attempt to justify the DOL proposal.

Before discussing the methodological shortcomings, we note that much of the academic literature which is cited by the RIA is based on data which is now dated and may no longer be relevant. Significant changes have occurred in the past several years. Indeed, one of the most salient recent developments is that mutual fund fees have been declining substantially, and that has occurred independently of any explicit government driven interventions.

Over the period 1990-2013, front-end sales loads have declined by nearly 75 percent for equity funds and hybrid funds, and even more than that for bond funds.[54] The ICI argues this decline, at least in part, may reflect the increasing role of mutual funds in helping investors save for retirement. That is, mutual funds now often waive load fees on purchases made through defined contribution plans, such as 401(k) plans.

Additionally, nearly all net new cash flows in recent years have accrued to no-load mutual funds. Net flows to load mutual funds have been negative for all four years of the most recent data.[55]

1. The cited literature focuses on mutual funds, yet the DOL applies the results more widely

The academic research that serves as the basis for conflicted cost-of-advice estimates focuses on the commissions embedded in mutual fund purchases and sales. These are typically front-end loads, although there may be back-end loads and on-going fees such as 12b-1 fees.[56]

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[54] See Chapter 5 of the 2014 Investment Company Fact Book, *Mutual Fund Expenses and Fees*, available on-line at http://www.icifactbook.org/fb_ch5.html

[55] *Id*., in Figure 5.10.

Yet the DOL proposal extends far beyond mutual funds. To cite one example, the proposal ends the existing prohibited transaction exemption for variable annuities and states that they would be able to be sold only under existing compensation structures under the Best Interest Contract Exemption. Other assets classes, such as options on stocks, do not appear to be permitted for sale to IRA accounts under any of the proposed exemptions.

There is no justification provided, therefore, as to why the DOL would propose making such radical shifts to the way in which all assets are sold to IRA account holders, given that the academic literature on which the RIA relies so heavily is almost exclusively limited to the mutual fund literature. There is no basis in the academic literature for extrapolating conclusions applicable to mutual funds to other investment products that may not even have front-end sales loads.

2. The research cited in the RIA takes results associated with higher-than-average load funds and misapplies them to all funds.

One of most heavily cited academic papers in the RIA is Christoffersen, Evans and Musto (2013).[57] It is cited dozens of times, and is one of the leading sources of the baseline estimate of 100 bps per year in apparent "cost of conflicted advice" that the DOL claims is suffered by investors in commission-based retirement accounts.

It is therefore important to understand the claims that actually appear in Christoffersen et al. (2013). In particular, their study finds evidence that a subset of funds, those whose front-end loads are higher than other funds with similar characteristics, underperformed the average return of their fund category during the next year. In formulating much of their "cost of conflicted advice" aggregate figures, the DOL then assumes that *all* IRAs invested in front-end load funds

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[56] The RIA attempts to portray brokers and investment advisers in the professional IRA market as charging excessive fees to investors, yet it fails to mention one of the most salient developments in recent years – namely, that mutual fund fees have been declining substantially. It is notable that this has occurred independently of any explicit government driven interventions. Investment Company Institute (ICI) expense ratio data for three broad types of mutual funds over the years 2000-2013 indicate, for example, that in 2000 equity mutual fund investors incurred average expense ratios of 99 basis points. By 2013, that number fell to 74 basis points, a decline of 25 percent. The same basic pattern is true for hybrid and bond funds. In terms of front-end sales loads, it is again the case that they have declined substantially over time with no explicit government intervention. Over the period 1990-2013, they have declined by nearly 75% for equity funds and hybrid funds, and even more than that for bond funds. Additionally, nearly all net new cash flows in recent years have accrued to no-load mutual funds. Net flows to load mutual funds have been negative for all four years of the most recent data. See Chapter 5 of the 2014 Investment Company Fact Book, *Mutual Fund Expenses and Fees*, available on-line at http://www.icifactbook.org/fb_ch5.html

[57] Christoffersen, Susan E. K., Richard Evans, and David K. Musto (2013) "What Do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives," *Journal of Finance*, Vol. 68(1), p. 201-235.

suffer the same underperformance, thereby mistakenly applying a result from a subset of load funds to all load funds.

The extrapolation the DOL made is analogous to the following: Suppose we conduct medical research and find that people who consume more salt than average have a lower life expectancy by five years, and we then conclude that eating no salt will increase the life expectancy of everyone by five years. This is a logical fallacy. We have no evidence that people who eat a "normal" amount of salt would benefit from reduced salt intake, and so extrapolating to them is an error in logic.

Again, we emphasize this point because an official cost-benefit analysis needs to be precise and free of logical fallacies. By incorrectly extrapolating from a subset of mutual funds to all mutual funds, the DOL is effectively applying the 100 bps cost number to assets for which it does not apply. Hence, the benefit side of the cost-benefit analysis presented in the RIA is seriously flawed. The result is that it is impossible to conclude whether the benefits of the DOL proposal outweigh the costs.

3. **The academic literature cited in the RIA does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts**

The academic literature on which the DOL relies, such as Christoffersen, Evans, and Musto (2013), Bergstresser, Chalmers, and Tufano (2009),[58] Del Guercio and Reuter (2014),[59] generally compares the performance of mutual funds with loads (paid as commission to brokers) versus mutual funds sold directly to the public.

None of these academic studies actually compares the performance of accounts with a financial advisor who is a fiduciary to the performance of accounts with a broker or other financial advisor that is not a fiduciary. Hence they are using results that do not address the central question of the proposal. It is absolutely inappropriate to conclude that investors would

[58] Bergstresser, Daniel, John Chalmers, and Peter Tufano (2009), "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry", The Review of Financial Studies, 22(10), p. 4129-4156.

[59] Del Guercio, Diane and Jonathan Reuter (2014) "Mutual Fund Performance and the Incentive to Generate Alpha", The Journal Of Finance, Vol. 69(4), p. 1673-1704.

be better off under an expanded fiduciary standard on the basis of the academic literature being cited.

The bulk of the literature considers data at the mutual fund level and measures their loads and performance. These can be compared to direct-to-public investments such as a "S&P 500" index fund. The academic research generally has not undertaken a direct way of comparing how investors would fare under a fiduciary standard in relation to a broker-based suitability model or a self-direction model because that analysis requires account-level data from actual investors, rather than aggregate fund-level data.[60]

Absent account-level data, the DOL is drawing fallacious conclusions. Even if it were true that fund loads cause underperformance—which is not proven—there is no reason to conclude that consumers would be better off in fiduciary advised accounts based on the evidence cited by the DOL. Fiduciary advisors do not work for free. They must also be compensated for their work, and in some cases they may be providing a great deal more service than a commission-based non-fiduciary broker and may need even more compensation. If certain investors are forced out of commission-based accounts, they may either lose access to advice entirely, or they may switch to advisory accounts which may charge more, not less. Moreover, this increased expense is likely to be particularly acute for low-balance and low-activity accounts who may pay very low annual fees and loads because their portfolios tend to be static. Hence the DOL proposal is likely to disproportionately hurt low-income Americans.

[60] A small number of academic papers have looked at account-level data, but these are generally limited to extremely small sample sets that are not in any way representative of the spectrum of American consumers. For example, Chalmers and Reuter (2014) collect account level data, but it is limited to faculty and administrators in the Oregon University's optional retirement plan (ORP). See Chalmers, J. and J. Reuter (2014), "What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?" working paper, University of Oregon.

Table 5
The Cost of Conflicted Advice Estimated by DOL Varies Widely

Entry (1)	Page (2)	Amount (3)	Horizon (4)	Methodology (5)	Notes (6)
Estimates found in *The Effects of Conflicted Investment Advice on Retirement Savings* [1]					
1	2	$17 bil.	per year	100 bps (from academic lit) * $1.7 trillion assets in IRA funds	N/A
Estimates found in *Fiduciary Investment Advice: Regulatory Impact* [2]					
1	7	100 bps	per year	"Careful review" of academic literature	N/A
2	7, 98	$210 bil.	10 years	Applying performance gap (100 bps based on academic lit) to the current IRA marketplace	100 bps figure is the average underperformance associated with conflicts of interest in the mutual funds segment
3	7, 98	$500 bil.	20 years	See above	N/A
4	7, 98	$430 bil.	10 years	Applying performance gap (200 bps based on academic lit) to the current IRA marketplace	200 bps figure is based on academic studies that suggest that the underperformance of broker-sold mutual funds may be even higher than 100 bps, possibly due to loads that are taken off the top and/or poor timing of broker sold investment
5	7, 98	"nearly" $1 tril.	20 years	See above	On pg. 8 the RIA also mentions that adviser conflicts "could cost IRA investors as much as $410 bil. over 10 years and $1 tril. over 20 years. The $410 bil. number seems to come from the 200 bps points, but the RIA is unclear

6	8	$410 bil.	10 years	DOL estimate based on reduction in excessive trading, associated transaction costs, timing errors, improvements in performance of IRA investments other than front-load mutual funds	See above
7	8, 101	$40-44 bil.	10 years	DOL estimate based of assumption that rule will eliminate 100 percent of underperformance due to variable front-end-load sharing	"Baseline scenario" where the 1975 rule remains in place. Loads projected to decrease over time at the same rate as the baseline scenario. Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing. DOL considers this estimate "conservative". Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds
8	8, 101	$88-100 bil.	20 years	See above	See above
9	8, 102, 106	$30-33 bil.	10 years	DOL estimate based of assumption that rule will eliminate 75 percent of underperformance due to variable front-end-load sharing	The Report offers no basis for the selection of 75 percent underperformance
10	8, 102, 106	$20-22 bil.	10 years	DoL estimate based of assumption that rule will eliminate 50 percent of underperformance due to variable front-end-load sharing	The Report offers no basis for the selection of 50 percent underperformance

11	105	$44.1 bil.	10	Loads decrease over time at twice the rate of the baseline scenario. Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing and increased investment performance for broker-sold mutual funds. The DOL considers this estimate "reasonably high" Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds	N/A
12	105	$99.7 bil.	20	See above	N/A
13	105	$65.6 bil.	10	Represents upper limit. Loads paid by investors immediately fall to zero Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing and increased investment performance for broker-sold mutual funds. The DOL considers this to be an "illustration but does not expect the proposal to result" in this number. Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds	N/A
14	105	$135.1 bil.	20	See above	N/A
15	98	$18 bil.	per year	Applying performance gap (100 bps) to the current IRA marketplace	N/A

16	98	$10 bil.	per year	Christoffersen, Evans, and Musto (2013) find that each 100 basis points in load sharing paid to an unaffiliated adviser reduces future returns by 50 bps and 100 bps paid to a captive broker reduces future performance by 15 bps. Authors of the RIA project these results onto the current IRA marketplace	N/A
17	98	$125 bil.	10 years	See above	N/A
18	98	$285 bil.	20 years	See above	N/A
19	98	$26 bil.	per year	Harm to consumers if industry has simply shifted conflicted revenue streams, rather than reducing conflicts	This refers to a hypothetical where the industry shifts away from front-end load mutual funds into other revenue streams with conflicts of interest. Appears to be based off of Christoffersen, Evans, and Musto (2013).
20	98	$300 bil.	10 years	See above	See above
21	98	$700 bil.	20 years	See above	See above
22	101	$80 bil.	10 years	Underperformance seen by focusing only on how load shares paid to brokers affect the size of loads IRA investors holding load funds pay and the returns they achieve	The Report assesses the gains to investors attributable to the rule by specifically quantifying benefits in an area of the IRA market where the conflicts are well measured-namely front-end load mutual funds
23	101	$200 bil.	20 years	See above	See above

Sources:

[1] *The Effects of Conflicted Investment Advice on Retirement Savings.* The White House. February 2015

[2] *Fiduciary Investment Advice: Regulatory Impact Analysis.* The Department of Labor

APPENDIX: THE COST OF COMPLYING WITH THE DOL PROPOSAL

The Regulatory Impact Analysis published by the DOL also reported estimates for the costs of implementing the DOL's new Fiduciary Standard rules. These are essentially limited to compliance costs.

A detailed overview is presented in Table 6. Turning to the top row, compliance costs are estimated to range from range from $240 million to $570 million per year (equivalently, $2.4 billion to $5.7 billion over a 10 year horizon, abstracting from applying discount rates, inflation corrections or other dynamic adjustments).

Perhaps more important than the baseline numbers, however, is the incredibly complex and opaque, ad hoc, methodology and set of assumptions which were used to formulate these estimates.

For example, The DOL's cost estimates for complying with the DOL's proposed fiduciary rule rely on data submitted by SIFMA to the SEC in 2013 (the "SIFMA Data").[61] The SIFMA Data was collected and submitted by SIFMA to the SEC for the purpose of estimating the costs of complying with potential SEC fiduciary rule changes under Dodd-Frank Section 913.[62] Although the DOL states that "*there will be substantive differences between the [DOL]'s new proposal and exemptions and any future SEC regulation that would establish a uniform fiduciary standard…* ", the DOL nevertheless relies on the SIFMA Data as part of the basis for its cost estimates.[63] DOL's stated reason for doing so is that there are *"some similarities between the cost components"* in the SIFMA Data and the costs that would be required to comply with the DOL proposal.

However, the phrase "some similarities" implies there are some differences and the DOL is, by definition, unable to address the compliance costs that may arise due to such differences in the two regulatory regimes in question.

The SIFMA Data estimates the costs of implementing an SEC-established uniform fiduciary standard in two parts. The first was the cost for broker-dealers to develop and maintain

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[61] Regulatory Impact Analysis, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf, at pp. 160 – 65.

[62] SIFMA Comment to SEC dated July 5, 2013, http://www.sifma.org/issues/item.aspx?id=8589944317.

[63] Regulatory Impact Analysis at p. 161.

a disclosure form and customer relationship guide, similar to the Form ADV Part 2A that registered investment advisors use today.

The DOL proposal does *not* require a Form ADV Part 2A-type disclosure for broker-dealers, but it would require an extensive range of new disclosure obligations that do not exist today. These include: (i) contractual disclosures under the Best Interests Contract Exemption, (ii) point of sale disclosure, including the total cost of the acquired asset over periods of 1, 5, and 10 years; (iii) annual fee and compensation disclosure; (iv) public website disclosure, including a list of all direct or indirect material compensation; and (v) aggregated data regarding inflows, outflows, holdings, and returns, including the identity and amounts of revenue received, which DOL reserves the right to publicly disclose.

The disclosure estimates in the SIFMA Data are for broker-dealers to adopt an essentially “known quantity” disclosure form that is used by advisors today. The disclosure estimates in the SIFMA Data do not address any of the new disclosure obligations in the DOL proposal. Hence it is erroneous for DOL to use SIFMA’s disclosure estimates to approximate the costs of the extensive, new, separate and distinct, disclosures required under the DOL proposal.

The second part of the SIFMA Data is the estimated cost of implementing compliance oversight and training programs to adapt to a new SEC standard. In providing these estimates, SIFMA member firms were asked to make a host of assumptions. None of these assumptions, however, include the new obligations and potential liabilities that the DOL proposal may create, including: (i) new contractual liability under the Best Interest Contract Exemption, including potentially significant individual and class action litigation exposure; (ii) compliance with a new DOL exemption in order to engage in principal transactions; (iii) new restrictions on products that may be offered and sold, and (iv) the costs of creating the new data and information that are subject to the new disclosures outlined above.

In sum, the SIFMA Data applies to estimating the cost of a contemplated SEC fiduciary regime, under specific assumptions that were applied to such a contemplated SEC approach. It is not methodologically appropriate to use the SIFMA Data to estimate the cost of a separate and distinct DOL regime, with separate and distinct requirements, obligations, liabilities, and costs.

The DOL further compounds the apparent inconsistency by relying on the SIFMA Data and then suggesting that “*the SIFMA submission significantly overestimates the costs of the new* *proposal*."[64] The DOL thus appears to be relying on inputs into its cost analysis that it does not view as accurate, thereby undermining the reliability of its own methodology.

Lastly, we note that the US Chamber of Commerce submitted a comment letter to the OMB on May 20, 2015 outlining their view that the Department of Labor vastly underestimated the compliance costs associated with the proposed Fiduciary rule.[65] Specifically, the Chamber states (on p. 2) that real costs associated with the information collection requests alone may be "five to ten times greater" than the DOL's estimate of $792 million over ten years. The ten-page letter goes on to detail the various shortcomings and implausible assumptions made by the DOL in their calculations.

While we will not undertake to comment on the OMB letter, it does serve to emphasize the clear shortcoming of the DOL's estimates. Namely, they are not based on a scientific or empirical approach and the resulting estimates may or may not be wildly inaccurate reflections of the true costs. As a result, it would be inappropriate to include them as part of a formal assessment of the costs and benefits of a proposed change in public policy.

[64] Regulatory Impact Analysis at p. 162.

[65] Available on-line at http://www.uschamber.com/sites/default/files/oira_comments.pdf.

Table 6
The Costs of Compliance Are Based on Complex and Opaque Set of Assumptions

Estimates found in *Fiduciary Investment Advice: Regulatory Impact*[1]

Page (1)	Source (2)	Amount (3)	Horizon (4)	Notes (5)
157	Department of Labor Estimate	$2.4b-5.7 bil.	10 years	Total compliance cost. Cost mostly reflects the costs incurred by new fiduciary advisers to satisfy relevant PTE conditions
162	SIFMA estimate of average start up cost to develop and implement new, comprehensive supervisory systems, procedures and training	$5 mil.	one year	Estimated costs that would be incurred by broker-dealers
162	SIFMA estimate of annual on-going costs	$2 mil.	annual	
165	DOL estimated start-up cost of compliance for medium firms based on values provided by SIFMA	$663,000	one year	$5 million x (0.133). 0.133 is the estimated ratio of medium firms and large firms' cost based on figures provided for RIAs in the IAA comment letter
165	DOL estimated start-up cost of compliance for small firms based on values provided by SIFMA multiplied by DoL's ratio	$242,000	one year	5 million x (0.048). 0.048 is the estimated ratio of small firms and large firms' cost based on figures provided for RIAs in the IAA comment letter
166	DOL total estimated start-up cost of compliance in the first year	$892 mil.	one year	
165	DOL estimated on-going cost of compliance for medium firms	$265,000	annual	$2 million x 0.133 (the IAA ratio)
165	DOL estimated on-going cost of compliance for small firms	$96,900	annual	$2 million x 0.048 (the IAA ratio)
166	DOL estimated on-going cost of compliance after first year	$357 mil.	annual	
166	Estimated start-up cost of compliance for large firms based on values provided by the IAA	$1 mil.	one year	
166	DOL estimated start-up cost of compliance for medium firms based on values provided by the IAA	$145,000	one year	The DoL took the ratio between the cost SIFMA and IAA provided (.2181) and derived the costs from that ratio referred to as the

				"ADV ratio"
166	DOL estimated start-up cost of compliance for small firms based on values provided by the IAA	$53,000	one year	SIFMA estimates multiplied by ADV ratio
166	DOL total start-up cost of compliance after first year based on IAA	$195 mil.	one year	See above
166	Estimated on-going cost of compliance for large firms based on values provided by the IAA	$436,000	annual	See above
166	Estimated on-going cost of compliance for medium firms based on values provided by the IAA	$58,000	annual	SIFMA estimates multiplied by ADV ratio
166	Estimated on-going cost of compliance for small firms based on values provided by the IAA	$21,000	annual	See above
166	DOL estimated total annual ongoing costs for subsequent years based on IAA	$78 mil.	annual	See above

Cost of Developing and Maintaining a Disclosure Form and Customer Relationship Guide

161	SIFMA reported start-up cost for preparing a relationship guide similar to the Form ADV 2A	$2.8 mil.	one year	
161	SIFMA reported "low" start up cost	$1.2 mil.	one year	
161	SIFMA reported "high" start-up cost	$4.6 mil.	one year	
161	SIFMA reported average annual on-going cost	$631,000	annual	

Costs Incurred by Registered Investment Advisors

166	DoL Analysis of cost for legal consultation for small firms	$3,840	one year	Hourly rate of $480. 8 hours assumed
166	DoL Analysis of cost for legal consultation for medium firms	$7,680	one year	Hourly rate of $480. 16 hours were assumed.
166	DoL Analysis of cost for legal consultation for large firms	$19,200	one year	Hourly rate of $480. 40 hours were assumed.
167	DoL Analysis of costs of training for a large firm in the first year	$30,000	one year	
167	DoL Analysis of costs of training for a large firm after the first year	$10,000	annual	
167	DoL Analysis of costs of training for a medium firm in the first year	$4,000	one year	

167	DoL Analysis of costs of training for a medium firm after the first year	$1,500	annual	
167	DoL Analysis of costs of training for a small firm in the first year	$1,500	one year	
167	DoL Analysis of costs of training for a small firm after the first year	$1,500	annual	
167	Total cost to evaluate compliance with rule and provide training for a large RIA firm in the first year	$49,200	one year	
167	Total cost to evaluate compliance with rule and provide training for a medium RIA firm in the first year	$11,700	one year	
167	Total cost to evaluate compliance with rule and provide training for a small RIA firm in the first year	$5,300	one year	
167	Total cost to evaluate compliance with rule and provide training for a large RIA firm in the subsequent years	$10,000	annual	
167	Total cost to evaluate compliance with rule and provide training for a medium RIA firm in the subsequent years	$1,500	annual	
167	Total cost to evaluate compliance with rule and provide training for a small RIA firm in the subsequent years	$500	annual	
167	Total Cost for IRA firms in the first year	$110.8 mil,	one year	
167	Total Cost for IRA firms in the subsequent years	$11.9 mil.	annual	

Costs Incurred by Plan Service Providers

168	Start-up cost for a large firm	$49,000	one year	
168	Start-up cost for a medium firm	$12,000	one year	
168	Start-up cost for a small firm	$5,000	one year	
168	Aggregate start-up cost for training employees	$24.1 mil.	one year	
169	On-Going Costs for small firm	$10,000	annual	2,275 small service providers, 437 medium service providers, 142 large service providers
169	On-Going Costs for medium firm	$2,000	annual	
169	On-Going Costs for large firm	$1,000	annual	
169	Aggregate on-going costs for training employees, yearly	$3.2 mil.	annual	

				2,275 small service providers, 427 medium service providers, 142 large service providers

Additional Costs

171	Increased insurance premiums for consultants, firms and broker-dealer representatives	premiums for these affected service providers could be expected to increase 10 percent; average insurance premium is $3,000 per representative. Premium increase would be $300 per insured	N/A	DoL estimates that 50% of the cost reflects the expenses and profits of insurance carriers, while the remainder is not a cost but a transfer in the form of compensation paid to those harmed by the insured fiduciary investment adviser
172	one year premium increase for broker dealer representatives	$87 mil.	one year	290,000 broker dealers multiplied by $300
173	Cost of premiums and transfers from firms to plans or IRA investors	$63 mil.	annual	418,00 BD representatives and plan service provider employees could experience a $300 increase. 50% is paid out as compensation and 50% is paid to the insuring firm
174	First year cost for each BD representative converting to RIA status	$5,600	one year	50 hours preparing for Series 65 exam (at $106.06/hour) plus additional costs
174	Total first year cost of BD to RIA conversion	$59.4 mil.	one year	
174	Ten year cost of BD to RIA conversion	$445 mil.	ten years	
177	first year cost for producing and distributing the disclosures and subsequent compliance	$77.4 mil.	one year	
177	on-going cost for subsequent years for producing and distributing disclosures	$29.2 mil.	annual	
177	first year cost of the 6.3 million disclosures required under the new Principal Transactions PTE	$57.4 mil.	one year	
	on-going cost of the 6.3 million disclosures required under the new Principal Transactions PTE	$47.8 mil.	annual	
177	Disclosure requirements required by the amended PTE 86-128	$198,000	annual	
177	Seller's Carve-Out disclosures	$6.2 mil.	annual	Assumes 43,000 disclosures

178	The Platform Provider Carve-Out	$39,000	annual	Assumes 1,800 disclosures
178	The Investment Education Carve-Out	$121,000	annual	Assumes 2,800 disclosures
178	Total exemptions and carve-outs cost in the first year	$141.5 mil.	one year	Assumes 92.4 million additional disclosures
178	Total exemptions and carve-outs cost in the subsequent years	$83.5 mil.	annual	
178	Total exemptions and carve-outs cost in 10 years	$791.8 mil.	10 years	

Mentioned But Not Quantified

175	Increased traffic in Call Centers
176	Cost of creating or updating contracts
176	transitional impacts on the financial sector market
176	impact on asset providers
177	costs for complying with the new and amended PTEs

Sources

1 *Fiduciary Investment Advice: Regulatory Impact Analysis*. The Department of Labor

Our work in this matter is ongoing and we may update or change our opinions as we continue our review and analysis.