



# MONEY MANAGEMENT INSTITUTE

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July 20, 2015

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 NW  
Washington, DC 20210  
[Letter Submitted Electronically]

RE: Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice (RIN 1210-AB32)  
Proposed Best Interest Contract Exemption (ZRIN: 1210-ZA25)  
Proposed Class Exemption for Principal Transactions in Certain Debt Securities Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs (ZRIN: 1210-ZA25)  
Proposed Amendments to Various Exemptions (ZRIN: 1210-ZA25)

Ladies and Gentlemen:

The Money Management Institute (“MMI”) appreciates the opportunity to provide its views on the recently re-proposed Department of Labor (“DOL”) regulation to redefine the term “fiduciary” for purposes of the Employee Retirement Income Security Act of 1974 (“ERISA”) and Section 4975 of the Internal Revenue Code of 1986, as amended (the “Code”),<sup>1</sup> the two proposed prohibited transaction class exemptions (“PTEs”)—the Best Interest Contract Exemption (“BIC Exemption”)<sup>2</sup> and the class exemption for principal transactions in certain debt securities<sup>3</sup>—as well as proposed amendments to certain existing PTEs.

MMI supports appropriate efforts to protect investors, as well as efforts to preserve current business models and investor choice. We are concerned, however, that the DOL’s proposed regulation and PTEs might have the unintended consequence of ultimately harming investors saving for, approaching, or in retirement. There are several inconsistencies with the federal securities laws, as well as technical aspects of the proposal, that will negatively impact sponsors, managers, and platform providers in the separately managed account (“SMA”)

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<sup>1</sup> Definition of the Term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 80 Fed. Reg. 21928 (Apr. 20, 2015) (to be codified at 29 C.F.R. pts. 2509 & 2510) [hereinafter “Proposed Definition of Fiduciary”].

<sup>2</sup> Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960 (Apr. 20, 2015).

<sup>3</sup> Proposed Class Exemption for Principal Transactions in Certain Debt Securities Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, 80 Fed. Reg. 21989 (Apr. 20, 2015).

market by unnecessarily increasing the compliance burdens and costs and risks of providing services to retirement plan and IRA clients.<sup>4</sup> Such negative impact might very well lead firms to cut back significantly the types and levels of services they are willing to provide to such clients, drop out of the market entirely, or charge clients significantly more for those services.

We have provided alternative approaches for the DOL's consideration that we believe will achieve the DOL's stated goals more efficiently, at a lower cost, and without sacrificing investor protections or investor choice. We encourage the DOL to revise its proposal to address these concerns, as described in more detail below.

- The DOL should permit investment advisers and program sponsors to market their advisory programs and services without the risk of becoming investment advice fiduciaries. To provide clarity on this point, the DOL should (i) narrow the definition of "recommendation"; (ii) expand the investment education carve-out; and (iii) provide an explicit seller's exception for services.
- The DOL should clarify that SMA program model providers, which typically provide nondiscretionary advice to a SMA sponsor/manager, and not to or in respect of the sponsor/manager's clients, will not be treated as investment advice fiduciaries.
- The DOL should revise the proposal to address certain unnecessary restrictions on principal trading. The DOL should provide relief for principal trades where a sophisticated money manager executes trades through a program sponsor. In addition, the DOL should revise the proposed PTE for principal transactions to mirror the requirements of Temporary Rule 206(3)-3T under the Investment Advisers Act of 1940 ("Advisers Act").
- The DOL should not add impartial conduct standards to existing PTEs.
- The DOL should conduct focus groups followed by extensive testing prior to adopting any aspect of the proposal.

We further encourage the DOL to coordinate and collaborate with the U.S. Securities and Exchange Commission ("SEC"), which is the primary regulator for large investment advisers. We urge the DOL to harmonize the various rules and standards that apply to financial institutions so that investment advisers and others can continue to serve investors and provide them with guidance and choices to help in achieving their retirement goals.

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<sup>4</sup> Please note that with respect to the BIC Exemption, we and our members have numerous concerns and questions as to how financial institutions will be able to comply with the onerous requirements and further question the necessity of the DOL's restrictions on the types of assets it covers. However, we understand that several trade associations and their respective members will be submitting detailed letters explaining these concerns. Thus we have not included specific comments on the BIC Exemption in this letter, but direct you to such other letters on this issue.

## **I. Overview of MMI and the Role of SMA Programs in the Retirement Market**

MMI is the national organization for the advisory solutions industry, representing a broad spectrum of investment advisers that manage separate accounts, as well as sponsors of investment consulting programs. MMI was organized in 1997 to serve as a forum for the industry's leaders to address common concerns, discuss industry issues, and work together to better serve investors. Our membership is comprised of firms that offer comprehensive financial consulting services to individual investors, foundations, retirement plans, and trusts; related professional portfolio management firms; and firms that provide long-term services to sponsor, manager, and vendor firms. MMI is a leader for the advisory solutions industry on regulatory and legislative issues.

SMA programs play an important role in the retirement market by providing high quality institutional management options to investors with both large and small account balances. SMA programs are managed account programs sponsored by a financial institution, such as an investment adviser, dually registered broker-dealer/investment adviser, or a bank, that offers discretionary investment advisory services to clients, typically pursuant to arrangements with other financial institutions. SMA programs include (i) so-called "wrap fee programs," which the SEC defines as "an advisory program under which a specified fee or fees not based directly upon transactions in a client's account is charged for investment advisory services (which may include portfolio management or advice concerning the selection of other investment advisers) and the execution of client transactions,"<sup>5</sup> as well as (ii) programs where the client receives the same complement of services in unbundled form. Unlike clients in pooled vehicles such as mutual funds, clients in SMA programs receive tailored advice based on their investment objectives and financial circumstances, and retain direct and sole ownership of their account assets. Through SMA programs, many clients (including plans and IRAs) receive comprehensive investment services that include, in the aggregate, financial advisory, portfolio management, custody, securities execution, reporting, and consultation.

SMA programs are typically designed to comply with the nonexclusive safe harbor from the definition of "investment company" for certain discretionary investment advisory programs under Rule 3a-4 under the Investment Company Act of 1940. Rule 3a-4 is designed to ensure that investment advisers relying on the rule provide individualized or tailored advice to their individual clients, which negates the notion that the discretionary advisory program be deemed the pooling of client assets that may require registration as an investment company. For example, the rule requires the sponsor or its designee to provide quarterly statements of all activity in the account; to manage the account in accordance with reasonable client restrictions; and to contact each client at least annually to learn of changes in the client's financial situation or investment objectives and any changes in the restrictions imposed by the client.

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<sup>5</sup> See Investment Advisers Act Rule 204-3(h)(5), 17 C.F.R. § 275.204-3(h)(5).

Our members sponsor SMA programs that employ a variety of different investment philosophies and styles—including both active and passive management. We note that the DOL’s proposal, though it does not directly prohibit or limit the use of actively managed strategies, seems to be premised on the view that low-cost, passively managed strategies may be more beneficial to investors. This view is reflected in the proposal’s over-emphasis on disclosure of costs and fees, as opposed to the level and nature of services an investor receives and factors indicating the quality of investment products and services, as well as in the preamble’s discussion of a potential “low fee streamlined exemption.”<sup>6</sup> We are concerned that this view fails to recognize the potential benefits of active management, notwithstanding potentially higher costs associated with these strategies.

In evaluating the benefits of passive and active management, context matters and studies often diverge in their conclusions. Academic reviews analyzing the performance of passive and active management styles are influenced by the period covered, the methodology used, the investments and funds covered, and, to a certain extent, the authors’ biases. For example, the results of a study may have been different if it examined a period of time beginning one or two years prior. Moreover, studies primarily examine the average performance of managers compared to either a benchmark or to the average passive manager. They do not generally look at the performance of individual managers, which can differ greatly.

Indeed, while some studies may show that passive strategies beat active strategies net of fees and expenses, others have shown the opposite.<sup>7</sup> Studies have also shown that active management improves investment returns in times of market stress, such as bear markets and volatile markets.<sup>8</sup> Further, active management may provide better returns when pursuing certain investment strategies, such as value-based strategies involving U.S. or foreign issuers.<sup>9</sup> In light of this, we do not think that it would be appropriate for the Department to issue any final rule that would favor one strategy over the other. Investors and their advisers should be free to choose strategies they believe are most suited to achieving the investor’s investment objectives.

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<sup>6</sup> 80 Fed. Reg. at 21978 (indicating support for the position that “the optimal investment strategy is often to buy and hold a diversified portfolio of assets calibrated to track the overall performance of financial markets,” such as through a low-priced, passively managed target date fund.)

<sup>7</sup> See Robert C. Jones & Russ Wermers, *Active Management in Mostly Efficient Markets*, 67 FIN. ANALYSTS J. 29 (Nov. 2011); Antti Petajisto, *Active Share and Mutual Fund Performance*, 69 FIN. ANALYSTS J. 73 (July 2013).

<sup>8</sup> See Robert Kosowski, *Do Mutual Funds Perform When it Matters Most to Investors? US Mutual Fund Performance and Risk in Recessions and Expansions* (Aug. 1, 2006), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=926971](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=926971); Tobias Moskowitz, *Discussion: ‘Mutual Fund Performance: An Empirical Decomposition into Stock-Picking Talent, Style, Transaction Costs, and Expenses’*, 55 J. OF FIN. 1695 (Aug. 2000).

<sup>9</sup> See Morningstar Manager Research, *Morningstar’s Active/Passive Barometer: A New Yardstick for an Old Debate* (June 2015), available at <http://corporate.morningstar.com/US/documents/ResearchPapers/MorningstarActive-PassiveBarometerJune2015.pdf>. The DOL should also recognize that active managers may provide greater returns when pursuing strategies designed around niche and foreign indexes.

Our membership offers services that are critical to helping Americans achieve their retirement savings goals and investment objectives. The potential impact of leaving investment decisions to individual investors with little or no investment expertise has further concerned regulators, investor advocates, plan sponsors, and investment professionals alike. These potential effects have been the focus of studies comparing investment performance in defined benefit plans to performance in participant-directed plans. For example, one study indicates that defined benefit plans, which are generally centrally managed by sophisticated investment committees with the aid of professional investment advisers and consultants, have consistently outperformed defined contribution plans, which are generally participant-directed, by approximately 1% on average in terms of medians weighted by plan assets.<sup>10</sup> A 1% difference in performance over a participant's working life can have a dramatic impact on the amount the participant is able to save for retirement.<sup>11</sup> It is also worth noting that defined benefit plans outperformed defined contribution plans by margins of greater than 2% during the two most recent bear markets in 2000–2003 and 2008.<sup>12</sup>

Studies have also focused on identifying potential reasons for the underperformance of defined contribution plans relative to defined benefit plans. Some studies focusing on 401(k) plan investors found poor performance because participants tended to manage their investments by transferring assets to funds that have a recent history of high performance.<sup>13</sup> These studies indicate that “chasing returns” tends to result in lower returns because high performance is generally temporary, and fund performance tends to regress to the mean.<sup>14</sup> Other studies indicate that the plethora of investment options offered on a typical 401(k) plan menu impedes participant decision-making.<sup>15</sup> “Option overload” may result in asset allocations that may not be best suited to achieving the participant's retirement goals, for example, where the participant's account is invested by default or the participant allocates assets equally to each available option.<sup>16</sup> These studies also suggest that the more investment options there are,

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<sup>10</sup> Towers Watson, *Defined Benefit vs. 401(k) Investment Returns: The 2008-2009 Update*, March 2011.

<sup>11</sup> The Department of Labor illustrated the effect of a 1% decrease in investment returns in an example demonstrating the impact of 401(k) plan fees. In the example, an employee with 35 years until retirement had a 401(k) account balance of \$25,000. If the participant's returns on investments net of fees over 35 years averaged 6.5%, the participant would have \$227,000 at retirement. But, if the participant's returns net of fees over the same period averaged 5.5%, his account balance would grow to only \$163,000. The 1% difference in returns would reduce the account balance at retirement by 28%. U.S. Department of Labor, Employee Benefits Security Administration, “A Look at 401(k) Plan Fees,” Oct. 2010.

<sup>12</sup> Towers Watson, *supra* note 10.

<sup>13</sup> See, e.g., E. J. Elton, M. J. Gruber, & C. R. Blake, “Participant Reaction and the Performance of Funds Offered by 401k Plans,” *Journal of Financial Intermediation* (2007).

<sup>14</sup> *Id.*

<sup>15</sup> See, e.g., G. Huberman and W. Jiang, “Offering versus Choice in 401(k) Plans: Equity Exposure and Number of Funds,” *Journal of Finance* 61(2) (2006); Z. Bodie & H. Prast, “Rational Pensions for Irrational People: Behavioral Science Lessons for the Netherlands,” *Netspar Discussion Papers* (2011).

<sup>16</sup> *Id.*

the less likely employees are to participate in the plan.<sup>17</sup> Others have suggested that participants are overwhelmed by the large amounts of information and disclosures that they receive and cannot easily find and absorb the information they need to make informed investment decisions.<sup>18</sup> These, among other potential causes of underperformance in 401(k) plans, suggest that investors benefit from the help of an investment professional in managing their assets.

Finally, we note that diverse viewpoints and investment styles promote market efficiency, which in turn enhances economic growth and benefits the U.S. as a whole.<sup>19</sup> We are concerned that a regulation that substantially limits investor choice in the \$17.6 trillion retirement market may have a profound negative impact on capital formation and the efficiency of the U.S. capital markets. The DOL should give meaningful consideration to the broad impacts of this proposal before proceeding with a final rule.

## **II. Investment Advisers and Program Sponsors Should Be Able to Market Their Advisory Programs and Services Without Becoming Investment Advice Fiduciaries**

We are concerned that the DOL's proposal would unnecessarily restrict our members' ability to help retirement investors understand and choose among advisory programs and services, including retirement investors' decisions about whether to enter into advisory relationships, as opposed to brokerage or other relationships, and what type of advisory program, including an SMA, would satisfy their retirement needs. MMI members work with prospective clients to help them understand their options and make informed investment decisions. To aid in this decision-making process, our members provide prospective clients with extensive disclosures about their services, fees, conflicts of interest, disciplinary history, and other information. If a prospective client decides to enter into an advisory relationship, SMA program sponsors generally enter into a written agreement with the client that defines the contours of the firm's relationship with the client.

We recognize that the DOL is concerned that the current five-part test incorporated into the current definition of "investment advice" may allow some service providers to improperly avoid investment advice fiduciary status. We are troubled, however, that the DOL has proposed an approach that is so overly broad that it would treat as fiduciary acts nearly all discussions with prospective clients about available programs and products. Specifically, the DOL has proposed a definition of "fiduciary" that would encompass almost any communication about investment options with prospective clients. In addition, the DOL's proposed carve-out

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<sup>17</sup> *Id.*

<sup>18</sup> See, e.g., Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, 73 Fed. Reg. 43014, 43016 (proposed July 23, 2008) (noting that "information that is too detailed may overwhelm participants."); The ERISA Industry Committee, Letter to Office of Regulations and Interpretations, Employee Benefits Security Administration re: Fee Disclosure RFI (July 19, 2007); L. Boselovic, "New Regulations to Make 401(k) Quarterly Statements Even Longer," Pittsburgh Post-Gazette, (Aug. 30, 2012).

<sup>19</sup> See Jones & Wermers, *supra* note 7, at 42.

for investment education is so narrow that it would not provide our members with sufficient comfort that a particular conversation would not later be deemed investment advice.

Under the proposal, a person will be deemed an investment advice fiduciary if it (1) makes recommendations to a plan, plan participant, or individual retirement account (“IRA”) owner about investment options, distribution options, the management of securities in an account, or the selection of another person who will provide advice for a fee, and (2) either (i) represents it is acting as a fiduciary or (ii) “[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.”<sup>20</sup> Further, the DOL has defined the term “recommendation” to include any “call to action.”<sup>21</sup> This broad approach to what would constitute a recommendation, combined with the fact that it would only need to be “specifically directed to” a plan, plan fiduciary, plan participant, or IRA owner, will create uncertainty about the circumstances under which our members will be deemed an investment advice fiduciary. For example, even mailing general marketing material to a plan participant or IRA owner could be viewed as fiduciary investment advice if it is viewed as “directed to” the particular recipient.

Coupled with the broad definition of fiduciary investment advice are several narrowly defined carve-outs from fiduciary status. These carve-outs, including the carve-out for investment education and the counter-party carve-out, would not exclude many common marketing activities from the types of activities that could result in fiduciary status.

Because status as an investment advice fiduciary will subject financial institutions to the prohibited transaction restrictions under ERISA and the Code, as well as to potential liability for fiduciary breaches, we believe it is critical that the DOL provide clear lines defining those activities that would cause a person to be deemed an investment advice fiduciary and those that would not. Where clean lines are not drawn and our members cannot be sure whether they would be considered investment advice fiduciaries, they would need to restrict their activities to those that clearly do not involve investment advice, or risk a later determination that they were acting as fiduciaries and engaged in a prohibited transaction. To provide greater clarity about what creates fiduciary status, the DOL should (1) narrow the definition of “recommendation”; (2) expand the carve-out for investment education; and (3) provide an explicit seller’s exception for services.

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<sup>20</sup> We note that the provision of certain valuations and fairness opinions could also trigger investment advice fiduciary status.

<sup>21</sup> Specifically, “recommendation” is defined as “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.”

#### A. Narrow the Definition of “Recommendation”

In light of its breadth and consequences for the definition of “fiduciary” and related carve-out for investment education, the DOL should narrow the definition of “recommendation.” We understand that the DOL based its proposed definition, at least in part, on Financial Industry Regulatory Authority (“FINRA”) guidance under FINRA Rule 2111 (Suitability). FINRA’s suitability rule includes a reasonable-basis suitability component for generalized recommendations and a customer-specific suitability component for customer-specific recommendations, and each of those components applies to different levels of recommendations.<sup>22</sup> Specifically, reasonable-basis suitability applies to general recommendations (e.g., recommendations that investors consider investing in certain sectors, pursuing certain investment strategies, or using certain investment products, such as target date funds) and requires that the recommendations be suitable for at least some investors. In comparison, customer-specific suitability applies to customer-specific, or individualized, recommendations (e.g., recommendations that particular investors considering retirement in 2020 invest in a target date fund with a 2020 target date), and requires that the recommendations be suitable for the customer or customers to whom the recommendation is made based on the customer’s investment profile.

The DOL should revise the definition of “recommendation” or provide guidance to clarify that investment advice fiduciary status only applies where there is a customer-specific recommendation, as opposed to a generalized recommendation. At a minimum, this should include adopting, without modification, existing FINRA guidance on customer-specific recommendations. This will allow financial institutions to follow a consistent approach to determining what constitutes a recommendation.

Additionally, the DOL should clarify what information can be provided upon an investor’s request without being considered a recommendation. We are concerned that financial institutions may be reluctant to provide information, such as mutual fund prospectuses and other information about investment options or services, to retirement investors, even upon their request, if providing those materials would be viewed as a fiduciary activity because they are viewed as a recommendation that is “specifically directed to” the investor.

#### B. Expand the Investment Education Carve-Out

In addition to clarifying what constitutes a recommendation, the DOL should expand the investment education carve-out to provide financial institutions greater latitude in discussing and educating retirement investors about the services and investment options available through the financial institution. Our members find that most retirement investors need help in understanding their investment options and that an educational process can be quite helpful in allowing retirement investors to make important decisions about their retirement savings.

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<sup>22</sup> FINRA Rule 2111 also includes a quantitative suitability component, which is not relevant to this particular discussion.

These discussions are also important to our members' ability to market their services and to help investors make informed consumer choices.

We believe the proposed carve-out for investment education is unnecessarily restrictive for at least four reasons. First, it would not apply where information and materials provided would constitute a recommendation, whether standing alone or in combination with other materials. In light of the broad definition of recommendation, we are concerned that this limitation could be interpreted and applied to effectively eliminate the ability of our members to rely on the carve-out. Second, it is not clear whether the carve-out for plan information applies to information about investment advisory services, including, for example, various SMA options. Third, even if it did apply, the carve-out would be available only where the information does not reference the "appropriateness" of the service for the plan or IRA, or a particular participant or beneficiary or IRA owner.<sup>23</sup> Fourth, the other carve-outs for general financial, investment, and retirement information, asset allocation models, and interactive investment materials would not be available where they identify specific investment products or alternatives or distribution options, which is oftentimes necessary or helpful when illustrating general financial concepts.

The DOL should clarify that financial institutions can provide information about investment advisory services, including available account options and strategies, in reliance on the carve-out for product information. We further believe that, if the DOL is going to limit the availability of that carve-out to instances where there is no reference to the "appropriateness" of an investment alternative or distribution option, the DOL should clearly define what reference the "appropriateness" means, and provide sufficient examples so that financial institutions and advisers can understand what communications are permissible under the carve-out.

Additionally, the DOL should revise the carve-out for investment education generally to permit information that identifies or includes investment products and alternatives and distribution options. Our members frequently provide sample asset allocations and analytics to prospective investors that identify specific funds and holdings to demonstrate their investment approach. We believe investors find this information useful in evaluating potential providers. We also believe that these types of tools can be provided in a way that the investor would not reasonably believe that he or she is in a fiduciary relationship with the adviser, until after retaining the adviser to provide fiduciary services.

### C. Provide an Explicit Seller's Exception for Services

The DOL has proposed a specific carve-out for counterparty transactions with a plan fiduciary with financial expertise. We understand, however, that there are questions about whether this carve-out would be available for the sale of services and that, even if applicable to services, it would only be available in the limited circumstances outlined in the proposal. In

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<sup>23</sup> We note that the DOL has not provided any guidance as to what would be considered referencing the "appropriateness" of an investment alternative or distribution option.

particular, the carve-out would not otherwise be available to dealings with plan participants, IRA owners, and plan fiduciaries of small plans because of the limitations on covered investors under the carve-out.

We believe the DOL should expand on the concept behind the carve-out for counterparty transactions by providing a separate, explicit carve-out for the sale of services to plan participants, IRA owners, and small plan fiduciaries. This carve-out should allow a financial institution or adviser to sell and market services and account options to a plan participant, IRA owner, or small plan fiduciary without being deemed an investment advice fiduciary in circumstances under which the plan participant, IRA owner, or plan fiduciary is provided information about the non-fiduciary nature of the relationship and the conflicts of interest inherent in selling and marketing services and account options.

This would be consistent with the historical treatment of fiduciary and advisory relationships as distinct from sales and marketing activities. The DOL and the courts have long recognized that sales pitches and other efforts to sell services are to be distinguished from fiduciary acts.<sup>24</sup> Similarly, investment advisers under the Investment Advisers Act of 1940 (“Advisers Act”) have long been permitted to negotiate with clients the terms of an advisory relationship, and the adviser’s obligations are different when the adviser is dealing with a prospective client.<sup>25</sup> Under the Advisers Act, an investment adviser must disclose all material facts about conflicts of interest and potential conflicts of interest to both clients and prospective clients, and, once an advisory relationship is established and a fiduciary relationship exists, investment advisers owe additional fiduciary obligations to clients.<sup>26</sup> This distinction

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<sup>24</sup> See *Farm King Supply, Inc. v. Edward D. Jones & Co.*, 884 F.2d 288 (7th Cir. 1989); see also *Leimkuehler v. Am. United Life Ins. Co.*, 713 F.3d 905, 912–13 (7th Cir. 2013) (confirming that selecting both funds and their share classes for a menu of investment options offered to 401(k) plan customers does not, standing alone, transform a provider of annuities into a functional fiduciary under ERISA); *Hecker v. Deere & Co.*, 556 F.3d 575 (7th Cir. 2009) (citing *Farm King* and finding that “merely playing a role or furnishing professional advice” in the selection of funds is not enough to create fiduciary status), *rehearing denied*, 569 F.3d 708, *cert. denied*, No. 09-447 (Jan. 19, 2010); *Am. Fed’ of Unions, Local 102 v. Equitable Life Assurance Soc’y*, 841 F.2d 658 (5th Cir. 1988) (noting that simply urging the purchase of products does not make an insurance company an ERISA fiduciary with respect to those products).

<sup>25</sup> See generally, FRANKEL & SCHWING, REGULATION OF MONEY MANAGERS: MUTUAL FUNDS AND ADVISERS § 11.01 (2d ed. Supp. 2014).

<sup>26</sup> The antifraud provisions of the federal securities laws, as well as certain FINRA rules, also apply to broker-dealers when dealing with prospective customers. For example, section 15(c) of the Securities Exchange Act of 1934 (“Exchange Act”) prohibits a broker-dealer from inducing or attempting to induce the purchase or sale of a security using any manipulative, deceptive, or other fraudulent device or contrivance. Sections 9(a) and 10(b) of the Exchange Act and section 17(a) of the Securities Act of 1933 (“Securities Act”) also include antifraud provisions that are applicable to broker-dealers when dealing with retail customers. Similarly, FINRA Rule 2111 (Suitability) and FINRA Rule 2210 (Communications with the Public) apply to dealings with prospective customers.

We also note that the regulations under ERISA section 408(b)(2) require service providers, including those who provide fiduciary services, to disclose extensive information about direct and indirect compensation expected to be received prior to entering into an agreement or arrangement for services with an ERISA-covered retirement plan. DOL Reg. § 2550.408b-2(c).

between the obligations that investment advisers owe to prospective clients prior to entering into an advisory relationship and the obligations owed to advisory clients is important, and reflects how negotiation of the terms of an advisory contract is the subject of arm's-length negotiation between the investment adviser and the prospective client.<sup>27</sup> Further, we note that in these circumstances, with respect to investment advisers and broker-dealers, the federal securities laws would provide adequate protections for retirement investors.

Accordingly, we request that the carve-out be available where the financial institution or adviser can demonstrate that the plan participant, IRA owner, or plan fiduciary knows or reasonably should know that (1) the financial institution or adviser is marketing its services and account options in a sales capacity; (2) the financial institution's or adviser's interests may not be aligned with the interests of the plan participant, IRA owner, or plan fiduciary because the financial institution or adviser will receive additional compensation if it is hired; and (3) the financial institution and adviser are not providing impartial investment advice in marketing and/or selling its services and account options. This could be accomplished through clear, consistent, and meaningful disclosures to the prospective customer.

### **III. Model Providers Should Not Be Treated as Investment Advice Fiduciaries**

We are also concerned that the DOL's proposal may treat firms that provide investment models to a fiduciary SMA program sponsor/manager as investment advice fiduciaries even though the model providers typically provide generic model portfolios that are not individualized or specifically directed to a plan, plan participant, or IRA owner.

Under certain SMA programs, an investment adviser other than the sponsor serves as the discretionary portfolio manager to the program client with respect to a particular strategy and account, and has a direct advisory and fiduciary duty to such clients.<sup>28</sup> Under other programs ("Model-Based Programs"), the SMA program sponsor serves as both the sponsor and the discretionary portfolio manager (a "Sponsor/Manager"). In Model-Based Programs, the Sponsor/Manager has the direct advisory and fiduciary duty to its clients. In this case, the Sponsor/Manager frequently hires a third party to provide it generic model portfolios with respect to a particular strategy that the Sponsor/Manager may consider in its provision of services to its clients. These model providers generally do not know the identity of, or have any information about, the Sponsor/Manager's clients, and have no advisory relationship with the Sponsor/Manager's clients. The model provider's models are not individualized or directed to any of the Sponsor/Manager's clients.

As proposed, the definition of "fiduciary" would include a person that renders investment advice about the investment of money or other property of a plan or IRA to, among

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<sup>27</sup> See FRANKEL & SCHWING, *supra* note 25, at § 12.01 (discussing advisory agreements); Amendments to Form ADV, Investment Advisers Act Release No. 3060 (July 28, 2010), 75 Fed. Reg. 49234, 49234–35 (Aug. 12, 2010) (discussing the client's responsibility to either accept the terms of, or otherwise renegotiate, an advisory agreement).

<sup>28</sup> Additionally, under current law, in many cases the SMA sponsor serves as investment advice fiduciary.

others, a plan fiduciary. Thus, if a Sponsor/Manager or other fiduciary in a Model-Based Program were a fiduciary to a plan or IRA in this context and uses models (and changes to those models) in managing the client's account, the model provider could be deemed to be providing advice to the Sponsor/Manager—a plan fiduciary—and could therefore be deemed a fiduciary itself under the proposal. Treating model providers as investment advice fiduciaries would disrupt access to these valuable arrangements. Retirement investors benefit from the comprehensive services provided to them by Sponsor/Managers in Model-Based Programs by obtaining access to the expertise of institutional money managers when investing smaller amounts of assets that would otherwise not be eligible for the money manager's services. An expansive application of the definition would be duplicative, inefficient, and costly while giving ERISA plans, plan participants, and IRA owners no, or only marginal, additional protections.

We see no reason why investment advice fiduciary status should extend to model providers in Model-Based Programs where they (1) do not have privity or an advisory relationship with the plan, plan participant, or IRA owner; (2) do not exercise investment discretion over the particular account; (3) do not generally have specific knowledge about the plan, plan participant, or IRA owner; and (4) do not provide any investment advice that is tailored to the particular financial objectives or investment circumstances of the plan, plan participant, or IRA owner. As previously noted, in Model-Based Programs, the Sponsor/Manager has a direct advisory and fiduciary duty to its clients. Specifically, the client and the Sponsor/Manager will enter into a discretionary investment advisory agreement. The Sponsor/Manager will enter into a model provider agreement with the model provider, to which the client is not a party, and under which the model provider agrees to provide its generic models in a particular strategy to the Sponsor/Manager. The Sponsor/Manager will decide how and when to employ the models and will manage the clients' accounts on a fully discretionary basis.

It is important to note that in Model-Based Programs, the Sponsor/Manager generally has responsibility vis-à-vis its client for exercising investment discretion over the client account in accordance with ERISA and the Code's prohibited transaction rules, including when making investment decisions as to specific investments and implementing trades. As such, the Sponsor/Manager, an investment adviser, would be subject to ERISA's duties of prudence and loyalty, as well as the prohibited transaction rules under ERISA and Section 4975 of the Code, as applicable. Thus, there is no gap in regulatory coverage in this context as the Sponsor/Manager will ultimately be responsible to the client, and it would be unnecessarily duplicative to impose such obligations on the model provider. In addition to the fact that model providers generally do not know the identity of or have any information regarding the Sponsor/Manager's clients, and have no advisory relationship with the Sponsor/Manager's clients, there is already a fiduciary—usually a highly sophisticated fiduciary chosen by the client—with respect to the same activity. Treating model providers as fiduciaries to the Sponsor/Manager's clients would require model providers to perform activities that are already being performed by the Sponsor/Manager as a fiduciary.

We therefore request that the DOL revise the proposal to clarify that model providers are not investment advice fiduciaries. This would protect access to Model-Based Programs, and other similar beneficial practices. At the same time, it would recognize that fiduciary obligations still apply to the financial institutions that exercise investment discretion over the accounts of ERISA plan and IRA end clients. Specifically, we request that the DOL modify the rule to carve out from the definition of fiduciary those persons that provide models to plan fiduciaries where the plan fiduciaries are either (1) registered as investment advisers under the Advisers Act or state law, or (2) banks as defined in Section 202(a)(2) of the Advisers Act. This approach would ensure that model portfolios are implemented only under the fiduciary oversight and direction of a sophisticated fiduciary investment manager chosen by the client, while not significantly disrupting current model portfolio practices or limiting retirement investors' access to a beneficial business model for delivering efficient and effective retirement asset management.

#### **IV. Comments on Principal Transactions with Program Sponsors**

##### **A. DOL Should Provide Relief for Principal Trades Where a Discretionary Money Manager Executes Trades Through a Program Sponsor**

Where a discretionary money manager (as opposed to a model manager) that is unaffiliated with the program sponsor directs trades for an ERISA plan or IRA client account through the sponsor, which is a common arrangement under these types of programs, the sponsor would need to rely on a PTE in order to execute the transaction. If the sponsor is viewed as a fiduciary because of its relationship with the client account (i.e., through the program it recommends the money manager), even though the sponsor may not be responsible for the particular trade being placed by the unaffiliated money manager, there would be exemptions to permit agency trades,<sup>29</sup> but none to permit principal trades. Because principal trades would not be permitted under these circumstances where the sponsor is viewed as a fiduciary with respect to the client's assets being managed by the unaffiliated money manager, the money manager would need to break up its trade orders and place portions of them separately away from the sponsor. In certain situations, we believe that restricting the ability of sponsors to execute these trades for clients in a principal capacity may unnecessarily prevent the money manager from obtaining better pricing for their retirement clients, as illustrated in the examples below.

There are a number of situations where a sponsor might be in the best position to execute an order received from an unaffiliated money manager. For example, the sponsor might be a market maker in a security and provide the best available market or be able to match, or even beat, the best price available. The sponsor might also be able to fill orders for fixed income securities out of its inventory rather than going out into the market to find securities that satisfy the criteria provided by the money manager. In such cases, clients may benefit from better pricing and potentially avoid additional transaction costs.

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<sup>29</sup> See, e.g., PTE 86-128 (providing relief for use of an affiliated broker to execute agency trades).

We believe the DOL should provide relief for principal trades executed by the sponsor where an unaffiliated money manager has exclusive authority to select securities for client accounts, and the sponsor does not recommend, select, or play any role, in the money manager's selection of securities. The typical concerns about principal trading, including dumping of securities, are not present in this situation because the sponsor has no authority to select securities to be purchased or sold in client accounts. In fact, the sponsor would not be in position to dump securities because only the money manager, consistent with its fiduciary duties, can select securities to be purchased or sold for the accounts.

Requesting this relief is also consistent with the approach to principal trading under the federal securities laws. As you may know, the SEC staff has taken a similar position with respect to principal trading under Section 206(3) of the Advisers Act. In a 1997 no-action letter, the SEC staff granted no-action relief for a program sponsor that executes, as principal, orders received by unaffiliated money managers.<sup>30</sup> The staff agreed that, although the sponsor was an adviser to the client, when the sponsor executed trades for clients upon the instruction of an unaffiliated money manager, the sponsor was not acting as adviser in relation to that trade so long as it did not recommend, select, or play any role, directly or indirectly, in the manager's selection of securities to be purchased for or sold on behalf of clients.

We encourage the DOL to provide similar relief as part of its rulemaking or, if more appropriate, through interpretative guidance. The DOL could accomplish this by clarifying that, in the context of trades executed in an SMA program, where the trade is directed by a money manager that is a qualified professional asset manager ("QPAM") under PTE 84-14 and unaffiliated with the executing dealer, the relief for principal transactions under PTE 75-1(II) is available even where the executing dealer (or its affiliate) may be a fiduciary program sponsor. This can be accomplished by clarifying both (i) that the condition under subsection (d) of PTE 75-1(II) that prohibits the dealer from being a fiduciary with respect to the transaction is satisfied where the trade is placed by a QPAM, irrespective of whether the dealer is affiliated with the fiduciary program sponsor or an advice fiduciary with respect to the assets, and (ii) that the QPAM does not engage in a separate ERISA Section 406(b) violation under these circumstances. Allowing sponsors to execute trades as principal in instances where the sponsors do not play any role in selecting securities for client accounts will help many clients receive better pricing, avoid unnecessary additional transaction costs, and provide for more efficient trading for client accounts. We would be happy to provide additional information and data regarding this issue, upon request.

**B. DOL Should Revise the Proposed Principal Trading PTE to Mirror the Requirements of Temporary Rule 206(3)-3T Under the Advisers Act**

Certain SMA programs may be provided on a "guided" or non-discretionary basis. In these programs, trades may be executed on a principal basis by the program sponsor (or an

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<sup>30</sup> Morgan, Lewis & Bockius LLP, SEC Staff No-Action Letter, 1997 SEC No-Act. LEXIS 529 (pub. avail. Apr. 16, 1997).

affiliate). We believe that the proposed class exemption for principal transactions in certain debt securities could be available for these trades but have concerns that the conditions are unnecessarily restrictive.

As proposed, the principal trading PTE includes several inconsistencies with Temporary Rule 206(3)-3T under the Advisers Act that we believe are unnecessary to protect retirement investors, would present practical issues in implementation, and would prevent financial institutions from relying on the PTE. Ultimately, if financial institutions cannot rely on the PTE and make available to retirement investors those securities and other products that are generally traded only on a principal basis, the end result will be to harm retirement investors by limiting their access to products and services. In this regard, we believe the DOL should revise the proposed PTE to be consistent with the requirements of Temporary Rule 206(3)-3T.

In the seven years since the temporary rule was implemented, the SEC has examined firms for compliance with the requirements of the rule and have found that firms rely on the rule and have established policies and procedures to monitor compliance with the rule's requirements.<sup>31</sup> We outline the significant differences between the proposed PTE and Temporary Rule 206(3)-3T below.

*Eligible Assets.* The DOL should expand the availability of the PTE to all types of securities to provide financial institutions with greater flexibility in executing client transactions. As proposed, the PTE is only available for transactions in certain debt securities (i.e., corporate debt securities, agency debt securities, and U.S. treasury securities) that possess no greater than a moderate credit risk and are sufficiently liquid that they could be sold at or near fair market value within a reasonably short period of time. The PTE would not be available for other securities that are commonly traded on a principal basis, such as municipal securities and equity securities. We do not believe such limitations on the availability of the PTE are appropriate, and are concerned that they may ultimately cause investors to lose access to certain securities (e.g., municipal securities) or receive worse pricing (e.g., for equity securities). In comparison, the SEC included no such limitations on the types of securities that can be traded in reliance on Temporary Rule 206(3)-3T under the Advisers Act.<sup>32</sup> We request that the DOL revise the PTE to make it available for the purchase and sale of any asset.

*Pre-Transaction Disclosure.* The DOL should revise the pre-transaction disclosure requirements to provide greater flexibility in deciding whether to execute a trade in a principal transaction. Rather than requiring that the financial institution state that it will execute a principal trade prior to effecting the transaction, the DOL should revise the PTE to provide that the financial institution must disclose that it may execute the trade as principal. This approach would be consistent with Temporary Rule 206(3)-3T, would provide flexibility in deciding how

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<sup>31</sup> See Temporary Rule Regarding Principal Trades With Certain Advisory Clients, Investment Advisers Act Release No. 3893 (Aug. 12, 2014), 79 Fed. Reg. 48709, 48711 (Aug. 18, 2014).

<sup>32</sup> Temporary Rule 206(3)-3T contains a similar restriction to the proposed PTE preventing the investment adviser or an affiliate from being the issuer of, or at the time of the sale, an underwriter of the security to be traded as principal.

to obtain the best price and execution of a client's securities transactions, and would avoid situations where the disclosure obligations cause a client to miss out on an investment opportunity or receive a worse price.

When combined with the requirement that financial institutions disclose pricing information, including two quotes obtained from ready and willing counterparties and any markup or markdown to be charged, we believe that requiring prior customer consent will be unnecessarily restrictive in practice. We encourage the DOL to revise the PTE so that it does not require affirmative consent to the specific terms of a principal transaction. Rather, the client should give oral consent permitting the financial institution to engage in a principal transaction if the financial institution, after receiving the client's consent, decides trading on a principal basis will allow it to obtain best execution. As the SEC has recognized, "in many instances the adviser may not know whether a particular transaction will be effected on a principal basis."<sup>33</sup>

*Require Consent Be Revoked in Writing.* As proposed, the PTE would require that a retirement investor provide affirmative, written consent, on a prospective basis, to principal transactions and that certain disclosures inform the retirement investor that the consent is terminable at will at any time and without penalty. The PTE does not, however, clarify that the revocation be in writing. The requirement that a customer provide written notice that it no longer consents to principal transactions is important in documenting whether such consent is effective and avoiding potential claims that the adviser engaged in a principal transaction without the client's consent. We encourage the DOL to revise the PTE to provide that the retirement investor must revoke consent in writing.

*Ongoing Disclosure of Fees.* As proposed, a financial institution relying on the PTE would need to inform the retirement investor of the right to obtain complete information about all fees and other payments currently associated with the retirement investor's investments. We recognize the importance of providing retirement investors with information about fees and other expenses. We question, however, whether the availability of a PTE should be conditioned on the ongoing disclosure of such information. A retirement investor will generally receive disclosure of the transaction as required by Rule 10b-10 under the Exchange Act, as well as in customer account statements, and will have access to this information upon request. In addition, we question whether the PTE should require ongoing disclosure about fees and other payments with respect to all investments, rather than just those investments executed in reliance on the PTE. In this regard, we believe the DOL should more closely track the requirements of Temporary Rule 206(3)-3T. Specifically, disclosure should be limited to the information required by Rule 10b-10 under the Exchange Act, and an annual written disclosure listing all transactions that were executed for the retirement investor in reliance on the PTE with the date and price of the transaction.

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<sup>33</sup> See Temporary Rule Regarding Principal Trades with Certain Advisory Clients, Investment Advisers Act Release No. 2653 (Sept. 24, 2007), 72 Fed. Reg. 55022, 55028 (Sept. 28, 2007).

*Disclosure of Markups and Markdowns.* The DOL has proposed to require that a financial institution relying on the PTE disclose the markup or markdown on a principal transaction prior to engaging in the transaction and on a confirmation. We question whether this information would be useful for investors in evaluating principal transactions, and believe it may actually work against investors' best interests. Obtaining this information prior to receiving the customer's consent will present logistical issues and could delay the execution of the transaction. In most instances, the financial institution or adviser will need to obtain consent to a recommended transaction, and then go into the market to obtain two quotes and determine whether to execute the trade as principal. Once it has obtained this information, the financial institution or adviser will need to obtain the retirement investor's consent to the transaction. This delay in obtaining pricing information and subsequently obtaining the customer's consent could cause retirement investors to miss out on investment opportunities or receive worse pricing.

Further, we question whether retirement investors will benefit from this information or use it to determine whether they could obtain better pricing through another financial institution. We also understand that requiring this disclosure on confirmations will require expensive systems modifications and the adoption of policies and procedures to ensure customers receive accurate information. Rather than requiring this type of disclosure, we recommend that the DOL require that financial institutions and advisers disclose the maximum markup or markdown percentage that a financial institution permits and provide contact information for an individual at the financial institution that can provide more information. This information could be provided in the contract, as well as in annual or other periodic disclosure documents. We believe this approach would facilitate investor education without the implementation issues discussed above.

#### **V. Effect on Current Exemptions**

The DOL has proposed to introduce subjective impartial conduct standards to PTEs 86-128 (affiliated transactions), 77-4 (affiliated mutual funds), and 75-1 (underwritings). We are concerned that doing so will create uncertainty about whether financial institutions can properly rely on those PTEs. Determining whether a financial institution has satisfied the principles-based impartial conduct standards will require a subjective, facts-and-circumstances analysis. It is unclear who will make these determinations and how financial institutions will monitor and document compliance.

Though the rules-based approach of the prior PTEs may be viewed as inflexible, the DOL must recognize that it fosters certainty in compliance. This is particularly important in the context of a strict liability prohibited transaction where loss of the exemption could require rescission of transactions, payment of significant excise taxes, and self-reporting to the Internal Revenue Service. Accordingly, we oppose the DOL's proposed addition of impartial conduct standards to existing PTEs.

If the DOL proceeds with introducing principles-based conditions into these PTEs, we request that the DOL adopt a balanced, principles-based approach to the *penalties* that could

apply if an exemption's conditions are not satisfied. Specifically, the penalties and corrections that apply when a firm violates one of the exemption's conditions should correspond to the magnitude of the violation. We have concerns that applying a principles-based methodology to the rules-based prohibited transaction rules will result in disproportionate penalties and corrections, and unintended consequences.

**VI. DOL Should Conduct Focus Groups Followed by Extensive Testing Prior to Adopting Any Aspect of the Proposal**

We are concerned that the proposed definition of fiduciary and approach to investment education will result in clients actually receiving *less* information, tools, and assistance to aid them in their retirement planning. We appreciate that the DOL has requested comment on whether these requirements would be helpful to investors. In this light, we encourage the DOL, rather than simply requesting comments on the utility of the proposed requirements, to study the impact of its proposal, including through focus groups and subsequent investor testing designed to determine what requirements and information would be most acceptable and useful for retirement clients.

Other regulators, including the SEC, have effectively used investor testing to develop useful and informative disclosure documents.<sup>34</sup> In fact, we understand the DOL has begun conducting focus group testing to understand better the impact of disclosures required under Section 408(b)(2) of ERISA.<sup>35</sup> Further, we believe the DOL would obtain a better understanding of the impact of its proposal if it were to engage in focus group and subsequent testing involving plan sponsors, plan fiduciaries, and financial institutions that would be impacted by the proposed regulation and PTEs.

**VII. Conclusion**

Thank you again for the opportunity to provide our comments on the proposed regulation and PTEs. Should you have any questions or require additional information, please contact Craig Pfeiffer, MMI President & CEO, at (202) 821-4102.

Respectfully submitted,



Craig Pfeiffer  
President & CEO  
Money Management Institute

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<sup>34</sup> For example, the SEC engaged in focus group testing prior to adopting the summary prospectus requirements and in investor testing of target date retirement fund comprehension and communications as it considers disclosure requirements for target date funds.

<sup>35</sup> Proposed Information Collection Request Submitted for Public Comment; Evaluating the Effectiveness of the 408(b)(2) Disclosure Requirements, 79 Fed. Reg. 14085 (Mar. 12, 2014).

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