The
ERISA
Industry
Committee

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Office of Regulations and Interpretations (Room N–5653)
Office of Exemption Determinations (Suite 400)
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210
Attention: Conflict of Interest Rule and D–11712

RE: RIN 1210–AB32 (Conflict of Interest Rule)
ZRIN 1210–ZA25 (Proposed Best Interest Contract Exemption)

Ladies and Gentlemen:

The ERISA Industry Committee ("ERIC") is pleased to submit this response to the request of the U.S. Department of Labor ("DOL") for comments regarding its proposed rule and proposed prohibited transaction exemptions and related amendments concerning conflicts of interest in retirement investment advice (collectively the regulation and the exemptions are referred to as the "Conflict of Interest Rule"). The proposed Conflict of Interest Rule was published in the *Federal Register* on April 20, 2015.

Given the varied issues that our comment addresses, we have included a Table of Contents on the next page of this letter.

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ERIC'S INTEREST IN THE PROPOSED CONFLICT OF INTEREST RULE

ERIC is the only national trade association advocating solely for the employee benefit and compensation interests of the country's largest employers. ERIC supports the ability of its large employer members to tailor health, retirement, and compensation benefits for millions of employees, retirees, and their families. ERIC's members provide comprehensive retirement benefits to tens of millions of active and retired workers and their families.

ERIC believes that employees, retirees, and their families who wish to receive advice with respect to how to invest their retirement accounts or education to help them achieve their retirement savings goals should continue to have meaningful opportunities to do so. In 2010, in response to the DOL's earlier proposed regulation, ERIC provided comments that supported these objectives. ERIC appreciates that the DOL considered its prior comments and addressed, in the current proposal, many concerns of large employers that ERIC raised in its comments on the DOL's earlier proposal.

Specifically, ERIC appreciates the DOL's position that non-individualized communications, such as in newsletters or generalized proxy statements, do not fall within the fiduciary definition. In addition, ERIC believes that the carve outs for "Counterparties to the Plan" (the "Seller's Carve Out"), "Employees of the Plan Sponsor" (subject to the clarifications discussed below), "Swap and Security Based Swap Transactions," and "Financial Reports and Valuations" will be helpful to large plan sponsors and appropriately address large employer and plan activities that do not raise the conflict of interest concerns that are at the core of the Conflict of Interest Rule.

ERIC recognizes that the proposed Conflict of Interest Rule will likely result in higher costs for service providers, which may be passed on to employer-sponsored plans (and, ultimately, to participants in those plans) or be offset by a reduction in the services that the service provider makes available to plans and participants. As a result, ERIC believes that the increased regulatory burdens that would be created by the Conflict of Interest Rule must be carefully tailored so that they do not needlessly increase costs without providing corresponding benefits to plan participants.

In addition, ERIC remains concerned that the Conflict of Interest Rule will create uncertainty among plan sponsors, plan participants, and service providers. In this comment, ERIC seeks to clarify the proposed regulation to make sure the final regulation does not capture, as fiduciary investment advice, additional activities by plan sponsors and their employees that do not pose a risk of creating a conflict of interest.

OVERVIEW

1. The Investment Education Carve Out Should Permit Reference to Specific Investment Funds. The "Investment Education" carve out's prohibition on identifying specific investment options will prevent well-intentioned employers from providing meaningful investment education to their employees. The "Investment Education" carve out should be modified to allow plan sponsors to identify specific plan investment options in connection with asset allocation models, consistent with current DOL guidance. Helping employees link asset allocation models with specific investment funds offered under a retirement plan is critical to the ability of these employees, who have varying levels of investment sophistication, to apply the investment education and implement an appropriate investment strategy. In addition, employers who are using custom or other "white labelled" investment alternatives in their retirement plans sponsors may be unable to offer even basic investment education unless the "Investment Education" carve out is revised. *See* Part 1, beginning on page 5.

2. Conversations Among Co-Workers Should Not Constitute Fiduciary Investment Advice. The regulation should make clear that comments from employees of a plan sponsor to their co-workers do not constitute fiduciary "investment advice," where the comments are not within the scope of the employees' duties for the plan sponsor and the employees are not providing the comments in exchange for a fee or other compensation. Considering such comments to be fiduciary investment advice does not further the goals set forth in the proposed regulation's preamble and subjects individual employees needlessly to personal liability risk. The regulation can clarify this issue in at least two ways: (a) the "Employees of the Plan Sponsor" carve out can make clear that the employee's normal compensation constitutes a "fee or other compensation" for purposes of the carve out because, in that situation, the employee's normal job duties include providing the investment information, but that a plan sponsor's employee's normal compensation does not constitute a "fee or other compensation" in other circumstances, and (b) the definition of "Fee or other compensation, direct or indirect" can be clarified to provide the a plan sponsor's employee's regular compensation is not a "Fee or other compensation, direct or indirect" as long as the employee's normal job duties do not entail providing investment advice under a plan. *See* Part 2, beginning on page 8.

3. A Mere "Suggestion" Should Not Constitute an Investment "Recommendation." Because the concept of a "recommendation" is central to the Conflict of Interest Rule, the definition of "recommendation" must be narrowed so that it does not include activities that do not create a potential conflict of interest. A mere "suggestion" should not constitute fiduciary investment advice, absent some "endorsement" of or "encouragement" to engage in a particular strategy (or strategies). *See* Part 3, beginning on page 12.

4. A Plan Sponsor Should Not Be Liable for the Actions of a Call Center Employee Employed by a Third Party. If, under the final regulation, employees of a plan's call center (and, potentially, the employer of those employees) can provide fiduciary investment advice during an interaction with a plan participant, the regulation should clarify that a plan sponsor does not incur fiduciary or co-fiduciary liability for any investment advice provided by the plan's call center employees, as long as the plan sponsor is not the employer of the call center employees and takes reasonable steps to ensure that they do not provide specific investment recommendations. *See* Part 4, beginning on page 13.

5. The Regulation Should Make Clear that, as Under Existing Guidance, Employers with "Limited" Involvement in a Health Savings Account Are Not Fiduciaries. Existing DOL guidance provides that health savings accounts ("HSAs") generally will not constitute ERISA employee welfare benefit plans. To ensure consistency with this guidance, the final regulation should state explicitly that employers do not become investment fiduciaries or co-fiduciaries as to an HSA merely by virtue of having "limited" involvement with the HSA within the meaning of the existing guidance. *See* Part 5, beginning on page 14.

6. Employers that Are Financial Institutions Should be Treated the Same as Other Employers. The Best Interest Contract Exemption should not exclude financial institutions that provide investment options to employees in their in-house plans. This exclusion may harm participants by preventing otherwise willing financial institutions from taking fiduciary responsibility for investment advice to their employees. *See* Part 6, beginning on page 15.

7. The "Applicability Date" Should Reflect the Extensive Work Required to Implement the Regulation. The DOL must consider the compliance challenges imposed on service providers in setting the applicability date of the final regulation. Additionally, given the extent to which the proposed regulation differs from the current regulation, the final regulation should state expressly that it shall not be taken into account with respect to advice provided before the applicability date of the final regulation. *See* Part 7, beginning on page 15.

8. DOL Should Make a Formal Proposal Regarding a "Low Fee" Exemption. Plan sponsors need an opportunity to review a more detailed proposal before issuing formal comments in response to the DOL's consideration of a prohibited transaction exemption covering "low-fee investments." Preliminary, a prohibited transaction exemption covering "low-fee investments" may not be feasible in the context of a typical employer defined contribution plan, but a more detailed proposal on this issue is necessary before ERIC can make any meaningful comments. *See* Part 8, beginning on page 16.

9. The "Seller's Carve Out" Is Helpful to Large Employers. ERIC appreciates the DOL's inclusion of the "Seller's Carve-Out" in the proposed regulation. ERIC agrees that larger plans should be able to rely on this carve out, and it is not in a position to opine on the precise size threshold sufficient to be included in this carve out, given that ERIC members' plans already exceed the thresholds in the proposed regulation. *See* Part 9, beginning on page 18.

DISCUSSION

1. <u>The Investment Education Carve Out Should Not Prohibit References to Specific Plan Investment Options.</u>

Plan sponsors can play an important role in educating their employees about saving and investing for retirement, and, in accordance with the DOL's long-held position, they need not be an investment advice fiduciary to provide employees with this investment education. However, unless the regulation differs from the proposal, it will meaningfully change long-standing DOL guidance on investment education in a manner that will harm participants.

Specifically, the proposed regulation's prohibition on identifying specific investment funds in the "Investment Education" carve out will hinder the DOL's goal of providing effective and useful educational materials to plan participants. *See* 80 Fed. Reg. at 21945. The proposed regulation should be modified to remove the prohibition on providing information about "specific investment products" and "specific investment alternative" included in Sections (b)(6) and (b)(6)(iv)(E) of the proposed regulation. *See* 80 Fed. Reg. at 21958-59.

For the past two decades, plan sponsors have relied upon Interpretive Bulletin 96-1 ("IB 96-1") in developing more effective ways to engage participants in the process of investing for their retirement. As recognized by the DOL in the preamble to IB 96-1, prior to the issuance of this interpretive bulletin, many plan sponsors were deterred from providing investment education due to "uncertainty regarding the extent to which the provision of investment-related information may be considered the rendering of [fiduciary investment advice under ERISA]." IB 96-1 addressed this uncertainty by drawing a distinguishing line between education and investment recommendations, providing plan sponsors with assurance as to how to provide investment education without becoming investment advice fiduciaries.

As illustrated in the following examples, the proposed regulation, as drafted, would upset this balance, particularly with respect to education concerning asset allocation models. Under the proposed regulation, plan sponsors who are unwilling to become investment advice fiduciaries would be prohibited from providing meaningful investment allocation education to their employees. Such employees who either will not or cannot pay for an outside financial adviser will be effectively cut off from receiving investment allocation advice.

- **Example 1. Plans with Custom Investment Funds**. XYZ Company is a large employer that sponsors a 401(k) plan with specific investment options that are customized for, and available only to, XYZ Company plan participants. By providing custom investment fund options, XYZ Company's investment fiduciaries are able to keep expenses at 25% of the average retail cost for comparable investments. To reduce participant confusion, each investment fund is named descriptively by asset class. For example, the fund investing in large-cap stocks is named the "Large Cap Stock Fund," the fund investing in small-cap stocks is named the "Small-Cap Stock Fund," the fund investing in long-term bonds is called "Long-Term Bond Fund," and so on. XYZ company wishes to educate its employees regarding generalized asset allocations that are appropriate based on age and risk tolerance.

  Under the proposed regulation, it appears that XYZ Company would be precluded from providing asset allocation investment education within the "Investment Education" carve out. Any asset allocation recommendations essentially would identify the name of specific investment products in apparent violation of the "Investment Education" carve out. For example, education that a participant who is in her mid-30s and has a moderate risk tolerance should invest 50% in large-cap stock funds, 30% in small-cap stock funds, and 20% long-term bond funds would appear to identify the name of the specific funds in XYZ's plan. To comply with the "Investment Education" carve out, XYZ Company would have to rename its investment options to ones that are not linked to the fund's asset class—adding complexity to participant's investment choices and resulting in potentially significant costs for the plan sponsor—producing a result that cannot possibly be the intent of the proposed regulation.

- **Example 2. Plans with "White-Labeled" Investment Funds**. Same facts as Example 1, except that XYZ Company is a smaller employer that sponsors a 401(k) plan with retail investment options from fund companies that are rebranded by their asset class. For example, a proprietary fund generally available to employers called, "ABC Fund Institutional Index, Plus Shares," is rebranded, "Large Cap Stock Fund," because this fund invests in large cap stocks and XYZ believes that such "white-labeled" or generic names will be easier for its employees to understand.

  As above, because XYZ Company's investment options have been branded descriptively by asset class, XYZ Company would appear to be barred from providing asset allocation education without taking on investment advice fiduciary responsibility unless it renamed its fund options with less logical names. Doing so would result in participant confusion and unnecessary costs for the employer. As in Example 1, such a result cannot support the goals of the proposed regulation.

- **Example 3. Plans with Retail Fund Names**. Same facts as Example 1, except that XYZ Company's plan has investment options that have retail names such as "ABC Fund Institutional Index, Plus Shares" that do not identify the underlying asset class.

  Unlike Examples 1 and 2, XYZ Company could provide asset allocation education to participants within the "Investment Education" carve out. However, the proposed regulation's prohibition on identifying specific investment products would greatly reduce the usefulness of this education. XYZ Company could educate participants about the proper mix of asset classes based on age and risk tolerance. But without identifying which investment options correspond to which asset classes, participants would have to conduct their own research to implement the recommendations suggested by their asset allocation model. This research might be beyond the level of sophistication of many plan participants.

Acceptance of investment advice fiduciary status based on the provision of asset allocation education in the above examples may expose plan sponsors to unacceptable litigation risk, as illustrated in the following example:

- **Example 4. Litigation Risk**. XYZ Company (from Example 1) distributes a brochure providing asset allocation education, based on an employee's age and risk tolerance. A participant who is in her mid-30s had invested 100% of her account in stable value funds. After reviewing XYZ Company's brochure, the participant changes her asset allocation to what seems more appropriate based on

> her age and risk tolerance: 50% in large-cap stock funds, 30% in small-cap stock funds, and 20% in bond funds. The economy goes into recession, and the participant experiences severe losses—losses that in the short term are substantially greater than had she remained in the stable value fund.
>
> If XYZ Company is an investment advice fiduciary as to the asset allocation education (by identifying the plan's funds and forgoing the proposed carve out), XYZ Company may reasonably fear lawsuits by the participant and others like her who may claim that the company breached its fiduciary duties by providing imprudent investment advice (despite having provided information reflected in widely accepted asset allocation models). Because such claims would be based on the company's generalized and broadly disseminated investment education, such suits could be class actions—thereby increasing the cost of defense and potential liability.

As reflected in these examples, the risk of liability might cause well-intentioned plan sponsors to refrain from providing meaningful asset allocation education. For many plan participants—especially middle-class or lower-income employees—plan sponsors may be the only available source of their investment education. It would be a disservice to these participants to preclude plan sponsors from identifying plan investment options within the "Investment Education" carve out. As drafted, the proposed regulation would make asset allocation education meaningless and deprive participants who either will not or cannot retain an outside investment adviser from receiving important investment education. The final regulation should modify the "Investment Education" carve out to allow plan sponsors to identify specific investment options as part of asset allocation education, in the manner described above.

2. The Regulation Should Make Clear that Discussions Among Co-Workers Cannot Result in Fiduciary Investment Advice.

ERIC appreciates that the DOL has provided a carve out for employees of the plan sponsor who provide advice to a plan fiduciary. However, this carve out is ambiguous and should be clarified.

First, the carve out, as drafted in the proposed regulation, appears to apply only to the "person" who provides advice to a plan fiduciary. The final regulation should modify the carve out so that it clearly includes employees reporting to the "person" who provides the advice to the fiduciary. For example, the carve out should apply not only to the plan sponsor's chief financial officer if he or she provided financial information to the plan's investment committee, but it should also apply to the staff of the chief financial officer if they provide information to the chief financial officer to provide to the plan fiduciary. This could be accomplished by including the underlined language in the following clause: ". . . the person<u>, either directly or indirectly,</u> provides the advice to a plan fiduciary, ..." It is likely that the DOL intended to cover these individuals in the carve out, but the language should be expanded to remove any doubt as to the scope of the carve out.

Second, the carve out's requirement that the employee receive no fee or compensation "beyond the employee's normal compensation" might be interpreted to mean that an employee's "normal compensation" generally constitutes a "fee or other compensation, direct or indirect," for purposes of determining whether an individual has provided fiduciary investment advice.

The DOL should modify the proposed regulation so that it is clear that a plan sponsor's employee's normal compensation does not constitute a "fee or other compensation, direct or indirect," for purposes of providing investment advice, unless the employee provides the investment advice *as part of the employee's job duties for the plan sponsor*. Such is the case for the employee addressed in the "Employees of the Plan Sponsor" carve out in the proposed regulation. This employee, as part of his or her job duties for the plan sponsor, provides reports and recommendations to investment committees and other fiduciaries of the plan. As recognized in the proposed carve out, an employee who provides this advice "[i]n his or her capacity as an employee of [the plan sponsor]" is compensated for that advice by his or her "normal compensation for work performed for the employer." *See* 80 Fed. Reg. at 21943, 21957.

By contrast, an employee of a plan sponsor who discusses investment issues outside of the employee's job duties is *not* compensated for that advice by his or her normal salary from the plan sponsor. If this employee receives no other fees or compensation in connection with this advice, the "fee or other compensation" element of the proposed regulation's fiduciary definition should not be met.

To avoid confusion, the final regulation should reflect the following modifications:

- The "Employees of the Plan Sponsor" carve out should make clear that the carve out is necessary because an employee's "normal compensation" constitutes a "fee or other compensation, direct or indirect" only if the employee's job duties (for which at least a portion of the employee's normal compensation from the plan sponsor is paid) include providing investment advice to the plan fiduciaries; and

- The definition of "fee or other compensation, direct or indirect" should state expressly that, in the context of an employer-sponsored plan, a plan sponsor's employee's "normal compensation" does not constitute a "fee or compensation, direct or indirect" for advice, where the individual's normal employment duties for the plan sponsor do not include providing investment advice under the plan.

It is not feasible to have any approach other than one that makes clear that the normal compensation of a plan sponsor's employee who discusses investment issues is not sufficient to make that person an investment fiduciary, unless providing investment advice is part of that person's employment duties. For example, the final regulation should not provide that an employee's salary is sufficient to constitute "compensation" under the investment advice regulation if the employee works in the plan sponsor's human resources ("HR") department. Such an approach would be grossly overinclusive: the internal structure for providing HR services vary widely from plan sponsor to plan sponsor, and many HR employees may have no interaction with retirement plans, let alone have duties related to investment recommendations. Likewise, a rule characterizing salary of employees whose job duties include performing tasks related to the retirement plan is "compensation" that can make the person an investment fiduciary would also miss the mark: such a rule could capture IT professionals or in-house attorneys who may provide services for the plan but whose job has no relation to the provision of financial advice.

The following examples illustrate the need for the clarifications listed above: a plan sponsor's employees who engage in informal investment-related discussions with their co-workers outside of their official duties and for no compensation neither satisfy the "fee or other compensation, direct or indirect" element of the fiduciary definition nor pose a risk of providing conflicted advice:

- **Example 1: Conversations Between Co-Workers**. A new hire in a factory becomes eligible to participate in his employer's 401(k) plan. Having no significant investment experience, the new hire asks a co-worker who has worked at the factory for decades, and is nearing retirement age, how he should invest in the plan. The soon-to-be retiring co-worker recommends that the new hire invest in the plan's target date funds; she tells the new hire that she has invested in target date or similar asset allocation funds over her entire career and is now about to retire with a large sum of money in her 401(k) plan account. The new hire does not provide his co-worker with any compensation in exchange for this recommendation, and the co-worker receives no direct or indirect benefits from the recommended investment funds.

- **Example 2: Conversations with a Trusted Employee**. Same facts as Example 1, except that the co-worker is a union shop steward rather than someone who works side-by-side with the plan participant in a factory. This union shop steward is an employee of the company but also is responsible for protecting the interests of her co-workers in the union.

  The union shop steward should not be considered a fiduciary when providing this investment recommendation. While the shop steward is a trusted adviser with respect to issues arising under a collective bargaining agreement, the shop steward is not an investment adviser and her job duties do not include providing investment advice under the 401(k) plan. As such, the investment recommendation to the co-worker is provided in the shop steward's personal, and not employment, capacity, and the shop steward receives no compensation from the co-worker or investment funds.

- **Example 3: Interactions with an HR Employee (Defined Contribution Plan)**. An employee nearing his retirement date calls his employer's HR department to discuss his upcoming retirement. During the course of the conversation, the HR employee informs the retiring employee that he may keep his 401(k) within the employer's plan or roll it over into an IRA. The retiring employee asks the HR employee which option would be best. The HR employee responds that, in his opinion, the company 401(k) plan does not provide enough fixed income investment options for retirees and that he should considering a rollover into an

IRA in order to have greater investment flexibility. The retiring employee follows this recommendation and rolls over into an IRA.

The HR employee does not receive a commission, fee, or any other compensation from the co-worker or the IRA provider. The HR employee's job description requires that he provide information about distribution options at retirement, but the job description does not include providing recommendations regarding the advisability of rollovers. The HR employee was merely giving an opinion in response to a question from a co-worker.

Example 4: Interactions with an HR Employee (Defined Benefit Plan). Same facts as Example 3, except that the retiring employee participates in a defined benefit plan and asks for advice about whether he should elect to receive annuity payments or take a lump sum distribution upon retirement. The HR employee responds that, in his opinion, a lump sum distribution is preferable because, if the retiree dies young, his family will still have substantial assets.

As above, the HR employee does not receive a commission, fee, or any other compensation from the co-worker and is not empowered by his employer to provide advice about the form of distribution in a defined benefit plan. Again, the HR employee was giving his opinion in response to a co-worker's question.

In each of these examples, the "fee or other compensation, direct or indirect" element of the proposed regulation's fiduciary definition is not met. The employee providing the investment recommendation has not received any compensation from the employer, the co-worker, or any investment fund *for providing the recommendation*. The inquiry should end here. However, absent a clarification in the final regulation, the phrase "beyond the employee's normal compensation" in the "Employees of the Plan Sponsor" carve out could be misconstrued as meaning that the salary of the employee providing the investment recommendation constitutes a "fee or other compensation, direct or indirect" and, therefore, that the employee has provided fiduciary investment advice.

If the DOL is concerned that employees might be confused as to whether they are receiving investment advice from their co-workers, as part of their co-workers' official duties, it could suggest that language along the following lines can be included in certain participant communications, such as SPDs or 402(f) notices, to clarify any potential misunderstanding:

> **<u>No investment advice from Company employees</u>**. Please be aware that no employee of Company is authorized to provide you with investment advice—such as advice about how you should invest your money within the plan or advice regarding whether you should take a distribution from the plan or roll over assets in the plan into an IRA. While certain employees of the Company may have specialized information about how the plan works and about different investment options that the plan offers, such employees still are not permitted to provide you with investment advice.

Finally, imposition of fiduciary status on co-workers like those in the above examples would needlessly expose them to significant risk of personal liability. For example, if these employees were fiduciaries, recipients of their "advice" could bring suit against their co-workers for breach of fiduciary duty for providing allegedly imprudent advice if the investments did not produce expected returns. Under ERISA, fiduciaries are personally liable for breaches of fiduciary duty. Because, in the examples above, the employees of the plan sponsor are providing investment advice outside of their official job duties, they might not be covered by fiduciary liability insurance and therefore, could face significant personal financial exposure, including, at a minimum, the costs of defending the lawsuit. Moreover, in contrast to a service provider call center where interactions are more tightly controlled and commonly recorded, the informal conversations reflected in the examples above are more likely to present issues of fact that must be resolved at trial. Thus, there would be significant risk that the regulation, if interpreted to capture informal discussions between co-workers, could trigger lengthy and costly litigation against employees who could personally be liable for investment discussions in which they engaged for no compensation.

3. The Regulation Should Narrow the Definition of "Recommendation."

The term "recommendation" is one of the most critical components of the definition of "Fiduciary" in the Proposed Conflict of Interest Rule. Other than in the context of an appraisal or fairness opinion, no person can be an investment advice fiduciary under the proposed regulation unless he or she makes a "recommendation" regarding some aspect of an investment.

A term as important as the term "recommendation" in the Conflict of Interest Rule must be clearly defined. However, the proposed regulation has defined this term in a manner that is too broad and too vague. Under the proposed regulation, a "recommendation" is "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." *See* 75 Fed. Reg. at 21960. The preamble to the proposed regulation explains that the source of this definition is FINRA's Rule 2111 and specifically requests comments on whether the final regulation should adopt some or all of the FINRA standards in defining communications that rise to the level of a "recommendation." *See id.* at 21938.

Interestingly, FINRA Rule 2111 does *not* define the term "recommendation." *See* FINRA Regulatory Notice 12-25, Q&A 2. Instead, FINRA Rule 2111 offers "several guiding principles" that parties should consider when determining whether a particular communication rises to the level of a "recommendation." *See id.*; FINRA Regulatory Notice 11-02 at pp. 2-3. FINRA summarizes these facts and circumstances as follows:

> For instance, a communication's content, context and presentation are important aspects of the inquiry. The determination of whether a "recommendation" has been made, moreover, is an objective rather than subjective inquiry. <u>*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*</u>

> *customer reasonably would be viewed as a suggestion that the customer take action or refrain from taking action regarding a security or investment strategy*. In addition, the more individually tailored the communication is to a particular customer or customers about a specific security or investment strategy, the more likely the communication will be viewed as a recommendation. Furthermore, a series of actions that may not constitute recommendations when viewed individually may amount to a recommendation when considered in the aggregate. . . . These guiding principles, together with numerous litigated decisions and the facts and circumstances of any particular case, inform the determination of whether the communication is a recommendation for purposes of FINRA's suitability rule.

FINRA Regulatory Notice 11-02, at p. 3 (internal footnotes omitted; emphasis added).

The proposed regulation has taken one of these principles— an issue that FINRA describes as only an "important factor" in determining whether a communication objectively constitutes a recommendation—and used it as the complete definition of "recommendation." The proposed regulation leaves out critical factors in the FINRA definition, including that the determination of whether something is a "recommendation" is an objective, rather than a subjective, inquiry.

In addition to incorporating the objective standard of the FINRA rule, the final regulation should further refine the definition to make it more appropriate in the context of the Conflict of Interest Rule. Under the proposed regulation, anything that is merely a "*suggestion* that the advice recipient engage in or refrain from taking a particular course of action" would constitute a "recommendation" (emphasis added).

The term "suggestion" is not appropriate: almost any comment can be construed as a "suggestion." It would be more appropriate to use a term such as "endorsement" or "encouragement" in the final regulation, which at least would impose some requirement that the person speak favorably or in support of a particular investment action. Although the FINRA rule uses the term "suggestion," it does so in the context of describing factors, not in the context of a definition. If the Conflict of Interest Rule is going to define "recommendation,"—and it might be appropriate to do so given that the reach of the Conflict of Interest Rule is broader than the reach of FINRA Rule 2111—it must do so more precisely than to cover a mere "suggestion."

4. Any Fiduciary Status of a Call Center Employee of a Third-Party Service Provider Should Not Cause Liability for Plan Sponsors and Should Be Limited in Scope.

The proposed regulation's preamble notes that call center employees and "possibly their employers" may be treated as fiduciaries. *See* 80 Fed. Reg. at 21945-46. As a preliminary matter, the regulation should make clear under what circumstances the employer of the call center employee could be an investment fiduciary. In addition, the final regulation (or its preamble) should clarify this issue in two respects.

First, the actions of a call center employee of a third-party service provider should not cause fiduciary or co-fiduciary liability for the plan sponsor. If call center employees are employed by a third-party service provider (and not the plan sponsor), there is no basis for imposing imputed liability on the plan sponsor.

Similarly, any investment fiduciary status of the call center employees or their employer should not be a basis for co-fiduciary liability. Assuming that the plan sponsor neither knowingly concealed a fiduciary breach by a call center employee nor had knowledge of such fiduciary breach and failed to take reasonable actions to remedy it, there would be no basis for imposing co-fiduciary liability on the plan sponsor under ERISA Section 405(a)(1) or (a)(3).

Likewise, a plan sponsor that acts prudently in its oversight of a third-party service provider has complied with its relevant duties under ERISA, has not enabled a co-fiduciary's breach, and therefore, is not subject to co-fiduciary liability under ERISA Section 405(a)(2).[1] The DOL should make clear that one way in which the obligations set forth in Section 405(a)(2) can be met is when plan sponsors take reasonable steps to ensure that call center employees are not providing specific investment recommendations to participants. Reasonable steps could include entering into an agreement providing that the service provider will supervise its call center employees and will take reasonable steps to ensure that they do not provide specific investment recommendations in violation of the Conflict of Interest Rule. Clarifying the regulation in this regard would support compliance with the regulation and assure plan sponsors that they will not have liability due to the actions of individuals employed by a third party, whose day-to-day activities they cannot control.

Second, if a call center employee (and, possibly, his or her employer) becomes an investment advice fiduciary with respect to one or more individual plan participants, that fiduciary status should be limited to the affected participant(s) and to the particular "recommendation" that constituted fiduciary investment advice. Neither the call center employee nor his or her employer should become a fiduciary with respect to all participants or with respect to future interactions with the affected participant(s) simply by virtue of becoming a fiduciary as a result of a limited interaction with one or more participants.

5. The Regulation Should Make Clear that, as Under Current Guidance, Employers With "Limited" Involvement with a Health Savings Account Are Not Fiduciaries.

In response to the DOL's request for comments as to whether it is appropriate to cover and treat HSAs in a similar manner to IRAs under the proposed regulation, ERIC seeks to clarify that: (a) the proposed regulation does not alter existing DOL Guidance, FAB 2004-01 as modified by FAB 2006-2, with respect to the ability of an employer to offer and contribute to a health savings account ("HSA") without the HSA becoming an ERISA welfare benefit plan, and

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[1] *See generally Silverman v. Mut. Ben. Life Ins. Co.*, 941 F. Supp. 1327, 1336 (E.D.N.Y. 1996) *aff'd*, 138 F.3d 98 (2d Cir. 1998).

(b) nothing in the proposed regulation will make the employer an investment fiduciary or co-fiduciary with respect to the HSA as long as its involvement with the HSA is "limited." As recognized in the existing guidance, if an employer has "limited" involvement with an HSA, the HSA is not an ERISA-covered plan. Such permissible involvement can include making contributions to the HSA (subject to specified conditions), selecting a single HSA provider, allowing HSA providers to market their HSA products in the workplace, or providing employees with general information on the advisability of using an HSA.

To ensure consistency with this guidance and to avoid confusion, the definition of "IRA" should state expressly that DOL Guidance, FAB 2004-01 as modified by FAB 2006-2, remains in full effect and that the mere act of offering a HSA, contributing to a HSA, making arrangements with third parties to market HSAs to employees, or providing general educational information about the advisability of using an HSA is not sufficient to transform the HSA to an ERISA-covered plan or otherwise to render the employer an investment fiduciary or co-fiduciary with respect to the HSA.

6. **<u>The Conflict of Interest Rule Should Treat Employers that are Financial Institutions the Same as Other Employers.</u>**

The Best Interest Contract Exemption in the final regulation should not exclude financial institutions that provide investment advice to employees in their in-house plans. This exclusion may have the effect of preventing otherwise willing financial institutions from providing fiduciary investment advice to their employees. The DOL should remove this exclusion from Section I(c)(1) of the Best Interest Contract Exemption and impose the same requirements on a financial institution when providing advice to employees in its in-house plans as it does on the financial institution when providing of fiduciary investment advice to the employees of unrelated employers.

In this context, it is unclear why the "special nature of the employer/employee relationship" should outweigh the protections afforded by the Best Interest Contract Exemption. *Cf*. Prohibited Transaction Exemption 86-128, 51 Fed. Reg. 41686 (Nov. 18, 1986) (citing ERISA Conference Report, H.R. Rep. No. 93-1280, 93d Cong., 2D Sess. 313, 314 (1974)) ("[I]t would be contrary to normal business practice for a bank … to purchase the products of another company [for] its own in-house plans."). By eliminating this exclusion, willing financial institutions may be more likely to offer fiduciary investment advice to their employees. And their employees will benefit from the Best Interest Contract Exemption to mitigate harm from potential conflicts. Financial institutions should be able to rely on the Best Interest Contract Exemption without special restrictions.

7. **<u>The Regulation Should Not Be Retroactive and its Applicability Date Should Take into Account the Substantial Undertaking Required for Implementation.</u>**

As the DOL has acknowledged, the proposed regulation would significantly change a rule that has been in effect for 40 years, establishing new circumstances under which service providers are subject to ERISA's fiduciary responsibilities. *See* 80 Fed. Reg. at 21928.

Although ERIC understands that the DOL now believes that it is appropriate to make a change, plan sponsors, service providers, and other stakeholders have relied on the existing interpretation of the statute for over 40 years.[2]

In recognition of the significance of the change, the Department has proposed a prospective effective date and applicability date—60 days and 8 months, respectively, after the final regulation is published in the *Federal Register*—for its new interpretation of the statute. *See* 75 Fed. Reg. at 65269. However, this timeframe might not be sufficient to ensure orderly compliance with the final regulation. While large employers likely will need to amend a single administrative services contract as a result of the new regulation, service providers may have to enter into individual contracts with more than 20 million Americans who have IRA accounts, in order to comply with the Best Interest Contract Exemption. To ensure an orderly process for plan sponsors' contract negotiations with service providers, the DOL should work with service providers to extend the applicability date in an appropriate manner.

Additionally, the proposed regulation does not expressly foreclose referring to the new regulation as persuasive authority with respect to advice provided before the applicability date. In light of the unique responsibilities that go along with being treated as a fiduciary—responsibilities that stakeholders outside the scope of the existing regulation reasonably believed that they did not have—the final regulation should state expressly that the DOL's new interpretation of the statute may not be taken into account with respect to advice, recommendations, or other information provided before the applicability date. For example, if a claim brought after the applicability date of the new regulation relates to advice given before the applicability date, the new regulation should not be taken into account for purposes of determining whether the advice was provided by a fiduciary.[3]

Notwithstanding the DOL's concerns with the existing regulation, stakeholders who relied on the existing regulation in good faith should not be exposed to potential liability for advice provided when the existing regulation was in effect.

8. The DOL Should Make a Formal Proposal Regarding a Low-Fee Exemption so that Interested Parties Can Make Meaningful Comments.

ERIC requests the opportunity to review a more detailed proposal before issuing formal comments in response to the DOL's consideration of a prohibited transaction exemption

[2] *See*, *e.g.*, *Schloegal v. Boswell*, 994 F.2d 266, 272-73 (5th Cir. 1993) (applying the existing regulation to determine whether an individual who provided advice was a fiduciary); *Glaziers & Glassworkers Union Local No. 252 Annuity Fund v. Newbridge Sec., Inc.*, 93 F.3d 1171, 1179 (3d Cir. 1996) (referring to the existing regulation to "clarify" what it means to "render investment advice").

[3] *See generally, e.g., Bowen v. Georgetown Univ. Hosp.*, 488 U.S. 204, 208-09 (absent an express statutory grant of retroactive rulemaking authority, administrative rules should not be given retroactive effect); *Health Ins. Ass'n of Am., Inc. v. Shalala*, 23 F.3d 412, 423-25 (D.C. Cir. 1994), *cert. denied* 513 U.S. 1147 (1995) (like legislative rules, interpretive rules should not be given retroactive effect); *Nat'l Mining Ass'n v. DOL*, 292 F.3d 849, 859, 864-65 (D.C. Cir. 2002) (new interpretation of existing rule should not apply with respect to transactions occurring before effective date).

covering "low-fee investments." If the DOL intends to issue this exemption, it should publish a separate proposal for comment on this particular topic.

As a practical matter, it is not clear that a "low-fee investment" exemption would be workable, particularly in the context of typical employer defined contribution plans. In contrast to IRAs or brokerage windows, typical employer defined contribution plans offer discrete investment options to plan participants. The number and type of investment options are constrained by a number of factors, including significant research that suggests that too many offerings are confusing to plan participants.[4] In such contexts, application of "low-fee investments" exemption could have unintended consequences. For example, as illustrated below, if "low-fee investments" were defined to apply to investments within a particular asset class, participants may be encouraged to invest in a non-diversified manner.

- **Example. Plans with a Single Investment Product that Qualifies as a "Low-Fee Investment."** Company XYZ sponsors a 401(k) plan for its employees. The plan offers a limited number investment options from ABC Fund that span various asset classes. A participant who is in her mid-30s had invested her plan assets pursuant to a generally-accepted investment allocation model, based on her age and risk tolerance: 50% in ABC Fund S&P 500 Mutual Fund, 30% in ABC Fund Small-Cap Stock Fund, and 20% in ABC Fund Bond Fund. The DOL finds that the ABC Fund S&P 500 Mutual Fund qualifies as a "low-fee investment" under the exemption. No other investment option offered under the 401(k) plan meets the definition of "low-fee investment." The participant receives fiduciary investment advice in compliance with the "low-fee investment" exemption encouraging her to invest in the ABC Fund S&P 500 Mutual Fund. She follows this advice and increases her investment in the ABC Fund S&P 500 Mutual Fund to 90% of her total assets. While the participant may have increased the proportion her holdings of low-fee investments, she did so at the expense of diversifying her investments pursuant to a generally-accepted asset allocation model.

If the DOL sought to address this concern by mandating that the investment product be "broadly diversified to minimize risk for targeted return," as contemplated in the preamble to the Best Interest Contract Exemption, different complications may arise. In contrast to a mutual fund designed to track a market index, a "broadly diversified" investment product's performance will vary based on the product's method of diversifying and its underlying assets. To ensure that the contemplated exemption provide meaningful benefits to participants, any broadly diversified product should be analyzed to account for returns net of fees. An exemption that encourages participants to invest in low fee funds that generate poor returns would not be in participants' best interest. However, analysis accounting for performance generates uncertainty. Poor short-term performance may cause the product to no longer to meet the requirements to be a "low-fee

[4] *See*, *e.g.*, "Pension Design and Structure: New Lessons from Behavioral Finance," Chapter Five: How Much Choice Is Too Much," Pension Research Council, The Wharton School of the University of Pennsylvania, http://www.pensionresearchcouncil.org/publications/document.php?file=78.

investment" without sufficient notice—fiduciary advice to invest in the product one day may fall within the exemption and the next day may not. While a safe harbor could be used to address this concern, more information about the DOL's proposal is necessary to provide more detailed comments.

9. <u>ERIC Is Not in a Position to Comment on Whether the Seller's Carve Out Should Include Smaller Employers or Smaller Plans.</u>

ERISA fiduciary obligations should not be imposed on sales pitches that are part of arm's length transactions between unrelated third parties and sophisticated plans. ERIC appreciates the DOL's inclusion of the "Seller's Carve-Out" in the proposed regulation to address this concern. ERIC requests that the final regulation adopt the material provisions of this carve out.

Generally, ERIC's members sponsor plans that substantially exceed the 100 plan participant and $100 million asset requirement contemplated by the proposed rule. By any measure, ERIC's members' maintain the investment-related experience sufficient to be included in this carve out. Accordingly, ERIC is not in a position to respond to the DOL's request for comment as to the precise size threshold needed to rely on this carve out.

ERIC appreciates the opportunity to provide comments on the proposed regulations. If there are any questions concerning our comments, or if we can be of further assistance, please contact us at (202) 789-1400.

Sincerely,

Annette Guarisco Fildes

Annette Guarisco Fildes
President & CEO