Introduction

We welcome the opportunity to comment on the Department of Labor's April 20, 2015 proposed rule on ERISA fiduciary duties and related new and amended prohibited transaction exemptions (PTEs). See 80 Fed. Reg. 21928 (April 20, 2015).

We are a registered investment adviser (RIA). We serve a variety of clients, including IRAs and ERISA retirement plans. When we are hired to advise ERISA plans, we are already subject to a fiduciary duty under the Investment Advisers Act and ERISA. We also serve as an investment adviser to various mutual funds, but in that capacity, we generally are not subject to ERISA fiduciary duties with respect to plans or plan participants who choose to include in their plans or portfolios the funds we advise.

The proposed rule would change that, in effect imposing a fiduciary duty on us as a result of almost any interaction between any of our staff—even those with no investment input or discretion whatsoever—and any plan or person who might possibly invest retirement assets in any mutual fund we advise.

While we applaud the Department's efforts to promote transparency in the market for retirement investment advice, the proposed rule would unnecessarily expand the scope of ERISA fiduciary duties for RIAs far beyond what Congress ever intended, with the practical effect of limiting interactions between mutual funds' investment advisers and plan fiduciaries, decreasing the amount of information available to plans, and thus likely reducing the availability of diversified investment options for plan participants.

To ensure the continued availability of diversified investment options to retirement plans and plan participants, we urge the Department to clarify the proposed rule to ensure that it addresses appropriate concerns while remaining consistent with the Department's statutory authority.

Until the Department does this, we believe it is premature to propose any new PTEs or to amend existing PTEs based on this proposal. Accordingly, we believe the Department should withdraw all proposed PTEs and PTE amendments associated with this proposed rule until a prudent rule is finalized.

Substantive Concerns

We are primarily concerned with the proposed definition of "investment advice" incorporating a unilateral "understanding" standard (proposed 29 C.F.R. § 2510.3-21(a)(1)), the proposed "compensated directly" components of the plan counterparty carve-outs (proposed § 2510.3-21(b)(i)(B)(3) and (C)(3)), and the proposed definitions of "recommendation" and "compensation" (proposed § 2510.3-21(f)(1) and (f)(6), respectively), all of which are so broad as to promote confusion, rather than clarity.

Taken together, these components raise two major concerns:

1) The proposed definitions of "compensation" and "recommendation," in conjunction with the unilateral "understanding" component of the proposed definition of "investment advice" would impose fiduciary duties where they should not reasonably be inferred; and
2) The phrases "compensated directly" and "in connection with the transaction," when read in the context of the proposed definition of "compensation," are too imprecise to reasonably inform an entity when it may be acting in a fiduciary capacity.

To address those concerns, we propose modifying the definition of "advice" in proposed (a)(1), the carve-outs in (b)(i)(B) and (C), modifying the definitions of "recommendation" and "compensation" to be consistent with ERISA § 3(21)(A) and (B), and to establish a reasonable causal link between advice, action, and compensation.

1) "Compensation," "Recommendation," and "Understanding"

The proposed rule indicates that where there is a "recommendation"[1] to a plan or plan participant in exchange for any "compensation" from any source[2] "pursuant to… [an] understanding"[3] (which may be unilateral[4] and need not be reasonable), the "advice is individualized to, or specifically directed to, the advice recipient," and the "understanding" is that the "recommendation" is to be used "in making investment or management decisions,"[5] then "investment advice" has been provided to the plan or plan participant. This definition of "investment advice" thus depends upon three particularly poorly conceived and ambiguous terms: Compensation, Recommendation, and Understanding.

The definition of "compensation" appearing in proposed § 2510.3-21(f)(6) conflates all direct or indirect fees or other compensation related to advice or "incident to" a transaction to make them entirely indistinguishable among each other throughout proposed § 2510.3-21. Thus, as currently proposed, wherever "fees" or "compensation" are mentioned in the proposed rule, one must essentially interpret them to mean "all income from whatever source derived," which eviscerates any potential meaning of the qualifiers "in exchange for" or "direct" in relation to compensation. Thus, we believe the only appropriate course of action is to re-propose clear and distinct definitions of "direct compensation," "indirect compensation," "direct fee," and "indirect fee" that reasonably identify the source, destination, and purpose of the compensation or fee.

The term "recommendation" is defined in the proposed rule 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." See Proposed § 2510.3-

[1] Proposed § 2510.3-21(a)(1).
[2] See proposed (a)(1), (f)(6).
[3] Proposed (a)(2)(ii).
[4] See 80 Fed. Reg. at 21934.
[5] Proposed (a)(2)(ii).

21(f)(1). The term "suggestion" within that definition means that almost any "communication"—anything from a subtle head shake to an explicit statement, or any information at all provided by a salesperson—could "reasonably" be deemed a "recommendation," and thus, cause an unintentional interaction to incur a fiduciary duty. Furthermore, there is no causal link between the "recommendation," the "action," and "compensation": Any compensation from any source would trigger the duty, regardless of: how long ago or in what manner the "suggestion" is provided; the amount or source of the compensation; whether the "advice recipient" has taken or avoided any action; whether that action is even remotely related to the one recommended by the communicator; or, as detailed below, even whether the individual making the communication is the person being compensated.

Finally, the term "understanding" is undefined and appears to be essentially boundless. Indeed, the preamble to the proposed rule indicates that an "understanding" need not be mutual.[6] Rather, the proposed rule indicates that a mere "suggestion" could be furnished pursuant to a recipient's unreasonable and misguided unilateral "understanding" that such suggestion should be used for making investment decisions, resulting in mutual fund advisers unwittingly becoming subject to fiduciary duties if any of the adviser's staff[7] engages in any "communication" whatsoever about the adviser or the fund to a plan fiduciary or plan participant.

2) "Compensated directly"

Although on its face, the proposed (b)(i)(B)(3) and (C)(3) counterparty carve-out condition of "compensated directly" appears to be rather clear, the definition of "compensation," described above, renders the phrase "compensated directly" ambiguous at best.

As currently drafted, because proposed (f)(6) defines "direct" and "indirect" compensation and fees to be all the same, the restrictions in the carve-outs could cause a mutual fund's adviser to become subject to ERISA fiduciary duties if a salesperson for the adviser discusses the mutual fund in any way with a plan fiduciary. For example, if at any time after "investment advice" (which would include basic marketing or sales information, according to the proposed rule) is provided about a mutual fund to a plan and the plan fiduciary adds the mutual fund to a plan menu, the fund's adviser will earn advisory fees resulting from the purchase of relevant mutual fund shares by plan participants. Under the proposed rule, this means that a "person" with investment discretion over plan assets (i.e., the mutual fund adviser, which had no direct interaction with the plan or its participants) has received "compensation" "in connection with" the "transaction" and the carve-out becomes unavailable, making the mutual fund adviser a "fiduciary" to the plan and its participants.

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[6] See 80 Fed. Reg. at 21934.

[7] It appears that the proposed rule relies upon the broadest possible reading of the ERISA § 3(9) definition of "person" to include a legal entity, rather than the § 3(21)(A) use of "person" in context (referring to "he"). While "he" could also refer to "she" or a group or class of people (see 1 U.S.C. § 1), there is no distinction in the proposed rule between an individual "person" who, though employed by the adviser, has no investment discretion whatsoever, and the "person" (i.e., legal entity) with investment discretion who employs that individual.

This result runs directly counter to the clear Congressional intent of ERISA § 3(21)(B), which indicates that an investment of plan assets in a mutual fund "shall not by itself cause such … such investment company's . . . investment adviser … to be deemed to be a fiduciary or a party in interest."

Therefore, if the Department moves forward with this proposed rule, we urge the Department to clarify, in accordance with ERISA § 3(21)(B), that asset-based fees paid by mutual funds to their investment advisers are specifically excluded from any definition of "fee" or "compensation" for purposes of the proposed rule.

Furthermore, we ask the Department to clarify that "in connection with the transaction" requires that the compensation must be "in exchange for" the "advice" and rationally related to the specific applicable transaction or series of transactions. For example, a fixed fee or commission paid by a plan to an adviser in exchange for recommending investment options to include in a plan should clearly be relevant compensation, whereas, as noted above, asset-based investment advisory fees earned by an investment adviser to a mutual fund simply by virtue of plan participants' investments in that fund should not be considered as compensation.

Moreover, the uncertainty surrounding the definitions of "investment advice" and "compensation" and the subsequent imposition of fiduciary duties likely would lead to a substantial chilling effect in the availability of information to plan fiduciaries about mutual fund investment options, thus reducing the availability of diversified investment options to plans and plan participants.

Questions and recommendation for further action

The rule as currently proposed raises multiple questions: Could basic factual information from a mutual fund's adviser about a fund's returns "reasonably be viewed as a suggestion that the advice recipient engage in … a particular course of action"? What kind of "action" is relevant? What is the rationale for imposing a fiduciary duty in response to a mere suggestion? How long after "advice" is rendered could a fiduciary duty attach? Would such fiduciary duty ever expire?

Perhaps these questions were not considered during the drafting process of the proposed rule.

We believe that if the Department moves forward with this proposal, it should withdraw the current rule and all associated PTEs and PTE amendments and propose a new version incorporating the following changes:

1) A definition of "investment advice" that incorporates a clear and reasonable chain of cause and effect among advice, action, and compensation.
2) A time limit after "investment advice" is provided during which some action or inaction must occur in order for the adviser to incur a fiduciary duty.

3) Clear, distinct, and reasonable definitions of "direct compensation," "indirect compensation," "direct fee," and "indirect fee." These definitions should make clear that where an investment adviser receives compensation merely by virtue of the fees it receives for advising the mutual fund, then the definitions shall not apply.
4) A definition of "recommendation" that goes beyond a mere "suggestion," (e.g., "a statement or other communication advocating a particular course of action or inaction taking into account the advice recipient's particular facts and circumstances"), and requires at least a reasonable mutual understanding of the purpose of the recommendation and the conditions under which it is being made.