Fund Democracy
Consumer Federation of America

October 6, 2008

FILED ELECTRONICALLY

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
Department of Labor
200 Constitution Avenue
Washington, DC 20210

Re: Investment Advice – Participants and Beneficiaries

Dear Mr. Wong,

We are writing on behalf of Fund Democracy and the Consumer Federation of America in response to the Department's request for comments on its proposed regulation regarding investment advice provided by fiduciaries to participants in participant-directed individual account plans (collectively, "401(k) plans"). We support the Department's effort to ensure that participants' access to investment advice is not unnecessarily limited by regulatory constraints while also seeking to effectuate Congress's efforts not merely to require disclosure of conflicted advice but to prohibit it.

Our most significant concern regarding the Department's proposal is its interpretation of the fee-leveling exemption for advisers to 401(k) participants. One of the major sticking points in the debate surrounding the PPA was how to address the risk that fiduciary advisers would recommend investments to participants based on the amount of compensation received by the advisers rather than what was best for the participants. Conflicts of interest of this nature have long plagued the securities industry. Although investment advisers are subject to a fiduciary duty that requires them to disclose the extent to which their compensation varies based on the investment options chosen by the client, the SEC and FINRA have effectively exempted brokers from this disclosure obligation even when the broker is providing individualized advice to clients. Advisers subject to banking and insurance regulations also are permitted to receive undisclosed compensation that incentivizes the salesperson to favor one investment option over another.

Congress decided to reject the disclosure approach altogether, choosing instead to impose a complete prohibition against any advisory arrangements in which the adviser's fees can vary based on the investment selected. The Department has taken this outright ban to heart in defining "fees" for this purpose to include: "[a]ny fees or other compensation (including salary, bonuses, awards, promotions, commissions or other things of value) received, directly or indirectly." By broadly defining "fees" to include any "thing of value" received "directly or indirectly," the Department shows its awareness of the creativity with which financial services firms have found ways to incentive their personnel to push proprietary products or to favor certain proprietary products over others.

For example, after brokers reduced direct cash incentive payments to their registered representatives in the wake of the Tully Report in 1995, they soon found other ways to incentivize their salespeople. Some brokers arranged to receive revenue sharing payments from fund managers that were disguised as administrative fees. Some shifted compensation to branch managers who found ways to provide incentives to their employees, such as by assigning orphaned accounts to representatives with the highest in-house product sales. Others picked up branch expenses so as to increase the size of the branch's bonus pool. Still others held non-cash competitions to push favored products.

We believe that attempts to prevent such differential compensation by targeting specific types of arrangements are unlikely to succeed. The ability of regulators to identify and ban specific practices cannot keep pace with the speed and creativity of sales managers. The Department's position that "fees" broadly include any "thing of value" is necessary to give teeth to Congress's ban on differential compensation.

We recommend that the Department express more forcefully this perspective in its adopting release. It should provide examples of "things of value" received indirectly by advisers, such as shares of bonus pools that depend in any way on relative profits of different investment options, allocation of orphaned accounts based on non-objective criteria, and business trips to resort destinations, in order to alert the industry that any way in which an adviser's benefits vary will violate the law. The Department should recognize that the question is not whether the industry will find ways to provide improper sales incentives to fiduciary advisers – for it is deeply ingrained in current industry practices to find ways to do so on the fringes of expressly prohibited conduct – but rather whether the industry understands that the Department will not tolerate the payment of soft benefits that create improper incentives. The best way to counter conflicted advice is for the Department to send a clear message that it will interpret broadly the kinds of incentives that can be used to push products and cause an adviser's fees to vary.

We also recommend that the Department provide further clarification of its position regarding the applicability of the varying fees prohibition to fees received by an adviser's affiliates. We are concerned that there may be confusion regarding the Department's statement, for example, that:

> an affiliate of a registered investment adviser, a bank or similar financial institution, an insurance company, or a registered broker dealer will be subject to the varying fee limitation only if that affiliate is providing investment advice to plan participants and beneficiaries.[1]

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[1] Another statement in the proposing release that the industry might attempt to take out of context is as follows: "[i]t appears that, while an individual may have a general interest in the overall success of his or

We understand the Department to mean that the mere fact that different investment options offered by an adviser's affiliate impose different fees will not cause the adviser's fees to "vary" for purposes of section 408(g)(2)(A)(i). We agree that Congress must have contemplated that adviser affiliates would charge different fees for different investment options without ***necessarily*** causing the adviser's fees to vary. But we believe that the Department should clarify that fees charged by an affiliate – not for providing investment advice to plan participants and beneficiaries, but for managing a mutual fund investment option, for example – ***would be*** subject to the varying fee limitation if the investment options contribute differently to the affiliate's profitability and the adviser's bonus is directly or indirectly based on the profitability of the affiliate. In this case, sales of a more profitable fund (or, more likely, a fund that is struggling) would indirectly cause the adviser's fees to vary within the meaning of the statute. This is the kind of illustration that would further demonstrate the Department's commitment to the ban on varying fees.

In conclusion, we wish to re-emphasize the choice that Congress made not to rely only on disclosure to protect participants against conflicted advice. Instead, Congress chose the more effective approach of flatly prohibiting conflicted advice by banning the receipt of varying fees by advisers to 401(k) participants. The challenge presented by Congress's approach is how to stymie the creativity of the many firms that profit not by the quality of their products but by the ingenuity of their sales practices. With the growth of defined contribution plans and the increasing importance of participants' individual decision-making role, it has never been more critical that the investment advice that participants receive be free of conflicts of interest. We hope that the Department will clarify its commitment to interpreting fees to encompass broadly any form of benefit received by an adviser that varies based on the investment option selected by the participant. Thank you for your consideration of our comments.

Sincerely,

Mercer Bullard
President and Founder
Fund Democracy, Inc.

Barbara Roper
Director of Investor Protection
Consumer Federation of America

cc by U.S. Mail: Honorable Elaine Chao, Secretary of Labor
Bradford Campbell, Assistant Secretary of Labor (EBSA)
Andrew Donohue, Director, Division of Investment Management, SEC

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her employing firm, this interest, by itself, would not be inconsistent with the individual compensation requirement." *See also* Field Assistance Bulletin No. 2007-01 at Issue 3 (Feb. 2, 2007) ("It is clear from section 408(g)(2)(A)(i) that only the fees or other compensation of the fiduciary adviser may not vary.").