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July 21, 2015

Via Electronic Mail
e-ORI@dol.gov and through www.regulations.gov

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

Re: Proposed Fiduciary Rule (RIN 1210-AB32; 1210-ZA25)

Dear Sir or Madam:

The Alternative and Direct Investment Securities Association ("ADISA" or the "Association", f/k/a "REISA") submits the following comments with respect to the Department's re-proposed rule defining who is a "fiduciary" by reason of providing investment advice for a fee or other compensation to retirement savers and retirement accounts (herein, the "Fiduciary Rule"), as well as the related "Best Interest Contract" Exemption ("BICE" or "BIC Exemption"). ADISA appreciates the opportunity to comment on these important regulatory proposals (referred to collectively herein as the "Proposal").

Background

ADISA (f/k/a/ REISA, the Real Estate Investment Securities Association) a national trade association that influences over 30,000 invetment professionals who offer and manage alternative investments. These alternative investments include, but are not limited to non-traded REITs, real estate partnerships, real estate income and development funds, tenant-in-common interests, oil and gas interests, equipment leasing, business development companies, and other securitized real estate investments. The Association has more than 4,000 active members, who are key decision makers who represent investment professionals throughout the nation, including sponsors and managers of real estate and related offerings, broker-dealers, securities licensed registered representatives, registered investment advisers, investment adviser representatives, accountants, attorneys, mortgage brokers, institutional lenders, qualified intermediaries, real estate agents and real estate brokers. ADISA works to maintain the integrity and reputation of the industry by promoting the highest ethical standards to its members and providing education, legislative and regulatory advocacy, and networking opportunities. The Association connects members directly to key industry experts providing timely trends and education and helping create a diversified portfolio for their clients.

Re-Proposed Fiduciary Rule and the Proposed "Best Interests Contract" Exemption

On April 20, 2015, the Employee Benefits Security Administration of the Department of Labor ("DOL") re-published an updated Fiduciary Rule proposal, which is intended to expand the definition of "fiduciary" under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Under the proposed Fiduciary Rule, fiduciaries with respect to employee benefit plans and individual retirement accounts ("IRAs"), would be prohibited from receiving compensation from third parties in connection with transactions involving plans and IRAs. The DOL released the proposed BIC Exemption on the same day. Under the Exemption, entities such as broker-dealers and insurance agents that are fiduciaries under the proposed Fiduciary Rule could receive compensation when IRA owners and others purchase, hold or sell certain investment products in accordance with the advice of these fiduciaries, but only if the broker-dealer or other financial adviser complies with the numerous requirements found in the Exemption.

Summary of Comments

We believe that the Proposal suffers from several fundamental flaws, and as such should be withdrawn by the DOL. As discussed below, these flaws fall into three categories:

A. The Proposal unfairly and improperly targets financial advisers who receive variable compensation, and would eliminate the ability of financial advisers and their clients to choose the service model most appropriate to their needs, especially the needs of younger and/or lower net worth individuals.

B. The Proposal represents a piece-meal approach to regulating financial advisers, which will only create confusion and differential treatment of savers and investors generally.

C. The BIC Exemption would limit the types of products and programs available to retirement accounts and their owners, and potentially negatively impact their ability to meet their savings and retirement goals.

Each of these points is discussed in more detail below.

A. The Proposal unfairly targets certain financial advisers and will limit investor choice

Financial advisers play an important role in assisting all manner of Americans meet their financial goals, including planning and saving for retirement. As an industry, financial advisers are subject to significant federal, state and self-regulatory organization regulation. They work in large and small firms located across the country, and focus their efforts on working directly with their clients to help them achieve their goals through a variety of investment strategies and products.[1]

Financial advisers are generally free to choose the business model that allows them to best deliver their services to clients. Some advisers have adopted the "fee-based" model, wherein clients are assessed a single all-in fee for advisory services based on the value of the assets placed with the adviser. Others are compensated on the basis of commissions or other payments tied to specific investments made by or for clients (referred to as "transaction-based

[1] The importance of investment advice is increasing among the middle class and is recognized more among the Gen Y and Xers: 92% of those 18-34 years old and 93% of the 25-50year olds consider expert financial advice important in planning their retirement (Natixis Global Asset Management Survey, 2014, accessible at http://durableportfolios.com)

compensation"). Clients receive advice and guidance based on their circumstances, including their objectives, assets, education and risk tolerance, and financial advisers tailor their business model(s) so as to best serve their clients. Indeed, across all ages and income levels, advised investors have more diversified portfolios producing more wealth for individuals.[2]

At present, the choice of business model is left to each adviser or advisory firm, based on its assessment of the needs, etc., of its clients and taking into account the differing economics of one compensation model versus the other. In particular, financial advisers do not typically employ different models depending solely on whether the client holds assets in tax advantaged retirement savings accounts such as an IRA or in taxable accounts (including trusts and other vehicles). The DOL's Proposal will change the current situation in fundamental and, we submit, unsupportable ways. By expanding the definition of fiduciary to encompass nearly all client relationships involving tax advantaged accounts or assets, the Proposal effectively validates the fee-based model and targets the transaction-based approach for a level of regulation that will, by intention or design, result in its disappearance from use in the retirement savings context (and perhaps altogether).

Admittedly, the Proposal does not purport to be business model specific. But by making nearly all financial advisers serving retirement savers and accounts into fiduciaries and proposing to allow variable compensation to be paid or collected only in compliance with the BIC Exemption, the Proposal would place firms and advisers using the transactional model at a significant disadvantage. The BICE as proposed is literally unworkable for financial advisory firms, creating additional liability and imposing an extraordinary level of compliance, operational and other costs on advisers and their firs. In fact, the proposed Exemption is so unwieldy, costly and cumbersome that is highly unlikely that advisers will actually seek to comply with its terms. Thus, in our view, the Proposal will lead to wholesale abandonment of the variable compensation based model by financial advisers.

While moving all financial professionals serving retirement savers and accounts to a fee-based, fiduciary model may sound positive, particularly as it would apply to higher net worth savers, there would be consequences for many retirement savers that the Proposal does not acknowledge. First and foremost, there is a large part of the retirement saver population that cannot be economically served under the fee-based model. Savers with lower balances, in particular, are not well served by a fee-based model, and it is not economic for advisers to provide services to them under the fee-based approach. The increased costs to migrate clients to a fee-based model would be substantial with estimates ranging from 74% to 196% in one study.[3] Furthermore, nearly 10% of all current IRAs come from smaller scale plans more susceptible to cost increase[4]

It is highly likely, therefore, that financial advisers will stop serving such savers, leaving them without the kind of professional advice that they currently need and can access. This is

[2] For those under $100k/yr in annual income, advised assets were 51-113% more than non-advised, depending on age (Oliver Wyman, "The Role of Financial Advisors in the US Retirement Market," July 2015).
[3] *Ibid*, pg. 7.
[4] US Chamber of Commerce's Report, "Locked Out of Retirement," 2015.

particularly likely to impact younger savers, who have not built up substantial retirement assets, as well as the large population of older savers who have not amassed a significant portfolio.[5]

In response to this point, DOL staffers have suggested that retirement savers with smaller balances can access so called "robo" advisers," which is a slang term for advisor firms that rely on computer driven model advice programs to serve clients, generally at low cost. While these advisers and their models may ultimately play in important part in helping investors achieve their goals, their business models and investment acumen is far from proven. Data shows that while "robo" advisers may offer lower costs, retirement savers may pay a high price when the element of human interaction is removed from the advice equation. To the extent that the Proposal gives preference to on-line, algorithm-based allocation and rebalancing tools, displacing personal, holistic investment advice delivered by a professional, this denies investors a choice regarding how they want to receive and pay for financial advice. Research shows that investors who work with financial advisors save more and are better prepared for their retirement.[6]

We believe that it is important to point out that the Proposal is founded at some level on the belief that financial advisers employing the commission-based compensation model maximize their profit from hidden or "back door" fees and payments by recommending expensive and/or poorly performing investment products to retirement savers. As expressed by various sources, the conflict of interest identified by the DOL and addressed by the Proposal is highly pervasive, and causes financial advisers to choose products and services that further their own rather than their clients' interests. Various government agencies have even attempted to ascertain the actual cost of the alleged conflict of interest and have asserted that variable (I.e., commission-based) compensation causes savers to lose returns as a result.

This is an extraordinarily sweeping and unsubstantiated assertion. Without any proof that the conflict it has purportedly identified is in fact affecting the behavior of financial advisers serving retirement savers (much less the returns experienced by retirement savers themselves), the DOL is putting forward a regulatory approach that effectively eliminates an entire long-standing business model for serving clients. We believe that the DOL's approach is flawed in two important respects:

- First, it presumes that the variable compensation elements are inherently conflict producing. The data cited by the DOL does not support the principle that variable compensation arrangements inherently incent financial advisers to choose products, classes or other elements that further only their interests. Broker-dealers and other financial advisory firms typically make decisions about share classes, load structures and other features for approved products as part of their diligence and approval process. Because the firms and their representatives are bound to ensure that products available for their clients are generally suitable for the purposes intended, most if not all of the conflict concerns are dealt with structurally and systematically.

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[5] To understand this point, one simply needs to know that a 1% fee would yield revenue to the adviser of approximately $300 using an average IRA balance of approximately $30,000.

[6] Analysis of Equifax data representing 20% of US consumer invested assets found that individuals with a financial advisor have larger account balances, including IRAs, across age, income, and wealth levels (90% of accounts reflected >25% more investment assets among advised accounts (Oliver Wyman, "The Role of Financial Advisors in the US Retirement Market," July 2015).

- Second, and more importantly, the DOL's view that financial advisers are unduly captured by the conflicts created by variable compensation products is simply not borne out by any statistical data or study. The evidence purportedly relied upon by the DOL involved settled litigation and enforcement proceedings. Those studies do not validate the principle that financial advisers routinely or even presumptively choose products or services or the like based in improper criteria. And they absolutely do not support the accusation that financial advisers are routinely choosing products because of "hidden" or "back door" fees and payments. To suggest that there is such data and that the data demonstrates the behavior cited is disingenuous and a disservice to an industry populated by highly trained professionals who work hard for the benefit of their clients.

In the final analysis, the Proposal is being defended on the ground that financial advisers have not and will not act in their clients' interests absent a fiduciary standard. We submit that such a view of the financial services and advisory industry is unfounded and, at bottom, unfair to the industry and its record of service to all clients. Protecting retirement savers and their savings is an important goal - it should not be accomplished by a proposal that undermines the industry, and eliminates an entire method of doing business followed by thousands of competent and reputable financial advisers without delivering tangible or measurable benefits for investors.

B. Partial Regulation Will Create Inequities and Other Differences

By only capturing advice given to retirement accounts, the Proposal is likely to create confusion. It will also foster litigation and differential portfolio construction principles for clients, depending on whether or not their assets are in a retirement saving account. Financial advisers may be able only to serve a portion of the assets of their clients, depending on which business model they have chosen.

The DOL admittedly does not have jurisdiction over broker-dealers except where the conduct pertains to retirement accounts. Its proposed expanded definition of "fiduciary" would sweep financial advisory firms advising or otherwise serving retirement savers into that status, however, such that advisers proposing to utilize a commission-based approach to serving their retirement saver clients would be required to adhere to the requirements of the BICE in doing so. This would be an unfortunate result for a number of reasons:

1. The service model required to comply with the Exemption differs greatly from that in use across the client base by nearly all financial advisers employing the commission-based model. As proposed, Clients that are retirement savers or accounts would have to enter into a contract or other agreement with their adviser, and products could be sold or recommended to such clients only to the extent that significant and burdensome disclosure and expense based information were made available per the Exemption. Thus, the experience of a retirement saver and a non-retirement safer would be very different, notwithstanding the fact that the same advisory firm and financial adviser is serving them.

2. The pricing for retirement accounts and savers might be very different from pricing accorded other accounts managed by the same firm. A firm that adopts a fiduciary model for its clients will charge very different fees and expenses than one that is serving its non-retirement and retirement accounts using a transaction fee- based business model. These differentials are

unlikely to result in clients paying fees that reflect the total value of the assets they hold with the firm.

3. Where a financial adviser employs the fiduciary (fee-based) model for some clients, including its clients who are retirement savers or accounts, the Proposal would likely ensure that the same client will have different portfolios. While it is not unusual for an adviser to place different products or securities in different accounts for tax, liquidity or other reasons, there is no reason why that result should be dictated by a regulatory construct.

As we believe to be evident, there are significant issues associated with the fact that the Proposal by its terms only reaches certain accounts and clients of financial advisers – i.e., retirement savers and accounts. If there is cause to impose an explicit fiduciary standard on broker-dealers, however, a uniform fiduciary standard would better serve the financial adviser and its clients. Having a separate standard applicable to the provision of services to retirement accounts will at a minimum create confusion and undue cost. More importantly, the DOL does not have significant familiarity with the financial advisory model that its proposal addresses (albeit in the retirement context).

In our view, leaving aside the inefficiencies and client problems associated with a partial standard, the DOL should simply defer its rulemaking activities in order to work in concert with the Securities and Exchange Commission and/or the Financial Industry Regulatory Authority to create universal standards. Workable standards that are business model neutral can be created that serve all investors equally. By working together to create a broad-based uniform standard, the investor protection goals sought by the DOL and others can be introduced and implemented across the industry and for the benefit of all investors.

C. Limiting the BICE to a List of Approved Assets is Not Appropriate

Financial advisory firms serve many individual and other investors, including those saving for retirement. Advisers use a variety of investment strategies, products and services to help clients reach their goals. Different products and services offer different risk/return profiles, and can provide a wide variety of benefits to investors, ranging from current income to capital appreciation. While assessing its return potential and associated risk profile is one key to understanding the value of a given instrument or product or strategy, some investment options offer additional potential benefits to investors, including such portfolio diversification, risk mitigation, non-correlation and tax efficiency. For many investors, these "alternative investments" can be and are important components of portfolio construction. Access to alternative investments can help their adviser diversify their portfolios, secure non-correlated returns and increase their current income, whether inside of or outside of tax favored accounts.

Investors --particularly younger investors--after having seen amplified volatility in the stock market increasingly turn to alternatives for portfolio diversification.[7] In 2014, shares in two popular categories of alternatives (non-listed REITs and BDCs), were held by well over a million retirement investors. These accounts represented a value of over $9 billion in 2014, up by 54% from 2012-2014. Stable growth in retirement portfolios certainly favors alternative investments, and the trend is likely to continue.

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[7] 78% of Millennials and 70% of Gen Xers endorse using alternative investments, an increase of 15-20% over Boomers (Natixis Global Asset Management Survey, 2014)

1. Use of a Defined Asset List is not good policy

Under the DOL's Proposal, products would not be available to retirement savers where sold subject to a commission or other variable compensation arrangement unless if sold in compliance with the BIC Exemption. As proposed, the Exemption employs a definitional concept that limits eligible products and programs to those that meet the definition of "Assets."[8] We believe that employing a static listing or category of variable compensation investments that may be sold pursuant to the BICE is poor regulatory policy.

- First, creating a universe of approved products means that the government rather than the most creative and expert financial system in the world is determining the scope and content of investment options for retirement savers and accounts. Employing a list will no doubt exclude important and useful new products from use by financial advisers, and will create an unnecessary and artificial distinction between retirement saver portfolios and portfolios that are available to investors generally.

- Second, a prescriptive asset list is also problematic because it selects which investments are appropriate based on current trends and beliefs, rendering it inflexible for future updates in investment products and strategies. Such an approach is problematic and may leave off potential future investments that may be appropriate and valuable for retirement investors.

At a time when self-directed retirement accounts are more important than ever, reducing potential returns, limiting options, and increasing risk through the lack of portfolio diversification is the wrong policy for retirement investors.

2. REITs, BDCs and Other Programs should be included in the Asset Definition

Financial advisers are key proponents of using a wide variety of investment products and programs, including "alternative" investments. They possess significant knowledge regarding their role in client portfolios, and they can and do utilize various alternative products and programs, including real estate investment trusts (REITs), business development companies (BDCs), oil & gas programs, etc. Importantly, many of these products and programs are sold subject to a commission or other payment that compensates selling firms and their representatives for their work in reviewing and recommending them to their clients, and thus could be sold to a retirement account only in accordance with the BIC Exemption.

Many investments are not traded on securities exchanges or otherwise have limitations on liquidity for investors. This lack of liquidity, in particular, often allows investors to capture returns that are not available in products and programs that offer full liquidity. The lack of liquidity allows these investment products and programs to make investments in or hold assets that are illiquid, including real estate, privately negotiated debt securities, oil and gas programs, and venture capital and private equity positions. Rather than constituting a negative element,

[8] Eligible Assets under the BIC Exemption include only the following: "bank deposits, CDs, shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs, exchange-traded funds, corporate bonds offered pursuant to a registration statement under the Securities Act of 1933, agency debt securities as defined in FINRA Rule 6710(l) or its successor, U.S. Treasury securities as defined in FINRA Rule 6710(p) or its successor, insurance and annuity contracts (both securities and non-securities), guaranteed investment contracts, and equity securities within the meaning of 17 CFR 230.405 that are exchange traded securities within the meaning of 17 CFR 242.600."

however, this lack of liquidity often allows investors to capture the "illiquidity premium" associated with the asset or asset class (or strategy) in question.[9]

If the DOL goes forward with a defined list of Assets eligible for use under the BIC Exemption, it is important that this list include all manner of investment products and programs to ensure that advisers employing the commission-based business model can build appropriate investment portfolios for retirement savers and accounts. As proposed, however, the term "Assets" excludes many non-listed and illiquid investment products and programs, both alternative and otherwise. Under this approach, a host of effective, diversifying and widely employed investments will be kept outside of the Exemption and will therefore be unavailable to retirement savers.

The Department has specifically asked that commenters who believe that additional investments should be included in the scope of the exemption provide the Department with full descriptions of those products, as well as information supporting the position that the products are a "common investment for retail investors." We submit that the list of Assets eligible for use under the BIC Exemption should include at a minimum (i) non-listed REITs, (ii) non-listed BDCs and (iii) non-traded oil & gas programs.

As a general matter, these investment programs and products share the following characteristics:

- They are compatible with the objectives of retirement investors in that they can provide income and inflation protection, as well as capital growth.
- They provide retirement investors with the opportunity to diversify and stabilize their portfolios of financial assets and thereby improve their risk/return profile in the same way that professionally managed institutional pension and endowment plans do – by investing in real assets or portfolios of private debt and equity operated by professional management which specializes in that asset class. These assets have historically shown low correlations with financial assets, and therefore are recognized as effective diversifiers.
- They provide retirement investors with provide portfolio diversification into assets which have low correlations with exchange-traded financial products, thereby reducing portfolio risk and increasing risk-adjusted returns.
- They provide improved liquidity, transparency and valuation discovery, and in many cases offer enhanced governance and investor-friendly structures, and professional management.
- They are subject to extensive regulation at the federal and state level.
- They have demonstrated investment performance in line with objectives.
- They have established themselves as integral components of investment and retirement accounts for millions of investors, including retirement savers and accounts.

For each such product, we are hereby submitting information regarding its role in a diversified portfolio as well as its current use both inside and outside of retirement savings accounts:

[9] See "The Hidden Cost of Liquidity: How Alternatives Can Reward Long-Term Investors" *Alternative Investment Quarterly,* January 2014.

a. Non-listed REITs

A non-listed REIT is an investment vehicle, typically in the form of a trust or corporation, that directly invests in real estate. Investors receive periodic cash distributions constituting a return of capital and a percentage of the REIT's taxable income. Like exchange-listed REITs, many non-listed REITs own, manage and lease investment-grade, income-producing commercial real estate in nearly all property sectors. They are also subject to the same IRS requirements that exchange-listed REITs must meet, including distributing at least 90% of taxable income to shareholders annually.

Offers and sales of interests in publicly-offered REITs are registered under the 1933 Act, and must comply with corollary state requirements. In addition, REITs are subject to the reporting and disclosure requirements of the 1934 Act, including the filing of quarterly, annual and current reports, proxy statements and other required items, all of which are publicly available through the SEC's EDGAR database.

b. Non-listed BDCs

A non-listed BDC is an investment vehicle that invests in the equity or debt of private companies and small public companies and is typically organized as a corporation or trust. BDCs generally make investments in private or thinly-traded public companies in the form of long-term debt and/or equity capital, with the goal of generating current income or capital growth. Investors typically receive periodic cash distributions that may include dividends. A non-listed BDC may choose to list, merge, sell its assets, or simply liquidate.

There are currently over 80 BDCs with over $70 billion in assets, of which, at least 70% is invested in private American companies. The sector is rapidly growing, with 21 new IPOs of BDCs since 2011, and 28 follow on offerings by BDCs since the beginning of 2014. Since the first non-traded BDC was created in 2008, there are now more than 25 non-traded BDCs currently being sold to retail investors through financial advisors, and the number is growing rapidly.

BDCs are a special category of investment company under the 1940 Act that was added by Congress to facilitate the flow of capital to private companies and small public companies that do not have efficient or cost-effective access to public capital markets or other conventional forms of corporate financing. BDCs are closed-end funds that elect to be regulated as BDCs under the Investment Company Act of 1940 (the "1940 Act"). As such, BDCs are subject to only certain provisions of the 1940 Act, the Securities Act of 1933 (the "1933 Act") (if their shares are publicly offered) and the Securities Exchange Act of 1934 (the "1934 Act"), as well as corollary state regulations. BDCs may qualify to elect to be taxed as a regulated investment company for federal tax purposes. The 1940 Act contains prohibitions and restrictions relating to transactions between BDCs and their affiliates, principal underwriters, and affiliates of those affiliates or underwriters, and requires that a majority of a BDC's directors be persons other than "interested persons" (as defined in the 1940 Act).

c. Other Direct Participation Programs, Including Oil & Gas Partnerships

Direct Participation Programs, as defined in FINRA Rule 2310, also include other publicly registered products which focus on a variety of asset-based and business lending areas. Currently, these other DPP Products include approximately $5.8 billion of public securities offerings currently in the market in such areas as oil and gas, equipment leasing, and impact

lending. All of these products are regulated by the SEC and FINRA as well as being subject to state securities regulations, including guidelines adopted by the North American Securities Administrators Association.

In particular, public non-listed oil & gas/energy partnerships provide individual investors with the opportunity to own interests in partnerships or limited liability companies which own oil and gas reserves or producing or non-producing properties. Investors receive cash distributions from income generated through the sale of oil and gas. While conducting business and owning assets in a fashion similar to many publicly traded energy companies, these partnerships are designed to mitigate for investors the volatility of traded energy securities markets while providing the potential benefits of energy asset ownership and diversification with securities which have low correlations to financial asset markets.

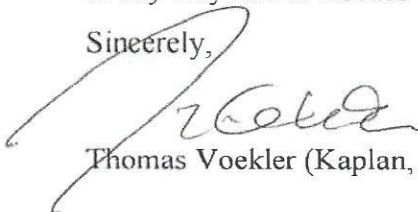
Oil and gas partnerships may be broadly categorized either as "drilling funds," which engage primarily in drilling operations, usually on properties where the presence of oil and/or gas reserves has already been proven (so-called developmental drilling funds), or as "income funds," which engage primarily in the acquisition, ownership and sale of production from existing, producing oil and gas reserves. Over the years, the magnitude of oil and gas partnership fundraising has varied in part with market expectations and supply/demand fundamentals in oil and gas markets. The interests in OG&Ps are registered under the 1933 Act.

In conclusion, we believe that the financial advisory community is already committed to and in fact delivers comprehensive, high quality advice to investors, whether inside or outside of retirement accounts, based on the best interests of the client. This framework should be constructed to leave room for multiple business models to operate in the delivery of that advice, and to make sure that alternative investments – particularly those without full liquidity and/or complete transparency in valuation – are included within that overall framework.

We have shown that financial advice will be limited if the Proposal goes forth as planned. The limiting of this advice will affect many categories of investors, but it will disproportionately affect the younger and less wealthy as they seek to properly diversify their retirement portfolios. We know this is not the intent of the DOL, but unfortunately it will likely be the unintended consequence.

We appreciate very much this opportunity to comment on the Proposal. ADISA is eager to help in any way and to discuss our comments further at your convenience.

Sincerely,



Thomas Voekler (Kaplan, Voekler, Cunningham & Frank), ADISA President

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