Law Office of Linda Dozier, PLLC
1629 K Street, NW, Suite 300
Washington, DC 20006
(571) 766-6406

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Filed electronically at e-ORI@dol.gov

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

Re: Definition of "Fiduciary," RIN 1210-AB32

Dear Sir or Madam:

The purpose of these comments is to reemphasize the enforcement-related reasons for revising the definition of "fiduciary" as it relates to the rendering of investment advice and to examine and evaluate the practical implications of enforcing the proposed regulation.[1] As explained in these comments, a final regulation that includes clear and consistent EBSA enforcement standards and procedures will best protect plans, participants, and plan fiduciaries, and ensure that consultants and advisers are afforded fair and efficient methods of complying with the regulation.[2]

I. ENFORCEMENT ISSUES UNDER THE 1975 REGULATION

Revising the definition of "fiduciary" as it relates to giving investment advice is important to address EBSA's long-standing enforcement issues with the existing 5-part test. The preamble to the proposed regulation notes that plan fiduciaries often hire consultants and advisers to assist them in performing their investment duties.

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[1] The opinions expressed in this letter are my own and do not reflect the opinions of any other person, organization, or agency. Although I submit these comments as a private practitioner, I spent more than 22 years as a professional in the Employee Benefits Security Administration's (EBSA's) Office of Enforcement.
[2] I do not address how this regulation may affect Individual Retirement Accounts (IRAs) because EBSA does not have enforcement jurisdiction over IRAs.

Under the current 5-part test, if those consultants and advisers have conflicts of interest and the plan experiences a loss or engages in a prohibited transaction resulting from the plan fiduciary's reliance on the consultant or adviser's conflicted advice, the fiduciary may bear the full burden of liability for that loss. The consultant or adviser can avoid being cited as a fiduciary because one or more of the elements of the 5-part test are not satisfied and the consultant/adviser is not otherwise a fiduciary. The plan fiduciary then is in the unfair position of having relied on expert advice in order to more prudently perform its fiduciary duties, but nevertheless bears the liability that results from the adviser's conflicted interests.

EBSA investigators work diligently to compile the evidence necessary to identify the person or entity responsible for a fiduciary breach. However, in order to cite an investment adviser for a fiduciary breach under ERISA in cases where fiduciary status cannot otherwise be established, an investigator must establish a ***factual record that supports each element of the 5-part test***. Specifically, the 5-part test requires that, to be found a fiduciary, the adviser must have:

> (1) Rendered advice as to the value of specific securities or other property, or made recommendations as to the advisability of investing in, purchasing, or selling securities or other property, (2) on a ***regular basis*** (3) under a ***mutual*** agreement, arrangement, or understanding with the plan or plan fiduciary (4) that the advice would serve as **a primary basis** for investment decisions with respect to plan assets, and (5) that the advice would be individualized based on the particular needs of the plan.

The most problematic elements are the requirements that the advice have been rendered on a *regular* basis and that there have been a *mutual* agreement or understanding that the advice would be a primary basis for the plan fiduciary's specific investment decision. As noted in the preamble, the regular basis requirement is an artifact of the 1970's that needs to be eliminated because expert advice today is routinely furnished on a one-time basis.

The "mutual agreement, arrangement or understanding" requirement presents a more difficult question. On the one hand, consultants and advisers often take advantage of this requirement and effectively avoid fiduciary liability by merely including disclaimers in their service contracts with plans. Such disclaimers explicitly deny that any mutual agreement exists regarding the fiduciary's ability to rely on the investment advice as a primary basis for making an investment decision. On the other hand, consultants and advisers nevertheless proceed to offer the investment advice on which the plan fiduciary relies.

The disclaimer practice is the most egregious when plan fiduciaries seek advice from consultants or other experts to assist them in their fiduciary duties, proceed to rely on the advice, and only learn later that the adviser's conflicts or other operational failures made the advice unreliable. In addition, because of their reliance (despite the disclaimer), plan fiduciaries may fail to ask questions aimed at identifying and evaluating the adviser's conflicts of interest. In this respect, the Department correctly seeks to eliminate the abusive practices by which consultants and advisers act to induce plan fiduciaries to rely on their services while disclaiming responsibility. Nevertheless, the Department must exercise care to avoid inappropriately imposing fiduciary liability on consultants and advisers who actually do not expect or intend that their professional services will be relied upon by plan fiduciaries in making investment decisions.

Once an investigator finds that the 5-part test cannot be used to establish fiduciary status, the investigation may instead focus on whether the consultant or adviser can be deemed to have acted as a *de facto* fiduciary under a functional analysis. That is, the investigator must determine whether fiduciary status was conferred by virtue of the fact that the consultant or adviser actually exercised discretionary authority or control over the investment of the plan's assets. Typically, consultants and advisers are careful not to step over the line whereby they would either have control and authority over a plan fiduciary's investment decision or directly over the plan's assets. Thus, depending on the facts and circumstances of a particular investigation, establishing the factual record to demonstrate fiduciary status of a consultant or adviser in such cases is extremely complex, time-consuming, and expensive both for the Government and the person or entity that is the subject of the investigation.[3]

While the1975 regulation has presented enforcement challenges to the Department for many years, the issue came to a head nearly ten years ago when, in 2005, the U.S. Securities and Exchange Commission issued its "Staff Report

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[3] The preamble to the first proposal published in the Federal Register in 2010 (See U.S. Department of Labor, Employee Benefits Security Administration, 75 Fed. Reg. 65263 (proposed October 22, 2010) (referred to herein as the "2010 Proposal) discussed many of the enforcement concerns arising from the 5-part test. In the current 2015 proposal these concerns are not included in the preamble.

Concerning Examinations of Select Pension Consultants, May 16, 2005" (the "SEC Report").[4] In preparing the report, the SEC's Office of Compliance Inspections and Examinations (OCIE) examined 24 large pension consultants. OCIE found, among other things, that more than half (13) of the pension consultants or their affiliates had ongoing relationships with both pension plans and money managers and that, for some of these consultants, the compensation received from the money managers comprised a significant part of their annual revenue. Further, while OCIE could not definitively conclude that consultants skewed their recommendations to investments handled by specific money managers with whom they had relationships, it did find that most of the pension consultants provided their plan clients with little or no disclosure of their relationships with or services provided to the money managers.[5]

As explained in the SEC Report, under the securities laws,

> an adviser owes its clients a duty of "utmost good faith, and full and fair disclosure of all material facts" as well as an affirmative obligation "to employ reasonable care to avoid misleading clients." Thus, the Advisers Act in recognition of the adviser's fiduciary duty [under the securities laws], requires advisers to provide disinterested advice, and to ensure this, requires advisers to disclose material facts. Whether an adviser's relationships with other parties create a material conflict of interest depends on the facts and circumstances.[6]

In contrast to the securities law standard that mandates disinterested advice and disclosure, ERISA requires fiduciaries to act in accordance with the higher standards of conduct derived from trust law principles. In particular, ERISA requires that fiduciaries discharge their duties to the plan "solely in the interest of the participants and beneficiaries" and for the "exclusive purpose" of providing benefits and defraying reasonable expenses.[7] Furthermore, ERISA fiduciaries must act in accordance with the prudent man standard that requires the fiduciary to discharge his duties with the "care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like

[4] https://www.sec.gov/news/studies/pensionexamstudy.pdf (the SEC Report)
[5] Id., pp. 5-6.
[6] Id., pp. 1-2.
[7] 29 U.S.C. section 1104(a)(1)(A)

character and with like aims."[8] In addition to these overarching trust law principles, ERISA fiduciaries are also charged with avoiding prohibited transactions unless a statutory or administrative exemption applies.

Although the SEC addressed certain conflicts of interest through its 2005 examination project and subsequent enforcement efforts, the SEC Report's findings prompted EBSA to institute its own investigative review to determine whether conflicts of interest had resulted in losses to the plans that might be addressed under ERISA's more demanding fiduciary rules. Accordingly, following the issuance of the SEC Report, EBSA's Office of Enforcement commenced a national enforcement project styled the "Consultant and Adviser Project (CAP)." The CAP was intended to determine whether there were conflict of interest issues that should be addressed under ERISA and whether plans had, as a consequence, incurred losses that could be recovered.

EBSA's National Office worked closely with its Regional Offices to identify appropriate investigative targets, plan investigations to address issues, analyze the resultant evidence, cite violations, and obtain corrections. A major challenge that the CAP presented was the fact that it was very difficult and resource intensive to determine whether the pension consultants and advisers were fiduciaries under the 5-part test. The disclaimer provisions in the service contracts and other similar issues often made it difficult to establish fiduciary status under the 5-part test. Thus, despite dedicating valuable investigative resources to address potentially serious conflicts of interest, EBSA was unable to pursue potential violations, at least in part, because of the 5-part test.[9]

Despite enforcement results that were limited by the 1975 regulation, the CAP provided compelling evidence that the Department needed to take concrete steps to eliminate the 5-part test and structure a new standard that defines fiduciary investment advice in a manner more consistent with the statutory language. The language of the statute states simply that " . . . a person is a fiduciary with respect to a plan to the extent . . . he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so." [10]

[8] 29 U.S.C. section 1104(a)(1)(B)
[9] See the 2010 Proposal at pp. 65271-2.
[10] 29 U.S.C. section 1002(21)(A)(ii)

Accordingly, the revised definition of fiduciary should define investment advice in a manner that is consistent with the law itself but also recognizes the practical implications that any such revision will have (1) for the adviser industry that seeks to comply in good faith with the regulation, and (2) for the Government when it seeks to fairly and effectively enforce the regulation.

II. DEFINITION OF "RECOMMENDATION" IN THE PROPOSED REGULATION

Under the proposed regulation defining "fiduciary" in connection with rendering investment advice, the term "investment advice" includes, among other things, (1) "a recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property . . ." and (2) "a recommendation as to the management of securities or other property. "[11] Thus, the definition of the term "recommendation" is critical to determining whether a communication by a consultant or adviser to a plan, plan fiduciary, or plan participant rises to the level of being a "recommendation" that could result in the adviser being deemed a fiduciary under ERISA. The proposed regulation defines a "recommendation" as being "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" [emphasis added]. [12] The preamble indicates that the language of this definition has been taken from the Financial Industry Regulatory Authority ("FINRA") guidance relating to its suitability rule.[13] The Department specifically requests comments on whether it should adopt some or all of the standards developed by FINRA in defining the term "recommendation."

Setting clear and consistent guidelines for EBSA enforcement actions requires adopting a final regulation that defines what constitutes a "recommendation" with a

[11] 75 Fed. Reg. 21956 (proposed April 20, 2015)
[12] Id., 21960
[13] FINRA Rule 2111 is the suitability rule which states that firms and their associated persons "must have a reasonable basis to believe" that a transaction or investment strategy involving security that they recommend is suitable for the customer. This reasonable belief must be based on the information obtained through the reasonable diligence of the firm or associated person to ascertain the customer's investment profile. http://www.finra.org/investors/suitability-what-investors-need-know

level of certainty comparable to the one that EBSA investigators currently use in determining *de facto* fiduciary status. The proposed definition does not satisfy this standard. A reasonable level of certainty for determining what constitutes a "recommendation" that confers fiduciary status is essential, not only because consultants and advisers need to know when they are fiduciaries and must therefore comply with ERISA's many rules and requirements, but also because such certainty is necessary for effective, efficient EBSA enforcement.

For the following reasons, I urge the Department to amend the proposed definition of "recommendation" because it is too vague to ensure fair, effective, and consistent enforcement.

As an initial matter, FINRA's broad language defining the term "recommendation" is not appropriate in the ERISA context. FINRA uses this general definition to evaluate unsuitable recommendations but, importantly, investment advisers and their representatives already know by virtue of registration when they are subject to FINRA's rules. In contrast, ERISA investment advice fiduciary status is not determined through registration, but instead is determined through application of the definition in the regulation implementing the statute. Accordingly, a specific definition or standard is essential to ensure that an adviser knows and understands the extent of his applicable fiduciary responsibilities and potential liabilities.

The dangers of adopting too vague a definition are twofold: consultants and advisers will not necessarily know when they are acting as fiduciaries, but also EBSA investigators will encounter uncertainty when determining which consultants and advisers are subject to ERISA's fiduciary requirements. In this regard, investigators may be reluctant to cite a consultant or adviser for an ERISA violation when the person appears to have acted in good faith and was genuinely unaware of having acted as a fiduciary in committing a breach. Such uncertainty would have many serious consequences such as increased and unnecessary costs to those investigated, increased delays in completing investigations while seeking interpretive guidance, increased litigation, and a greater likelihood that enforcement resources will focus largely on the more "obvious" cases. Only by revising the proposed regulation to provide greater clarity for the meaning of "recommendation" can the Department avoid wasting valuable investigative resources and avoid substantially increasing costs to the consultants and advisers subject to EBSA investigations while possibly allowing more egregious violations to go unaddressed.

III. SUGGESTED REVISIONS TO THE PROPOSED DEFINITION OF "RECOMMENDATION"

In the interests of ensuring compliance and fair and effective enforcement, the definition of "recommendation" should be revised so that it is consistent with ERISA's statutory scheme. Specifically, the definition of "recommendation" contained in the final regulation should reflect the ERISA elements of discretionary control and authority when evaluating whether the content and context of a communication rises to the level of a "recommendation." Doing so would replace the subjectivity of the proposed definition with objective standards and help improve the ability of consultants and advisers to comply with ERISA's fiduciary requirements. The following are presented as criteria that could be applied to specific circumstances when determining whether a communication is a recommendation:

- **CONTEXT-RELATED FACTORS**:

    - Communication Responds to Fiduciary Request for Advice. Did the adviser provide the communication in response to a plan fiduciary's request for advice or assistance relating to a specific investment-related decision? Having responded to a request from a plan fiduciary for substantive guidance on a specific investment decision would establish the context in which the plan fiduciary would reasonably expect to rely on the adviser's response and the adviser could expect to be deemed a fiduciary.

    - Communication Is Expected to Convey Judgment and/or Expert Knowledge On Which Fiduciary May Reasonably Rely. Regardless of whether the adviser disclaimed having made a recommendation, did the adviser provide a judgment or conclusion based on special knowledge or expertise that the adviser knew, or should have known, the plan fiduciary lacked and would reasonably rely on in making the investment decision?

- **CONTENT-RELATED FACTORS**:

    - Discretion Used in Producing the Communication. To what extent did the adviser exercise discretion in deciding the content and conclusion presented to the plan fiduciary? Did the adviser merely follow an established formula in developing the content or one dictated by the fiduciary, or instead did the adviser affirmatively choose what content to include and/or exclude? Was the selection/exclusion of the content a key factor in supporting the conclusion that was subsequently presented to the plan fiduciary?

    - Communication Substantively Argues for a Specific Outcome. Regardless of whether the adviser specified that the communication was merely investment information or education, or otherwise stated that the communication was not a recommendation, did the communication present information in a manner calculated to influence the plan fiduciary to take a specific action or seek a specific result? For example, even if an adviser stated he is not making a specific recommendation, if the content of the communication was persuasively structured to lead to a specific investment outcome, the adviser would nevertheless have exercised a degree of “control” or “authority” by effectively arguing in favor of (or against) a particular course of action.

    - Level of Analysis Supports Plan’s Reliance on Communication. Was the level of analysis contained in the communication sufficient that a plan fiduciary could reasonably rely on the judgment underlying the conclusions in the communication when executing his fiduciary duties? For example, did the communication include an analysis comparing the costs, benefits, or risks of different investment options with a level of detail that provided the plan fiduciary with the necessary direction to make the investment decision?

For purposes of this discussion I have not separately addressed the term “presentation” that is included in the proposed regulation because it should not be a determining factor in whether a communication rises to the level of a recommendation. This term should be excluded because the manner of presentation does not affect the content of the communication nor the relevant context in which it is rendered and also does not implicate the elements of ERISA fiduciary status, namely discretionary control or authority. Instead, the final regulation should include broad language making clear that any communication, no matter how presented, is subject to analysis as long as it satisfies the context and content factors.

IV. COMPILING EVIDENCE REGARDING FIDUCIARY STATUS

Because ERISA is an extremely complex statute, gathering evidence and analyzing potential violations is often a time-consuming and difficult task, both for the Government and the party being investigated. Accordingly, the final regulation defining investment advice “fiduciary” should explicitly address the potential difficulties in proving or disproving certain elements of the definitions adopted in the final regulation.

For example, assume an investigator interviews a plan fiduciary who states that she had a meeting with her pension consultant and he recommended, based on the plan’s specific needs, that she invest the plan’s assets in a particular private equity fund. The investigator then interviews the consultant who states that, while he provided the plan fiduciary with educational information about different investment options, he explicitly stated and explained to the plan fiduciary that he did not recommend any specific investment product. Because the advice was provided verbally, there is no documentary evidence or third party to corroborate either statement.

Under these circumstances, an investigator must determine whether the communication rises to the level of being a recommendation that would make the consultant an investment advice fiduciary. What other proof should the investigator look to other than uncorroborated statements by the two parties? As indicated above, if the Department adopts a more precise definition of what constitutes a recommendation through the application of specific determining factors, the investigator likely could compile evidence of the factors related to the content and context of the communication that would permit a determination of whether a “recommendation” was made.

For example, the investigator could gather information about the extent to which the consultant analyzed the plan’s specific investment needs and the manner in which an investment in the private equity fund could meet those needs. Likewise, the investigator could determine whether the plan fiduciary requested a recommendation and whether she sought the advice because of the consultant's level of expertise. Having gathered this type of information for all of the applicable factors, an investigator would then weigh the facts to determine whether the preponderance of the evidence objectively indicated conduct consistent with the exercise of fiduciary authority and control by the consultant or adviser regarding the content and context of the communication whereby it constituted a recommendation for purposes of the regulation.

To heighten its effectiveness, the final regulation should include specific evidentiary guidelines that will provide the foundation for weighing the key factors to determine fiduciary status when the evidence, particularly verbal statements, is not conclusive. For example, if the evidence shows that the fiduciary had previously relied on the consultant's expertise in making a difficult investment decision and the consultant was familiar with the needs of the plan, such evidence might be used to demonstrate fiduciary status even though there is no documentary evidence of the actual rendering of the "recommendation." Clear guidelines for making such inferences must be spelled out in the final regulation, however, because inferences based on context where there is no nexus between the separate acts might inappropriately lead to a finding of fiduciary status.

For example, take the case of an adviser who provided written advice to a plan fiduciary on May 19th recommending investment in the ABC private equity fund but claims to have provided investment education information only on the XYZ private equity fund one month later on June 20th. At that time the discussion between the adviser and plan fiduciary occurred over lunch with no other witnesses and no written record. In both instances the plan fiduciary claims the adviser provided investment advice on which the fiduciary believes he could reasonably rely whereas the adviser admits only to having provided investment advice in May but not at the June meeting. The question that investigators must answer is whether the context in which the communication was given on June 20th includes making a contextual inference based on the rendering of written advice one month earlier.

In this case the evidentiary problem of having an uncorroborated verbal communication combined with a contextual inference could lead to a conclusion that unfairly characterizes the adviser's communication as a recommendation that occurred on June 20th. Thus, including *contextual* inferences in the definition of "recommendation" would require the Department to define the extent to which evidence of such facts may be used and relied upon for enforcement purposes.

The limits of using such inferences to establish fiduciary status should be stated and explained, preferably with examples, in the final regulation itself.

Once having established fiduciary status based on contextual inference, the closely related question is whether a fiduciary breach was committed with respect to a particular transaction. For example, using the example described above, if an investigator finds that the adviser rendered fiduciary investment advice on June 20^{th} based on the "context" of having admitted to rendering advice on May 19^{th}, did the adviser commit a fiduciary breach on June 20^{th}? Assuming that the adviser performed extensive due diligence in connection with the recommendation on May 19^{th}, but performed no due diligence in connection with the communication to the plan fiduciary on June 20^{th}, is this a breach of the prudence rule and, if so, is it fair to cite the adviser for a fiduciary breach in one transaction where fiduciary status can only be inferred based on an entirely separate transaction?

Unlike investigations of *de facto* fiduciaries where evidence of fiduciary status is established on a transaction-by-transaction basis and includes concrete evidence such as, trust account signature cards, execution orders, and trade confirmations, among other things, investigations of fiduciary investment advice are far more likely to involve reconciling conflicting verbal statements. Therefore, unless there is supporting documentation regarding the rendering of investment advice, investigators might proceed to rely on the context in which the advice was rendered which could lead to array of problems including litigation. Thus, the Department should clarify both the limits of using contextual inferences as evidence of fiduciary status, but also precisely explain how such contextual evidence will be used in finding and citing fiduciary breaches.

V. CONCLUSION AND RECOMMENDATIONS

As the Department proceeds to finalize the regulation, it is critical that its terms are fairly and effectively enforced. With that goal in mind, the Department should further consider the following:

- Because the term "recommendation" is central to a finding of fiduciary status in rendering investment advice, the term should be precisely defined in the context of ERISA's central themes of discretionary authority and control and implemented through the application of both specific content and context factors that can be proven through direct and indirect evidence.

- The Department should clarify that inferences drawn from the context of the communication cannot be applied to other transactions to substantiate a substantive violation.
- The Department should clarify that enforcement actions under the final regulation will not rely solely on oral evidence where there is no corroboration. In addition, evidence relating to contextual or content factors would substantively negate any disclaimer asserted by the adviser.
- The term “presentation” should be deleted from the definition of “recommendation” because the mere fact that recommendations may differ in how they are presented should not determine fiduciary status.

In summary, while advisers and consultants will work to comply with the new regulation once it is finalized, the proposed definition of “recommendation” is both vague and ambiguous and will make it difficult for consultants and advisers to know when they are fiduciaries in specific circumstances. In addition, rather than providing a desirable degree of flexibility to EBSA’s enforcement efforts, the ambiguity and vagueness of the proposed definition will more likely impede effective and efficient enforcement in a manner comparable to the 5-part test. Accordingly, the Department should revise the definition of “recommendation” to include content and contextual factors, develop evidentiary guidelines for proving such factors, and explain the application of the factors and their evidentiary limitations through a series of examples in the regulation. By doing these things, the Department will better ensure fairness to the advisory industry as well as more effective, efficient, and consistent enforcement of ERISA’s fiduciary rules and regulations.

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Thank you for the opportunity to comment on this very important proposed regulation. If you have any questions, please do not hesitate to contact me at (571) 766-6406.

Sincerely,

Linda Dozier, Esq.
Law Office of Linda Dozier, PLLC