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July 21, 2015

FILED ELECTRONICALLY

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11712
U.S. Department of Labor
200 Constitution Avenue, NW, Suite 400
Washington, DC 20210

Re: Proposed Best Interest Contract Exemption (ZRIN 1210-ZA25)

Vanguard appreciates the opportunity to comment on the Department of Labor's (the "Department") April 2015 proposed Best Interest Contract Exemption ("BICE") and related new and amended prohibited transaction exemptions. This letter supplements Vanguard's comment letter on the Department's proposed Conflict of Interest Rule defining fiduciary investment advice under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") (the "Proposal").

Vanguard is one of the world's leading asset managers, managing over $3 trillion for institutional and retail investors. Vanguard manages over $775 billion in defined contribution ("DC") and defined benefit ("DB") plan assets and provides recordkeeping and administrative services for over 4 million participants in over 6,100 DC and DB plans. We also manage over $475 billion for over 9.7 million individual retirement account ("IRA") investors.

Vanguard commends the Department for proposing a new prohibited transaction exemption and its proposed changes to existing prohibited transaction exemptions concurrently with its expanded definition of fiduciary investment advice. As many noted at the time of the Department's 2010 fiduciary proposal, it is impossible to evaluate the effectiveness and workability of a new definition without understanding the available exemptions. The Department's concurrent exemption proposals allow interested persons to provide informed feedback.

The feasibility of a broader fiduciary standard depends on workable prohibited transaction exemptions that allow beneficial advice services to continue. Without workable exemptions, investors could be foreclosed from obtaining both investment advice and investment products from the same institution, regardless of whether those products and services meet investors' needs at a reasonable cost. Specifically, ERISA's prohibited transaction provisions could operate to prevent fiduciary investment advisors from recommending affiliated investment products to clients, even when both the advice services and the investment products recommended are in an investor's best interest. The Department recognized that such a prohibition was inappropriate immediately following the passage of ERISA when it issued class exemptions from the prohibited transaction rules for various service providers to be able to recommend and sell their own products and services (e.g., Prohibited Transaction Exemptions ("PTEs") 75-1, 77-4 and 84-24). Such a common sense approach is equally justified to allow the provision of investment advice. Vanguard's clients should not have to choose between our investment advice and our mutual funds or exchange traded funds. To that end, we support the Department's intent to propose an exemption that allows beneficial advice services and compensation arrangements to continue. However, the Department should streamline the requirements of the BICE and remove any conditions that undermine the uniformity of a national enforcement regime. Our recommendations for improvement of the BICE, its enforcement regime, related exemptions and transition relief are summarized below.[1]

Executive Summary

1. <u>The Department should streamline the requirements of the BICE to improve its operation and help ensure broader availability of fiduciary investment advice</u>. The feasibility of a broader fiduciary standard depends on workable prohibited transaction exemptions. The Department can effectively mitigate its concerns about conflicts of interest and foster broader availability of fiduciary advisory services by making the following changes to the BICE.

    - Relief should be available for plans of any size and the broader range of transactions, compensation types and assets now affected by the new definition of fiduciary investment advice. As proposed, relief is available only with respect to advice provided to participants, IRA investors and plan sponsors of small plans that are not participant-directed. In light of the extensive protections in the exemption, relief should be available for plans of all types and sizes as well as participants and IRA investors (collectively, "Retirement Investors"). In addition, the Department should expand the transactions and compensation covered by the exemption to include non-investment transactions and compensation, such as that resulting from accounts established in response to fiduciary rollover or distribution advice.

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[1] We note that our support for the expansion of the definition of fiduciary investment advice—as amended by the suggestions in our companion letter on that rule—is contingent on the issuance of workable exemptions for the provision of investment advice as redefined by the Proposal.

- Advisors and Retirement Investors should not be required to enter into written contracts before advice is provided. Particularly in combination with the expansive definition of investment advice, this approach could discourage clients from obtaining fiduciary investment advice. We recommend instead that advisors be permitted to provide an enforceable acknowledgement of their obligation to act in the client's best interest when providing investment advice.

- Any disclosure and data retention requirements should build on the Department's existing foundation. The BICE would require an individualized dollar-amount disclosure of the cost of all investments recommended, including cost projections based on assumptions about investment returns. This disclosure is extraordinarily complex and expensive to implement and can confuse Retirement Investors, who could be misled by projected investment returns built into the Department's required cost projections. Vanguard proposes a more streamlined disclosure regime, one that builds on the strong foundation the Department created through three separate regulatory initiatives in the past 10 years detailing investment and fee disclosure requirements for retirement accounts.

- Retirement Investors and advisors should be able to agree to a limited scope of advisory services. The Department should clarify that Retirement Investors can seek targeted investment advice from investment advisors, who will then have a fiduciary duty to provide advice that is responsive to the client's request. Similarly, the Department should confirm that financial institutions offering proprietary funds may limit the scope of their advice services to proprietary funds if clearly disclosed to Retirement Investors. Several provisions in the BICE can be interpreted as foreclosing relief to investment advisors providing advice solely with respect to affiliated investments.

2. <u>The Department should not overturn the uniform standards of a federal enforcement regime by promoting enforcement of the BICE in state courts and through class action lawsuits</u>. The BICE requires a set of detailed warranties, enforceable in state court and through class action lawsuits, to be included in client contracts. This approach threatens the long-standing principle of ERISA preemption and would increase cost and limit services for Retirement Investors because interpretation of the exemption's complex conditions would depend on the uncertainty of class actions pursued through state courts. The threat of such lawsuits alone would chill advisors' and financial institutions' willingness to provide advice. In Vanguard's view, the conditions of the proposed exemption are sufficient to protect Retirement Investors, and the exemption should not require investment advisors to make additional warranties enforceable through costly class action suits in state court.

3. <u>The Department should provide broader relief for fiduciary advice delivered before the Proposal's applicability date</u>. The Department should provide clear relief for all transactions and compensation that did not result from fiduciary investment advice as defined by the prior

regulation for advice delivered before the Proposal is applicable. Unless the Department expands this transitional relief, advisors and financial institutions will not have the records needed to establish compliance with the new exemptions and could even be liable for recommendations that were not considered investment advice at the time, with no opportunity to alter past conduct to comply with new standards.

4. The Department should expand existing exemptions to reflect its expanded definition of fiduciary investment advice. The Department should review its exemptions beyond the BICE to ensure that it has provided relief for advisor transactions and compensation unconnected to investments. Specifically, if the Department concludes that recommendations regarding investment advisory services or distribution activity should be included in the definition of investment advice, it should expand exemptions like that provided in ERISA section 408(b)(14) to include those transactions and compensation. In addition, the Department should take this opportunity to modify the audit requirement of the ERISA section 408(b)(14) exemption and update and streamline PTE 77-4 to provide expanded relief and to simplify compliance.

5. Vanguard supports further investigation of a streamlined exemption where the potential for abuse is limited. Vanguard believes the Department should continue to consider a simplified exemption premised on low-cost investments or compensation arrangements where conflicts of interest are less worrisome and can be addressed with fewer conditions. The Department should consider this possibility separately, and it must be developed with much more specificity through public notice and comment.

The discussion below details Vanguard's recommendations and provides detailed suggestions for improvement in the BICE, its enforcement regime, related exemptions and transition relief.

I. The exemption should be available with respect to any Retirement Investor and for a broader set of transactions, compensation types and assets.

The Department should permit financial institutions and advisors to rely on the BICE with respect to all their Retirement Investor clients. In light of the extensive protections included in the exemption, there is no clear reason to prevent any advisor or financial institution from obtaining relief under the BICE based on plan size or IRA status. We agree with the Department that service providers to larger plans in particular might not rely on the BICE in providing investment counseling services; for example, they may choose to rely on the counterparty carve-out or another exemption. Providers, however, should have the option to structure their compliance programs to rely on the BICE. Providers may benefit significantly if they could follow a single prohibited transaction compliance strategy with respect to all their clients and for all products and services. Participants, particularly those who have both plan accounts and IRAs with the same institution, would benefit from the consistent disclosures and service experience such an approach would foster.

Similarly, the Department should make the BICE available for all advice services, regardless of the mechanism by which a financial institution or advisor provides advice. "Robo-advice" can be difficult to define. It is generally used to refer to online advisory services that do not provide access to investment professionals for consultation or guidance. However, it is not clear whether the term would include hybrid programs that involve a combination of computerized advice models and individual advisors, or services that may provide guidance through a computerized model under certain asset levels and only add access to an investment professional above a certain asset level. Whatever the definition, the BICE should be available to all these advisory service models on an equivalent basis as advisor-based advice because both are generally targeted to individual investors. Robo-advisors may choose to rely on other exemptions, such as the statutory exemption for participant advice under ERISA section 408(b)(14), but in light of the extensive protections afforded under the BICE, there is no clear reason for the Department to prevent them from obtaining relief under the BICE as an alternative.

The Department should also broaden the relief under the BICE to include distribution and rollover recommendations. The Proposal would classify these recommendations as fiduciary investment advice for the first time, making prohibited transaction relief potentially necessary. As we explain in our separate letter on the Proposal, we do not agree that distribution and rollover discussions are fiduciary investment advice in the absence of a specific investment recommendation. However, if the Department determines to classify that activity as investment advice, then there is no exemption for those discussions and relief should be available under the BICE.

Additionally, the Department should provide relief for all types of service compensation associated with plan or IRA transactions in addition to investment product fees. As proposed, the BICE does not provide any relief for service compensation or compensation related to account fees that an advisor or financial institution may receive. In this regard, the advisor also has a potential conflict not only if he or she advises a participant to roll over to an IRA, where the advisor or its affiliates will receive additional fees resulting from advice with respect to the IRA, but also if the advisor recommends that the participant leave his or her assets in the plan, if the advisor or its affiliates receive compensation from the plan (e.g., per capita recordkeeping fees). Accordingly, the Department should amend the BICE to permit the advisor and financial institution to receive service and account-based compensation if disclosed to the Retirement Investor.

The Department should not restrict the asset types with respect to which relief is available. The BICE restricts relief to a limited pool of assets, generally registered securities and other regulated investment products (e.g., bank and insurance products), but many advisors will need broader relief even if they recommend purchasing investments only in such registered or regulated investment products. Due to the scope of the Proposal, an advisor recommending a rollover may be a fiduciary under the Proposal not only with respect to the investment purchased in an account after rollover but also as a result of advising a participant or IRA investor to sell a non-covered investment, such as a partnership or hedge fund interest, in order to roll over to an IRA or purchase covered assets. Unless the advisor can limit the scope of the fiduciary investment advice to the investments made after the distribution or rollover, the advisor may need relief under the BICE with respect to the sale of investments in the prior plan or IRA, for example, if the advisor or an affiliate receives compensation as a result of the sale.

Lastly, we recommend that the Department extend the BICE to cover discretionary investment management services. It is particularly important that the Department extend the BICE if the Department determines not to modernize PTE 77-4 as requested below because advisors and financial institutions need an exemption for discretionary management that is more suitable to current market practices. Allowing advisors and financial institutions to follow a consistent approach with respect to their nondiscretionary and discretionary advice programs instead of having to rely on multiple exemptions could reduce the costs of exemption compliance for the institution and ultimately for investors, particularly if the BICE is materially simplified as we request in this letter.

II. The Department must make multiple changes to streamline and simplify the proposed exemption's contractual requirements.

Vanguard agrees that advisors to Retirement Investors should be required to act in the best interests of the Retirement Investor when providing investment advice. In the case of IRAs, in the absence of a statutory best interest standard comparable to ERISA's "prudent person" standard, the Department has added a best interest standard by contract as a condition of the BICE. This approach effectively extends a fiduciary standard to IRAs.[2] Without significant changes to the BICE, however, Retirement Investors are not likely to benefit from this protection because institutions will avoid providing advice rather than structure their services to comply with the BICE. Specifically, the Department should make certain changes relating to the timing, structure and content of the required contractual provisions to make them more workable. As detailed below, an acknowledgement of fiduciary status and commitments at the time of the Retirement Investor's initial contact with the financial institution would better suit the dynamics of many initial client conversations.

The Department also must not condition the availability of the exemption on the financial institution offering specific investments to meet the Department's view of a Retirement Investor's financial objectives and needs. Instead, the standard should be whether the

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[2] In the Preamble, the Department stated that the best interest standard is intended to parallel the fiduciary standards already applicable to plans subject to ERISA and extend them to IRAs. 80 Fed. Reg. 21928, 21970 (Apr. 20, 2015). However, the best interest definition does not follow the statutory language precisely and we are concerned that this variation may result in inconsistent standards. The Department should revise the best interest definition to track ERISA's statutory text precisely or simply incorporate the duties of prudence and loyalty by cross-reference to the applicable sections of ERISA.

advisor is providing advice that is consistent with the investor's objectives. Relatedly, the Department should clarify that the breadth of the best interest standard does not prevent the Retirement Investor and the advisor from agreeing to limit the scope or duration of the investment advice that will be provided.

A. Advisors, financial institutions and Retirement Investors should not be required to enter into a multi-party written contract before advisory services can be described.

By requiring advisors, financial institutions and Retirement Investors to enter into a written contract before advisory services can be discussed, the Department may inadvertently reduce the amount of advice available to Retirement Investors. Most initial investment interactions between advisors and Retirement Investors, particularly participants and IRA investors, will occur through a website or a call center before there has been any opportunity to establish a written contract between the parties or before the Retirement Investor is even a client. In the context of an initial conversation, where the prospective client is determining whether he or she wants to work with the advisor or financial institution, Retirement Investors do not expect that they will have to sign a written contract and wait several days for counter-signatures before having that conversation. Furthermore, many will refuse to enter into such a contract before they have made the decision to hire the advisor. It also may be impossible to get existing clients, who are redefined as investment advisory clients under the Proposal, to sign a contract to continue receiving ongoing advice. That would be the probable result of the written contract requirement. In the absence of a simplified fiduciary definition that clearly recognizes marketing activities as non-fiduciary, financial institutions likely will take a prudent, conservative approach by requiring a written contract before providing even the most basic information about potential investment options to a prospective Retirement Investor client.

Instead, the Department should permit advisors to commit to fiduciary obligations through an enforceable acknowledgement when the Retirement Investor engages the advisor rather than through a multi-party contract before conversations may begin. We agree that the advisor should make a clear commitment to the Retirement Investor if the advisor will be providing fiduciary investment advice, but the mechanism for making that commitment must be practicable. In our view, it should be permissible to create such an enforceable commitment through an acknowledgement or disclosure in the case of prospective clients and through notice and negative consent to existing agreements in the case of existing clients.[3]

[3] Some commenters may suggest that the Department require a written contract only before the advice is actually implemented instead of at the time the advice is provided. That approach is not practicable in our view. In a call center environment, the discussion and the implementation are often simultaneous and the financial institution will not always know how quickly an investor acts on the discussion. For example, an investor may have a conversation with a call center representative, hang up and then go online and immediately act on the information given without ever consulting again with the call center, or the call center being aware that the investor implemented its

If the Department retains a written contract requirement in a final exemption, it should limit the requirement to the party legally acting as advisor (institutional or individual) and the Retirement Investor. A tri-party contract would be not only cumbersome to implement but also inconsistent with investor expectations. Investors typically perceive the primary advisory relationship to be with either the individual representative or the financial institution, but not both. The tri-party agreement would not provide any additional protection to the Retirement Investor because there is only one investment advisor, whether that is an individual or the financial institution itself. In fact, it might create a situation where the investment professional and financial institution each tries to avoid responsibility by pointing to the other as liable for a breach. Structuring an agreement in this fashion is particularly unworkable for institutions that service smaller plans, participants and IRAs. Many financial institutions use a team-based approach to provide investment advice to smaller investors and the client's advisory relationship is with the financial institution, not any one individual. In that case, the investor may discuss investments with one of several individuals on the team, who might be different for every interaction. This team approach is particularly common with low-cost hybrid robo-advice models that may include conversations with individual representatives.

B. Financial institutions and advisors should not be required to offer a "broad range of investments" as long as Retirement Investors receive advice that fully addresses their request.

The Department should not require either the financial institution or advisor to offer and recommend a broad range of investments as long as the advisor provides advice that is completely responsive to the Retirement Investor's request.[4] If the Retirement Investor has requested comprehensive investment advice, advisors should be required to give a clear disclosure if advice is limited to proprietary funds and if there are any *broad* asset classes (equity, fixed income, international) that are necessary to serve the best interests of the investor but that are not available through the institution. This disclosure should suffice whether the advisor only provides advice with respect to proprietary investments or places no limits on the scope of its advice. An advisor should be permitted to limit the range of investment options as long as it is clearly disclosed, and advisors should not be required to conclude in writing that those limitations do not prevent an advisor from providing advice in the Retirement Investor's best interest. If the only products for which an advisor offers advice services are proprietary funds, the advisor should disclose that fact. In all cases, if the advisor determines that an asset class that is needed to meet the Retirement Investor's goals is not available through the financial institution, the advisor should explain that

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recommendations. The investor might not even open an account with the financial institution with whom the discussion occurred but still implement the investment recommendation through another financial institution.

[4] Although the broad range of investments requirement under Section IV of the BICE is not a contractual requirement per se, we address the issue here because it relates to our concern that the BICE as proposed does not appear to permit the advisor to provide limited scope investment advice even if requested to do so.

determination to the investor so that the investor may decide whether to obtain the investment elsewhere.[5] In our view, the best interest standard already requires an advisor to inform the Retirement Investor of any investments needed to meet the Retirement Investor's goals that must be obtained elsewhere. As a result, requiring the financial institution to make a written finding that any limitations on the range of investments offered will not impede the advisor's ability to provide investment advice will yield no additional protection for Retirement Investors in addition to the already-applicable best interest standard.

At a minimum, the Department should remove references to the term "Assets" as defining the broad range of assets that the financial institution must offer. Generally, the BICE requires a financial institution to offer and an advisor to recommend a range of "Assets" broad enough to allow advisor to cover all asset classes reasonably necessary to serve the best interests of the Retirement Investor based on his or her investment objectives, risk tolerance, financial circumstances and needs. The reference to the defined term "Assets" suggests that the advisor must offer a wide range of investment products, not merely one type of product (such as mutual funds) across the range of major asset classes. The Department should clarify that the "range" refers to basic investment strategies (e.g., equities, fixed income, international) and not the type of investment vehicle (e.g., mutual fund vs. variable annuity). Similarly, the Department should further clarify that a broad range is not required if a Retirement Investor seeks advice on a specific asset class or limited group of asset classes. In other words, if a plan sponsor only seeks advice on an investment-grade fixed-income option, the relevant question should be whether the financial institution offers investment-grade fixed-income options for its representatives to recommend and, if so, which of those options meets the client's needs.

C. Retirement Investors and advisors should be able to agree to a limited advisory scope.

The Department should clarify that the BICE requirements to act in the client's best interest and offer a broad range of investments do not prohibit the advisor and Retirement Investor from agreeing to a limited scope or duration for advisory services. Under the Proposal itself, the Department clarified that a person who is a fiduciary by reason of providing investment advice with respect to any securities or other property of a plan or IRA is not deemed a fiduciary regarding any other securities or property with respect to which the person does not provide investment advice.[6] However, as proposed, the BICE does not clearly permit a fiduciary to limit the scope of its services to particular investments or investment strategy of a Retirement Investor.

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[5] We agree with the Department that no disclosure should be required when advising a participant in an employee benefit plan about selecting investments from a line-up of investment options selected by an independent plan fiduciary. BICE Section IV(c); 80 Fed. Reg. at 21986.

[6] Prop. DOL Reg. § 2510.3-21(c); 80 Fed. Reg. at 21959.

The best interest standard requires that advisors consider not only Retirement Investors' investment objectives, but also their risk tolerances, financial circumstances and investment needs. As a result, the BICE does not appear to recognize that a Retirement Investor may specifically request that an advisor provide advice only with respect to a specific need or risk preference. Retirement Investors should be able to seek investment advice with respect to a specific asset class or a single transaction, and that request should not trigger an obligation for the advisor to go beyond that request to assess the investor's entire investment profile. For example, a plan sponsor might hire an advisor to provide a one-time review of the plan's U.S. fixed income offerings. The Department should confirm that in such a case the advisor would satisfy the best interest standard by confining its advice to this market segment as specified by the plan sponsor and would not have an ongoing obligation to oversee the plan's investments. Without clarification from the Department, advisors may feel compelled to offer only comprehensive and ongoing advice services about a Retirement Investor's situation—and charge for it accordingly—to ensure that the best interest requirement under the exemption is satisfied. Accordingly, the Department must clarify that the parties may limit the duration and scope of the fiduciary engagement to a particular transaction or asset class so that Retirement Investors do not pay for more advice services than they really want or need.

Similarly, investment advisors also should be able to clearly define the scope of their investment advice services to make clear that they will not advise on the purchase of certain asset types. Under the warranty requirements, the institution is required to adopt written policies and procedures that are designed to mitigate the impacts of material conflicts of interest. However, for advisors that limit their advice programs to proprietary funds, it is not possible to fully eliminate conflicts. In the Department's view, a conflict is inherent when advisors provide advice on proprietary funds due to the investment professional's interest in the success of his or her employer or its affiliates, whether or not the investment professional is directly compensated by the funds.[7] However, this issue goes to the scope of the advice provided. The Retirement Investor and the advisor should each be free to determine the scope of the advice that will be requested or that will be provided. If the financial institution's representatives are only authorized to provide advice about the institution's proprietary funds, disclosure of that policy to the Retirement Investor should sufficiently inform them about the conflict.

These provisions in the BICE, in combination with the requirement to offer a broad range of investment options, suggest that the advisor and financial institution may have an obligation to override the Retirement Investor's wishes and provide comprehensive advice. Such a requirement may reduce the availability and quality of investment information available to Retirement Investors, especially participants and IRA investors. At many financial institutions, most initial and ongoing interactions occur through a call center, often initiated by an IRA investor who is specifically interested in that firm's investment products, looking

[7] *See* 29 C.F.R. § 2550.408b-2(e)(1).

for information about specific investments. In that case, the IRA investor has defined that firm's products as the scope of the investment universe and merely wants advice on allocating investments appropriately among them. The investor does not request or expect that the firm to provide advice on other firms' investment products and services.

III. Any disclosure and data retention requirements should build on the Department's existing foundation.

To minimize cost and duplicative disclosures, the Department should reduce and simplify the disclosure requirements of the BICE by leveraging its extensive efforts in recent years to adopt regulations requiring fee disclosure to plan sponsors and plan participants.[8] As proposed, the BICE would create an entirely new disclosure regime that would require financial institutions to calculate the total dollar amount of investment-related fees charged, a requirement that would be prohibitively expensive to implement for little benefit to Retirement Investors over the formula-based disclosures permitted under current law.[9]

Similarly, the BICE should not require advisors to provide an annual list of each asset purchased or sold during the applicable period and the price at which it was purchased or sold. This would duplicate the disclosures that fund firms and broker-dealers already provide at the time of a transaction. Instead, Department should allow advisors to rely on the fee, investment and service disclosures provided to plan sponsors and participants in compliance with ERISA section 408(b)(2) and section 404(a) participant fee disclosure regulations. For disclosures to IRA investors, the Department should allow advisors to rely on disclosures provided in compliance with other applicable laws, such as prospectuses, transaction confirmations and individual account statements.

In addition, the Department should base the frequency of disclosure on the expected duration of the advisory relationship. An annual disclosure requirement is appropriate only when the advisor is providing ongoing investment advice or discretionary management, because only in that situation does the advisor have an ongoing fiduciary obligation to the Retirement Investor. Many financial institutions offer one-time advice consultations, particularly when dealing with smaller plans and accounts. For these situations, an annual disclosure bears no relationship to the advice provided and could serve to confuse the

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[8] The Department has adopted three major regulations relating to fees in the last ten years, including the issuance of regulations under ERISA section 408(b)(2) relating to fee disclosure to plan sponsors, ERISA section 404(a) relating to fee disclosure to plan participants, and disclosure to the Department of additional fee information through annual Form 5500 Schedule C filings.

[9] Vanguard's cost to develop and produce required fee disclosures to plan sponsors and participants was approximately $5 million. This amount only reflects implementation of these regulatory requirements and does not reflect ongoing production and distribution costs. Importantly, the Department's contemplated disclosures under the BICE are individualized dollar-amount disclosures that would affect both our institutional and retail systems, in contrast to both plan sponsor and participant fee disclosure regulations, which permitted general, formulaic approaches to disclosure and generally affected only our institutional systems. Accordingly, costs of disclosure as proposed in the BICE would far exceed these plan sponsor and participant disclosure implementation costs.

Retirement Investor, who might not be invested in the recommended assets. In this situation, the advisor would not necessarily know whether the investor implemented the advice and an annual disclosure, which could relate to advice given as much as eleven months previously, would give the investor the inaccurate impression that the advisor is providing investment advice on an ongoing basis. Instead, a simplified point-of-sale disclosure is a more appropriate solution.

Further, many financial institutions offer one-time investment consultations in a call center environment in which advice is provided through access to a team, and the individual providing the advice may have very limited information about the caller. In those situations, the representative and the financial institution will not always have the information needed to track those to whom the institution provided a recommendation or what the recommendation was and therefore to make a subsequent disclosure consistent with the BICE's annual obligation. Rather than mandating that financial institutions build costly new reporting systems—or requiring Retirement Investors to choose between a much lower level of service and a fee-based ongoing advisory service—the Department should amend the BICE so that financial institutions are required to provide only a simplified point-of-sale disclosure to the Retirement Investor orally or electronically during or immediately after the conversation. The point-of-sale disclosure could be modeled on the participant fee disclosure[10] but confined to the fees and expenses associated with the investment, such as loads and sales charges, as well as any account-related fees (e.g., IRA custodial fees). A point-of-sale disclosure of fees and expenses will provide a Retirement Investor with the most immediately relevant information about the recommended investment product at the time when the investor is evaluating whether to act on the recommendation.

The Department should eliminate the revenue and performance data retention requirements and all provisions requiring reporting to the Department. The BICE already would require any financial institution relying on it to maintain detailed records about investment costs and performance at the institution- and advisor-level, respectively, and provide that information to the Department upon request. That requirement should be sufficient to ensure compliance and is consistent with the historical approach of the Department in other exemptions.[11]

Moreover, this proposed retention and reporting of cost and performance data would involve significant costs to build because many institutions do not need to track such information today with respect to investment discussions that do not constitute investment advice under the current regulation or related law, such as the Investment Advisers Act of 1940. The reporting also would not provide meaningful data to the Department. The Department's assertion that it needs the data to evaluate whether the exemption is working and how

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[10] 29 C.F.R. § 2550.404a-5.

[11] For example, no comparably detailed revenue or performance data retention requirements exist in other administrative or statutory exemptions for investment management or investment advice. *See, e.g.*, PTEs 77-4, 84-24, and ERISA section 408(b)(14) and the regulations thereunder.

compensation impacts performance[12] only makes sense if the Department is assuming that performance and cost should be measured in absolute terms and should be the same for all Retirement Investors. Clearly, this is not the case. The Department recognizes this principle in its definition of best interest by requiring that advice be tailored based on the preferences and financial circumstances of each Retirement Investor.[13] As a result, there is no basis for comparison of returns at the level of the individual advisor or financial institution level because either may focus on particular niches of Retirement Investors with very different needs and individualized risk tolerances. For example, some advisors may be dedicated to older investors who want more conservative, income-oriented investments and others might focus on younger, growth-oriented investors. Both may serve their respective clients groups well but their recommendations and performance would not be comparable in any way.

IV. The Department should eliminate the state law and class action enforcement regime encouraged by the warranty requirements.

The Department should eliminate the warranty requirements included in the BICE because they do not provide any additional substantive protections for Retirement Investors and would significantly limit the amount and type of advice available to them. The BICE already requires the advisor to act in the best interests of the Retirement Investor and refrain from providing any investment advice that would lead to the advisor, its affiliates and the financial institution receiving more than reasonable compensation. These specific contractual terms and other disclosure requirements of the BICE are more than sufficient to protect plans and participants. By requiring that a best interest standard be included in the contract or acknowledgement between the advisor and the Retirement Investor, the Department has provided an effective avenue for redress if the advisor fails to satisfy the best interest standard.

In contrast, the warranty provision appears to exist solely to expose advisors and financial institutions to additional claims for technical violations of the warranties that are completely unrelated to whether the advisor satisfied the best interest standard. For example, the requirement that advisors warrant compliance with all applicable laws could create potential liability for financial institutions for even immaterial violations that are unrelated to the quality of investment advice provided. Indeed, the only practical effect of the warranty provisions appears to be creation of a state law, class action enforcement mechanism for technical missteps by an advisor that are unrelated to whether the advisor has acted in the best interests of clients. Even the threat of class-action lawsuits could chill advisors' willingness to offer advice. As a result, retaining the warranty requirement would be a significant disincentive to providing advisory services that must rely on the BICE.

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[12] 80 Fed. Reg. at 21976.
[13] BICE Section VIII(d); 80 Fed. Reg. at 21987.

The Department should also eliminate the proposal's prohibition on waivers of or limitations on a Retirement Investor's right to participate in class-action litigation. Financial institutions may include mandatory arbitration provisions in contracts as a means to limit frivolous litigation, which ultimately can benefit Retirement Investors by reducing costs. By prohibiting such a waiver of class-action rights, the Department has essentially asserted that arbitration is an inadequate remedy. That position is contrary to Congress's express approval of arbitration as an alternative to the court system through the Federal Arbitration Act in a wide range of situations.

By turning over enforcement to the state courts, the Department would threaten the long-standing principle of ERISA preemption, which fosters the stability and uniformity upon which the voluntary employee benefit plan system depends. Using state courts as an enforcement mechanism would encourage frivolous lawsuits, driving costs up and turning interpretation of the exemption's complex conditions and the definition of fiduciary investment advice over to the uncertainty of a patchwork of litigation pursued through state courts. This extraordinary change in enforcement practices is unnecessary. The Department and the Internal Revenue Service (the "Service") already possess a very potent enforcement mechanism with respect to compliance with exemptions by providers to both plans and IRAs through the excise taxes under the Internal Revenue Code. Additionally, enforcement through state court causes of action would cause the Department to lose control over the development of interpretations of the exemption and financial institutions to lose the certainty they require when dealing with prohibited transaction exemptions. If a condition is sufficiently important for the protection of Retirement Investors, then the Department should include it in the requirements of the BICE so that the Department and/or the Service, as applicable, can enforce it. Financial institutions are accustomed to engaging with the Department on exemptive issues and need the certainty of dealing with an expert regulator on questions of interpretations and compliance. The consequences of engaging in a prohibited transaction are so severe that firms will not take on the risk if rulings from the state courts are conflicting or vague. As a result, firms could stop offering affected advice services, be forced to rely on an alternative exemption, or price their services to account for the potential litigation risks posed by the exemption.

By removing advisory services from ERISA preemption, the Department's proposed enforcement mechanism under the BICE exposes financial institutions, advisors and plan sponsors to risks and costs of litigation based on state law and juries. As a result, financial institutions will have to increase fees (whether at the account- or investment product-level) to account for the increased litigation risk. In the alternative, financial institutions will have to condition the provision of any meaningful investment guidance on the Retirement Investor agreeing to a formal fee-based investment advisory service. Without relief from such frivolous legal harassment, low-cost firms that already seek to act in the best interests of Retirement Investors will have to seriously consider discontinuing many of their current no-fee consultation services in favor of formal fee-based advice services, contrary to the

Department's own goal to preserve other business models. Retirement plan sponsors may decide to avoid this risk by eliminating advisory services to plan participants.

V. The Department should provide broader relief for fiduciary advice delivered before the Proposal's applicability date.[14]

The Department should broaden the definition of "covered transaction" under the BICE to be consistent with the settled expectations of advisors and their clients. In general, all transactions and compensation that did not result from fiduciary investment advice as defined by the prior regulation should be entitled to relief. The Department could achieve this result by revising the exceptions from relief to provide that relief is unavailable with respect to preexisting transactions only when the transaction would have constituted a nonexempt prohibited transaction under the law as it existed on the date of the transaction. This language ensures that the Department is not inadvertently granting retroactive relief for prohibited transactions that were not exempt before the applicability date while not placing an impossible compliance burden on advisors and financial institutions.

Without these revisions, the additional exceptions from relief under subsection (b) of the BICE appear to make the status of investment services and transactions as prohibited transactions partly contingent on the actions of the advisor or financial institution before the Proposal or BICE is final. This is inappropriate in two respects. First, in many cases, advisors and financial institutions will not have kept records necessary to identify the customers and assets for which advice (as redefined by the Proposal) was provided—they did not need to do so with respect to what were nonfiduciary relationships under then-applicable law. For example, they may not have needed any formal agreements with plan sponsors or participants to receive compensation. Second, advisors and financial institutions in those circumstances would not have been able to avoid a prohibited transaction by complying with another then-available exemption. For example, the BICE currently does not provide any preexisting transaction relief to robo-advice services even though interactive websites are currently a common mechanism for the delivery of investment education under Interpretive Bulletin 96-1. Similarly, if an advisor or financial institution provides additional investment advice to a Retirement Investor after the applicability date, the advisor or financial institution appear to immediately and retroactively lose coverage under the exemption with respect to compensation received before the applicability date, again with no opportunity to change its past conduct to comply with an alternative exemption or limit its services to avoid fiduciary status as redefined by the Proposal.

[14] The Department has proposed an applicability date that is eight months after the effective date of the final regulation defining fiduciary investment advice.

VI. The Department should expand existing exemptions to reflect its expanded definition of fiduciary investment advice.

In general, we believe that the Department should update and/or expand many of its existing PTEs in conjunction with any expansion of the definition of a fiduciary to help ensure that Retirement Investors have continued access to valuable investment services. Our comments with respect to the specific exemptions are outlined below.

A. The Department should expand and simplify the exemption for eligible investment advice arrangements under ERISA section 408(b)(14).

Although the Department did not propose any changes to the statutory exemption for participant and IRA investment advice added to ERISA by the Pension Protection Act of 2006, we hope that the Department will take the following comments into consideration in light of the expanded need to rely on statutory and administrative exemptions that will accompany an expansion of fiduciary status. To the extent that the Department continues to view recommendations or marketing of investment advisory services as fiduciary investment advice, it should revisit the scope of the exemptive relief provided by ERISA section 408(b)(14) to include recommendations of advisory services and distributions and rollovers necessary to consolidate assets within an advisory service. In the absence of this relief, investment advisors who provide investment advisory services designed to comply with ERISA section 408(b)(14) may not be able to describe or market such services without complying with the BICE for that single sales conversation. This will significantly increase cost and complexity of providing such services without any increased protection for investors, who are already being offered a fiduciary investment advisory service that complies with a prohibited transaction exemption. To the extent the Department continues to consider sales of investment advisory services a fiduciary activity, it should also expand the relief under ERISA section 408(b)(14) to include compensation resulting from such recommendations (e.g., investment advisory services fees, account opening fees) and the transactions necessary to effect those recommendations (e.g., rollovers to IRAs, liquidation of securities held in other accounts).

In addition, the Department should consider amending the audit requirement of the exemption under ERISA section 408(b)(14) to require evaluation of the operation of an advisor's procedures and controls designed to comply with the exemption, rather than requiring an audit of the advisor's strict compliance with the exemption itself. The statutory requirements of ERISA section 408(b)(14) are unique in requiring an annual audit of adherence to the exemption's conditions. In this regard, this exemption provides a greater degree of oversight by independent, professional third parties than any other exemption in ERISA, whether statutory or administrative. In finalizing its regulation under ERISA section 408(b)(14) in 2011, the Department concluded that this audit should require review of a program's compliance with each condition of the exemption, rather than a more typical controls-based audit, which evaluates the strength of an institution's procedures and controls designed to ensure compliance.[15] In operation, this is a much more difficult audit standard to satisfy, which can lead to "qualified" audits detailing any technical violation of any of the exemption's conditions, even if that violation affects only a single investor, and even if the error has been fully corrected in the investor's favor. This makes this exemption more difficult to satisfy in practice and has contributed to a lower rate of use of this exemption than the Department anticipated in its regulatory impact analysis supporting the 2011 regulation.[16] Accordingly, Vanguard urges the Department to amend the regulation under ERISA section 408(b)(14) to require an audit of the effectiveness of an institution's procedures and controls to ensure compliance, rather than the current compliance-based audit requirement.

B. The Department should modify PTE 77-4 to update its conditions and incorporate improvements adopted in similar individual prohibited transaction exemptions.

The Department should update PTE 77-4, which permits discretionary investment managers with respect to a plan to invest in affiliated open-end mutual funds, to improve its usability and to make it more consistent with the individual exemptions that the Department has issued since 1977. Under current law, PTE 77-4 is the only exemption under which financial institutions can clearly provide discretionary investment management services with respect to proprietary funds. In light of the growth of participant "managed account" programs as well as increased plan sponsor interest in assistance selecting and monitoring plan investment options, including the development of customized fund-of-funds portfolios for individual plans, it is important that the Department modernize this exemption to keep pace.

Specifically, Department should make the following technical updates:

- Expand the relief to include investments in exchanged-traded funds.
- Eliminate the requirement to obtain prior written approval from an independent plan fiduciary with respect to changes in the investment advisory fee or the specific fund(s) selected by the advisor. Instead, the advisor should be permitted to make changes if the plan is notified at least 30 days in advance of the change, to the extent practicable, and has the right to terminate the arrangement before the change is implemented. The Department has allowed such a "negative consent" approach in numerous individual exemptions since PTE 77-4.[17] A negative consent process does not present a risk of abuse due to the requirement in PTE 77-4 that the advisor offset its fees to the extent of

[15] *See* Investment Advice; Participants and Beneficiaries, 76 Fed. Reg. 66136, 66146-47 (Oct. 25, 2011).
[16] *See* 76 Fed. Reg. 66153-56 (estimating that availability of advice will increase from 40 percent of plans to 56 to 69 percent of plans as a result of the exemption). To the contrary, while Vanguard does offer certain investment advice services designed to comply with ERISA section 408(b)(14), we are aware of very few other institutions that choose to do so.
[17] *See, e.g.*, PTEs 94-86 (The Bank of California), 95-48 (Mellon Bank, N.A.), 2008-01 (Barclays Global Investors), and 2009-22 (PNC Financial Services Group).

the investment advisory fees paid to the advisor or its affiliate with respect to the mutual fund or that the advisor simply exclude any investments in its affiliated mutual funds from the calculation of its fee.

- Permit front- and back-end transaction fees that are paid into the fund on fund purchases and sales and eliminate the requirement that such fees be included in the prospectus at the time of investment and assessment. These fees are designed to ensure that non-transacting fund investors are not impacted by transaction costs and market impact generated by the activity of other fund investors and/or to deter excessive transaction activity that is detrimental to the interests of the fund's other investors.[18] If the transaction fee is paid back to the fund itself, and not to the advisor, then it is not properly considered "compensation."[19]
- Clarify that the prospectus delivery requirement may be satisfied by identifying a website address where investment materials can be obtained, with paper copies available upon the independent plan fiduciary's request. In our experience, plan sponsors uniformly prefer electronic copies of the investment information that they can readily share with their consultants, lawyers and other professional advisors, and are already accustomed to gathering such information from websites themselves in the normal course of overseeing plan investments. Use of electronic disclosure under PTE 77-4 would also be generally consistent with the Department's approach to disclosure of investment information in the BICE.

VII. Vanguard supports further investigation of a streamlined exemption where the potential for abuse is limited.

We are interested in exploring with the Department the concept of a simplified BICE when recommending low-cost or other investments or in connection with compensation arrangements that operate to limit the potential for abuse. That said, we do not believe that the Department should attempt to define a "high-quality" investment or make it a condition of such an exemption because the quality of an investment is difficult to determine objectively. Indeed, even reaching a consistent definition of an "index fund" can be a challenge in light of evolving investment approaches.[20] Although we believe that low-cost index funds should form the core of most investors' portfolios, we recognize that individual investor circumstances may vary, and the Department should not favor one type of investment over another. Instead, we believe that a simplified BICE would be more workable if the Department focused on the structure of the advisor's compensation rather

[18] In the case of prime money market mutual funds, the SEC's recent money market reforms will mandate the possible application of redemption fees beginning in 2016. Money Market Fund Reform; Amendments to Form PF, Investment Company Act Release No. 31166 (July 23, 2014), 79 Fed. Reg. 47736 (Aug. 14, 2014).

[19] *See, e.g.*, Supplemental Frequently Asked Questions about the 2009 Form 5500 Schedule C, Q&A 12, available at http://www.dol.gov/ebsa/pdf/faq-sch-C-supplement.pdf. Although Q&A 12 only specifically addressed redemption fees, we believe the same principle should apply equally to purchase fees that are paid into the fund.

[20] *See, e.g.*, *Smart beta: Not beta, but a bet* (Mar. 19, 2014), available at https://institutional.vanguard.com/VGApp/iip/site/institutional/researchcommentary/article/InvComSmartBeta

than the specific investment types an advisor recommends. For example, individuals whose compensation does not vary based on the specific advice given do not have an incentive to promote high-cost investment products over lower-cost ones. We would be happy to discuss these ideas with the Department in further detail. However, we do not believe that the Department has provided sufficient information to allow us or other commenters to evaluate this concept. Accordingly, we strongly urge the Department to undertake a separate rulemaking with an opportunity for notice and comment on any simplified exemption rather than proceeding directly to a final exemption.

* * *

Vanguard appreciates the opportunity to submit these comments and would welcome the opportunity to work with the Department if we can be of additional assistance. If you would like to explore any aspects of our comments in greater detail, please do not hesitate to contact Ann Combs at 610-503-6305, John Schadl at 610-669-4011, or Scott Milne at 610-503-5833.

Sincerely,

Martha G. King

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The Vanguard Group, Inc.

Cc: Office of Regulations and Interpretations
Employee Benefits Security Administration