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September 2, 2015

The Honorable Thomas E. Perez
Secretary
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

**Re: Definition of the Term "Fiduciary"; Conflict of Interest Rule — Retirement Investment Advice (RIN 1210-AB32)
Proposed Best Interest Contract Exemption (ZRIN 1210-ZA25)**

Dear Secretary Perez:

I am writing to express my strong support for the Department of Labor's (the "Department") proposed changes to the definition of a "fiduciary" under the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue Code, as well as the related exemptions. This much-needed regulatory update will strengthen the retirement security of millions of Americans by ensuring that persons who provide investment advice to retirement savers have a legal obligation to put their customers' interests first.

As an initial matter, I would like to applaud the Department for its rigorous, thorough, transparent, and evidence-based approach to this proposal. I would also like to thank the Department for their constructive engagement with me and my office throughout this process.

As with any proposed rule of this magnitude, certain clarifications will be necessary before the rule is finalized. However, I also believe that there are some changes that the Department should *not* make, because doing so would undermine the rule's critical investor protections.

Preserve the Seller's Carve-Out

I strongly urge the Department *not* to expand the so-called "seller's carve-out" to the retail market. Making the seller's carve-out available in the retail market would effectively allow advisers to disclose their way out of a fiduciary duty when they are providing advice to individual IRA owners and small plan providers in too many situations. This would undermine the core purpose of the Department's proposal, which is to ensure that retirement investors who need and rely on professional financial advisers receive unbiased advice that is in their best interest.

Many have argued that a broader seller's carve-out is necessary to ensure that routine marketing and sales pitches are not treated as investment advice subject to a fiduciary duty. To the extent that the line between marketing and advice is unclear in the proposed rule, the solution is not to provide advisers a broad carve-out that allows them to avoid a fiduciary duty altogether. Rather, the solution to an unclear line between marketing and advice is, quite simply, a *clearer* line between marketing and advice.

As such, the appropriate way to address this issue is by clarifying the definition of a "recommendation" in the rule. The Department has indicated on numerous occasions that the intent of the proposed rule is to capture only "recommendations" that would also be considered "recommendations" under FINRA's suitability rules and guidance.[1] If the definition of a "recommendation" in the Department's rule were explicitly aligned with the existing FINRA definition of a "recommendation," then the line between marketing and advice would no longer be unclear. Accordingly, I believe that the Department should clarify in the final rule that the rule only captures recommendations that would be considered as such under FINRA's suitability rules and guidance.

Replace Permissible "Assets" List With Principles-Based Approach; Alternatively, Include Listed Options as a Permissible Asset

As proposed, the Best Interest Contract (BIC) exemption is limited to compensation generated by investments in a defined list of assets.[2] According to the preamble to the proposed rule, the Department's intent was to limit the exemption to assets "that are commonly purchased by plans, participant and beneficiary accounts, and IRAs."[3] As a result, the list of permissible assets in the BIC exemption largely reflects the assets that are most commonly held in IRAs today.[4]

However, the Department's own argument for why this proposal is necessary is that the 1975 rule's overly narrow definition of "fiduciary" has allowed a large number of advisers to inappropriately steer individual IRA owners into investments that are not in their best interest.[5] That premise suggests that the Department's starting point should *not* be the list of assets that are most commonly held in IRAs today, as this list likely reflects investments into which IRA

[1] *See e.g.*, Statement of Deputy Assistant Secretary Tim Hauser, Department of Labor, *Conflict of Interest Public Hearing*, Panel 3 (August 10, 2015), available at: https://www.youtube.com/watch?v=b554mCkuOzU&list=PL6F71CF53337F836B&index=15.

[2] *See Proposed Best Interest Contract Exemption*, 80 FR 21960, 21987 (April 20, 2015). Specifically, the list of permissible assets under the BIC exemption include: bank deposits, CDs, exchange-traded stocks, Treasuries, government agency debt, registered corporate bonds, open-end mutual funds, ETFs, bank collective funds, insurance company separate accounts, exchange-traded REITs, insurance and annuity contracts, and guaranteed investment contracts. *Id.* Further, the proposed rule explicitly excludes options and futures. *Id.*

[3] *Id.* at 21967.

[4] *See* ICI, *Appendix: Additional Data on IRA Ownership in 2014*, Figure A10 (January 26, 2015), available at: https://www.ici.org/pdf/per21-01a.pdf.

[5] *See Definition of the Term "Fiduciary"; Conflict of Interest Rule — Retirement Investment Advice*, 80 FR 21928, 21928–21929 (April 20, 2015) (explaining that one of the reasons the Department "believes it is appropriate to revisit its 1975 regulatory definition" of a fiduciary is that "[n]on-fiduciaries may give imprudent and disloyal advice; steer plans and IRA owners to investments based on their own, rather than their customers' financial interests.").

owners *have been inappropriately steered.* This is, in fact, one of the very problems that the Department is trying to solve.

Rather than codifying a list of permissible assets, I believe that the Department should adopt a principles-based approach that would make the BIC exemption available to investments that meet certain criteria, such as liquid and transparent pricing, and a sufficient track-record as a useful investment for retirement savers.[6]

Alternatively, if the Department chooses to retain the list of permissible assets in the final exemption, I would urge the Department to include listed options as a permissible asset. Listed options are more liquid, and have more transparent and readily available pricing, than many of the investments currently on the list of permissible assets, such as corporate bonds. Moreover, listed options can be a basic risk-management tool for equity investors. As roughly 40% of IRAs are invested in individual equities[7] — a percentage that would be unlikely to materially change if the Department retains the list of permissible assets — I believe that the BIC exemption should include investments in listed options.

Specify that Health and Welfare Benefit Plans With No Investment Component Are Not Covered by the Rule

As you know, there remains some uncertainty about whether the proposed rule applies to advice regarding the selection of health and welfare benefit plans with no investment component to plan participants or fiduciaries. It is my understanding that this type of advice is not currently treated as "investment advice" under ERISA, as ERISA covers *investment* advice, and such health and welfare benefit plans have no investment component. Moreover, I don't believe it was the Department's intent to treat these types of discussions as investment advice that is subject to a fiduciary duty. Therefore, I urge the Department to clarify in the final rule that advice regarding the selection of health and welfare benefit plans with no investment component to plan participants or fiduciaries will not be considered investment advice under the rule.

Clarify Application to Model Portfolios Provided Through Intermediaries

The 1975 rule required, among other things, that advice be provided pursuant to a "mutual agreement" between the adviser and the retirement investor that the advice would serve as the primary basis for the investment decision. The Department's proposed rule sensibly removes this "mutual agreement" standard, and replaces it with a requirement that the advice be provided "pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA."

The preamble further states that "[t]he parties need not have a meeting of the minds on the extent to which the advice recipient will actually rely on the advice, but they must agree or understand

[6] *See e.g.*, Comment letter submitted by the Consumer Federation of America, at 57–59 (July 21, 2015), available at: http://www.dol.gov/ebsa/pdf/1210-AB32-2-00660.pdf.
[7] *See* ICI, *Appendix: Additional Data on IRA Ownership in 2014*, Figure A10.

that the advice is individualized or specifically directed to the particular advice recipient for consideration in making investment decisions." This new standard thus provides that fiduciary status can attach when the parties "understand" that the adviser's advice is "individualized or specifically directed to" the retirement investor.

The uncertainty surrounding the circumstances under which the parties "understand" that advice is "individualized or specifically directed to" the retirement investor has led some to question whether product manufacturers that provide model portfolios to third-party intermediaries would be considered fiduciaries under the proposed rule, even where the product manufacturer has no direct contact with the retirement investor whatsoever. While the intermediary's use of such model portfolios and associated investment tools to generate outputs that are individualized to the retirement investor could certainly render the *intermediary* a fiduciary under the rule, fiduciary status should not attach vicariously to the product manufacturer, where the product manufacturer has no direct contact with the retirement investor.

It is my understanding that the Department did not intend to subject product manufacturers that simply provide model portfolios and investment tools to third-party intermediaries to fiduciary status. Therefore, out of an abundance of caution, I urge the Department to clarify that fiduciary status will not attach vicariously to a product manufacturer that provides model portfolios and investment tools to third-party intermediaries, where the product manufacturer has no direct contact with the retirement investor.

Clarify Intent of "Without Regard To" Language in BIC Exemption

The proposed BIC exemption requires advisers, as a condition of the exemption, to agree to provide investment advice in the "best interest" of the retirement investor, with "best interest" defined as advice that is provided:

> "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, *without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party*."[8] (emphasis added)

As the Department notes in the preamble, this standard "is defined to effectively mirror the ERISA section 404 duties of prudence and loyalty" — and, indeed, the first half of this proposed standard copies ERISA's language nearly word-for-word.

The second half of this proposed standard, which begins with the phrase "without regard to the financial or other interests of the Adviser" (italicized above), was taken from section 913 of Dodd-Frank, which authorizes the SEC to promulgate rules subjecting broker-dealers and investment advisers to a uniform fiduciary duty.[9] Including this "without regard to" phrase thus ensures that the Department's rule will be compatible with any future SEC rule — something that many in the industry have stressed as being crucial to the workability of the Department's

[8] *Proposed Best Interest Contract Exemption*, 80 FR at 21984.
[9] 15 U.S.C. § 80b-11(g)(1).

rule.

The two concepts embodied in the proposed standard — the duty of prudence, and the duty to act "without regard to the financial or other interests of the Adviser" — are not incompatible, despite the fact that an action that is in the retirement investor's best interest might also benefit the adviser. In fact, ERISA has long reconciled a similar conflict, as ERISA also subjects fiduciaries to both a duty of prudence and a requirement to act "solely in the interest of" plan participants and beneficiaries.[10] ERISA reconciles these two concepts by recognizing that a fiduciary does not necessarily breach her duty by taking an action that incidentally benefits the fiduciary herself, as long as the fiduciary conducted a careful and impartial investigation, and reasonably concluded that the action was in the beneficiaries' best interest.[11]

It is my understanding, based on conversations with Department staff, that the Department does not intend the "without regard to" phrase in the proposed fiduciary standard to prohibit any conduct which would not already be prohibited by ERISA's current duties of prudence and loyalty — including conduct which is allowed under ERISA's "incidental benefit" doctrine.

Therefore, because the "without regard to" phrase provides the benefit of ensuring compatibility with any future SEC rule, and is not intended to alter the scope of ERISA's existing duties of prudence and loyalty, I urge the Department to retain this language but clarify its intent in the final rule.

I look forward to our continued conversations on this critically important rule, and thank the Department for its hard work on behalf of millions of retirement savers across the country.

Sincerely,

Carolyn B. Maloney

Carolyn B. Maloney
Ranking Member
Subcommittee on Capital Markets and
Government Sponsored Enterprises

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[10] *See* 29 U.S.C. § 1104(a)(1).

[11] *See e.g., Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982) ("Although officers of a corporation who are trustees of its pension plan do not violate their duties as trustees by taking action which, after careful and impartial investigation, they reasonably conclude best to promote the interests of participants and beneficiaries simply because it incidentally benefits the corporation or, indeed, themselves, their decisions must be made with an eye single to the interests of the participants and beneficiaries."); *Morse v. Stanley*, 732 F.2d 1139, 1146 (2d Cir. 1984) ("It is no violation of a trustee's fiduciary duties to take a course of action which reasonably best promotes the interest of plan participants simply because it incidentally also benefits the corporation."); *Tibble v. Edison International*, 639 F. Supp. 2d 1074, 1106 (C.D. Cal. 2009) ("Despite the rule's apparent absolute nature, however, courts have recognized that a fiduciary does not necessarily violate the rule by pursuing a course of action that 'incidentally benefits' the plan sponsor.").