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SUBMITTED ELECTRONICALLY

September 24, 2015

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

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
Attention: D-11712 and D-11713
200 Constitution Avenue, NW
Suite 400
Washington, D.C. 20210

Re: *Definition of the Term Fiduciary: Conflict of Interest Rule (RIN 1210-AB32); Proposed Best Interest Contract Exemption and Principal Transactions in Debt Securities Exemption (ZRIN: 1210-ZA25)*

Ladies and Gentlemen:

Fidelity Investments ("Fidelity") appreciates the opportunity to provide supplemental comments on the proposed rule to broaden the definition of "fiduciary" under ERISA and the Internal Revenue Code[1] and the accompanying proposed prohibited transaction exemptions (collectively, the "Proposed Regulation"). This letter provides comments in response to several questions raised by the Department of Labor ("Department") during its August 10-13 Public Hearings ("Public Hearings"). Part I of the letter responds to questions about the "new best interest paradigm" that Fidelity proposes in our July 21, 2015 comment letter and explains why this new paradigm would achieve the Department's stated objectives at a far lower cost and with significantly less disruption to the industry

[1] *Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice; Proposed Rule*, 80 Fed. Reg. 21928 (April 20, 2015).

and retirement investors.[2] Additionally, Attachment A dispels several misconceptions about our new best interest paradigm that have been articulated in recent weeks, and Attachment B sets forth the text we propose to implement our new best interest paradigm for both the regulation and the BIC Exemption. Part II of the letter responds to questions about the cost of complying with the Department's proposal and provides estimated costs for Fidelity to comply with certain aspects of the Department's Proposed Best Interest Contract Exemption ("BIC Exemption").[3]

As we stated both in Fidelity's July 21, 2015 Comment Letter and in our testimony at the Public Hearings,[4] we support a best interest standard for investment advice to retirement investors. Fidelity acts in the best interest of customers, and we believe that all financial services providers should be required to do the same when providing investment advice. Our proposed paradigm is not intended to undercut the Department's best interest commitment. Instead, it is designed to create a workable means to implement that commitment – one that would not result in the loss of critical guidance for retirement investors.

I. Fidelity's Proposal Establishes a Workable Best Interest Standard.

A. Advisors Must Be Allowed To Promote Their Own Services.

As we explained in our July 21, 2015 Comment Letter, one of the central flaws in the Department's proposal is that it would make it impossible for investment advisors to promote their own services or to negotiate the scope and conditions of their own engagement. The Proposed Regulation defines "investment advice" to include any "recommendation of a person who is also going to receive a fee or other compensation for providing" investment advice, which would include the recommendation of one's own services. The rule thus places all advisors – whether fee-based or commission-based – in a quandary: How can an advisor promote its own services in a manner that is in the customer's "best interest"? Would acting in the customer's best interest require the advisor to charge the lowest possible fee to all customers? Would the advisor be required to refer investors to its competitors if they offered lower fees or provided superior service? It is simply not commercially viable for an advisor to act in an investor's best interest when promoting its services or negotiating its compensation and the terms of its engagement.

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[2] *See* Letter from Ralph Derbyshire, Senior Vice President & Deputy General Counsel, FMR LLC Legal Department, to Office of Regulations and Interpretations, Employee Benefits Security Administration, (July 21, 2015) *available at*: http://www.dol.gov/ebsa/pdf/1210-AB32-2-00658.pdf ("July 21, 2015 Comment Letter").

[3] *Proposed Best Interest Contract Exemption*, 80 Fed. Reg. 21960 (April 20, 2015) available at: *http://webapps.dol.gov/FederalRegister/PdfDisplay.aspx?DocId=28202*.

[4] Fidelity's testimony is available at: Conflicts of Interest Proposed Rule, Related Exemptions and Regulatory impact Analysis Hearing, August 11, 2015, Panel 11 *available at*: https://www.youtube.com/watch?v=L-FhZXbRWzY&index=23&list=PL6F71CF53337F836B and *available at*: http://www.dol.gov/ebsa/pdf/1210-AB32-2-HearingTranscript2.pdf at 540:13.

Our new best interest paradigm resolves this problem by doing what is normally done in other fiduciary contexts: clearly distinguishing selling activity from advice. Our proposal contemplates that an advisor would not be a fiduciary when merely marketing and promoting its services or negotiating the terms of its engagement (including negotiations over both the amount of its compensation and the scope of the investment advice to be provided). We are not simply advocating for a broader "seller's carve-out" under the rule. Instead, under our new paradigm, once the terms of the engagement are established, all investment advice within that framework would be subject to fiduciary standards and would have to be made in the investor's best interest and without regard to the advisor's compensation. Thus, our new paradigm makes it possible for investment advisors to promote their own services, while still requiring them to act as a fiduciary once they have been engaged and are providing investment advice.[5]

There is nothing novel about this dichotomy between selling and advising in the context of a fiduciary relationship. To take a familiar example, attorneys have a fiduciary obligation to provide legal advice that is in the best interest of their clients. As with investment advice, there may be some relationship between the advice offered and the attorney's compensation. For example, when charging an hourly rate it might be in an attorney's interest to prolong litigation, while the client's interests might be better served by settling the lawsuit early. The attorney has a fiduciary obligation to put his or her self-interest aside and advise the course of action that is in the best interest of the client, which, in this example, might be settlement. The lawyer is not, however, required to set aside his or her own interests when negotiating the hourly rate that the client will pay or other terms and conditions of the attorney's engagement. The same reasoning holds for doctors, trustees, and other types of fiduciaries, and there is no reason why it cannot or should not hold for investment advisors.

B. Advisors Must Be Allowed To Implement the Best Interest Commitment through a Unilateral Contract.

During the Public Hearings, Mr. Hauser requested more specifics about Fidelity's proposed framework for simplifying the mechanics of the best interest contract, as well as Fidelity's views on several other commenters' proposed alternatives for creating a legally-binding best interest commitment.[6] We provide further responses to those questions below.

1. The Best Interest Contract Is Unnecessary for ERISA Plans.

One of the most important simplifications our paradigm offers is that it avoids the redundant and unnecessary contract requirement for ERISA-governed plans. ERISA's fiduciary duty rules

[5] We understand that the Department is concerned that investment advisors may have undisclosed conflicts of interest when negotiating the scope of their engagement. But our proposal addresses this concern by requiring advisors to disclose all material conflicts of interest before they are engaged.

[6] *See* Conflict of Interest Proposed Rule, Related Exemptions and Regulatory Impact Analysis Hearing Transcript ("Hearing Tr.") at 581:22-589:12 (Aug. 11, 2015).

already require firms providing investment advice to plans and participants to act in their clients' best interest. Plans and participants also already have the right to sue for breach of these fiduciary duties – they don't need a contract to do that. The best interest contract would therefore provide no additional benefit to ERISA-governed plans or their participants. And where the contract requirement offers no benefit, the costs and burdens required to implement it, for both firms and investors, cannot be justified.

During the Public Hearings, Mr. Hauser asked whether Fidelity would be amenable to a BIC Exemption that allowed firms to enter into contracts at the plan level, rather than having each and every plan participant sign a separate agreement. Although we acknowledged that this would be a substantial improvement over the current proposal, it is still unwarranted. In order to comply with this alternative proposal, Fidelity would have to expend a significant amount of time and effort creating, distributing, potentially negotiating, and securing execution of new contracts for each of the more than 23,000 plans that we service. In order to meet their own obligations as fiduciaries, each plan sponsor also would need to carefully review and potentially negotiate the contract, adding additional and unnecessary time and expense to be borne by the plan. Because the proposed best interest contract does not provide any additional benefit for plans or their participants beyond the benefits already conferred by ERISA, these costs would not be warranted.

2. A Unilateral, Legally-Binding Commitment for IRA Holders Would Be Far Less Burdensome and Equally Protective of Investors.

a. The Proposed BIC Exemption's Signature Requirement Would Be Extremely Burdensome and Ultimately Would Deprive Many Investors of Access to Advice.

For IRA investors who are not covered by ERISA's fiduciary duty rules, Fidelity has no objection to imposing a legally-binding best interest commitment. But, by requiring signatures from multiple parties in order to effectuate this commitment, the contract requirement proposed by the Department would be extremely onerous, if not impossible, for firms to implement. Under this regime, the BIC Exemption would be largely unattainable, and many investors would therefore lose access to investment advice.[7]

[7] As proposed, the best interest contract would have to be executed not only by the firm and the retirement investor, but also by each and every individual representative who provides that investor with advice. For firms like Fidelity – that interact with investors primarily through call centers – this requirement would render the BIC Exemption impossible to meet, because each time an investor calls a different representative is likely to answer. During the hearing, the Department appeared to appreciate the problems inherent in requiring individual representatives to execute the best interest contract. Accordingly, we assume for purposes of this supplemental letter that this requirement will be removed from the final BIC Exemption. We note briefly, however, that such a requirement would be both unnecessary and unprecedented: customers can hold firms accountable for any losses stemming from a violation of the BIC Exemption; and, so long as firms can be held accountable to customers for their representatives' conduct (not to mention accountable to state regulators, FINRA, and other SROs for any failure to adequately supervise their representatives), they have every incentive to ensure that their

In theory, in order to comply with the BIC Exemption, Fidelity would only be required to obtain signed contracts from those customers who seek our investment guidance. But, in practice, we would need to attempt to execute contracts up front with all of our more than eight million IRA customers, because (1) many of our customers do, in fact, seek guidance at some point in time, and we would need to be able to provide that guidance promptly upon request without first having to go through the contracting process, and (2) maintaining contracts with only a subset of our customers would require us to build, maintain and operate an extraordinarily complex tracking system, which would only increase the already substantial costs required to comply with the BIC Exemption.

Our primary concern is not just that it would be expensive to print and mail out contracts to our eight million IRA customers. Our primary concern is that it would be impossible in practice to ensure that we received those millions of contracts back with all required signatures. Investors are accustomed to receiving documents from Fidelity in the mail, but they generally are not accustomed to having to *affirmatively respond* to those documents. When we do ask customers to respond to written communication, surprisingly few of them comply. Here are a couple of examples:

- Fidelity regularly sends out letters to customers requesting certain critical information if it is missing from their accounts, but many customers never respond to these requests. For example, in June 2014 Fidelity sent 714,480 letters to IRA holders notifying them that they had failed to provide beneficiary information when opening their account; within the next six months, only 112,275 (or 16%) responded by designating a beneficiary.

- When customers make a request from Fidelity (such as a request to trade, or a request for distribution) but they fail to provide all the information necessary for Fidelity to comply with that request, the request is deemed "not in good order" (or "NIGO"), and Fidelity sends the customer a follow up letter asking for the missing information. A 2014 study demonstrated that more than one-third of customers do not respond to the NIGO letter, even though they initiated the request in the first place.

Additionally, attempting to collect hard copy signatures from investors would be extremely expensive. In its Paperwork Reduction Act Statement to the BIC Exemption, the Department assumes the best interest contract provisions "will be inserted into existing contracts with no additional cost for production, distribution" or signature collection.[8] But that assumption is simply not correct for our more than eight million existing IRA customers, who already have account agreements in place. For these existing customers, the cost to produce, distribute and attempt to collect these agreements is likely to be enormous. In our NIGO study (discussed above), we estimated that, on average, it cost

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representatives comply with the terms of their agreements, and to discipline or terminate them if they fail to do so. This system works perfectly well in all other commercial contexts, and there is no reason why it wouldn't work equally well here.

[8] 80 Fed. Reg. at 21980.

Fidelity $11.63 to collect missing information from an account holder.[9] Using this NIGO data – and assuming that the more than 3.4 million IRA holders who choose to receive hard copy statements would also elect to receive the best interest contract in hard copy – we estimate that the cost to Fidelity just to attempt to secure executed, hard-copy best interest contracts from our existing IRA customers would be at least $40 million.[10] Moreover, even with this enormous expense, we expect that we would only receive back a fraction of the signatures required by the BIC Exemption.

b. Fidelity's Proposal for a Legally-Binding, Unilateral Best Interest Commitment Would Be Far Less Burdensome but Equally Protective.

In order to avoid these logistical obstacles, Fidelity has proposed that the Department permit firms to make a unilateral, legally-binding best interest commitment to IRA customers. As we explained in Fidelity's July 21, 2015 Comment Letter, these unilateral contracts would have the same force and effect as a fully-executed written agreement and would serve just as well to achieve the Department's objectives. But, because the mechanics are simpler, allowing firms to unilaterally commit to the best interest standard would make it far less costly for them to comply with the BIC Exemption, and far easier for them to bind themselves to the best interest standard for all of their retirement investors.

The unilateral contract would include all of the representations set forth in the proposed BIC Exemption. It would make clear that its representations are contractual in nature, and that the investor accepts the terms of the contract by proceeding to transact business with the firm. Firms could post the unilateral contract on their website, but they would also have an obligation to convey this legally-binding commitment directly to each accountholder. Firms would be permitted to choose any reasonable method for communicating the best interest commitment, including by using each accountholder's preferred channel of communication (be it phone, mail or electronic delivery).[11] If a firm wishes to collect signatures back from IRA holders it may do so, but no investor signatures would be required. By giving firms the flexibility to bind themselves to the best interest standard in whatever

[9] This cost estimate includes (1) the costs to print, mail, and distribute the letters, (2) the costs to field related phone calls from the customers who receive those letters, and (3) the costs to enter the missing information into the necessary systems upon receipt. If anything, the costs would be higher for the best interest contract because (1) it would be a longer document, (2) it would likely result in more phone calls with questions from recipient customers, and (3) in the absence of a customer-initiated request, it likely would require more follow up from Fidelity to secure a signed response.

[10] If the Department makes no changes to the BIC Exemption, then this $40 million estimate would be only the tip of the iceberg: Indeed, we expect this estimate for securing hard copy signatures would more than *triple* to over $120 million if Fidelity were also required to obtain signed contracts from the 18 million-plus participants in the defined contribution plans that we service.

[11] For example, firms could disseminate it (1) orally to investors seeking advice on the telephone; (2) in connection with the account statements that existing customers regularly receive (either electronically or in hard copy, depending on the customer's preference); (3) as part of the account opening documents for new customers, or in amended account documents for existing customers; (4) by implementing a pop up box or click-through for investors who log on to their accounts electronically; or (5) using a combination of different delivery methods for different types of customers.

manner makes the most sense for their own business model, and by eliminating the unnecessary requirement that firms collect back signed documents from every retirement investor, Fidelity's proposed unilateral contract would greatly reduce the cost to firms of complying with the BIC Exemption, and greatly increase the number of best interest commitments actually made.

c. The "Negative Consent" Agreement Raised by the Department During the Public Hearings Would Also Be a Viable Alternative.

During the Public Hearings, Mr. Hauser asked us about several different alternatives for implementing the best interest contract that have been proposed by other commenters.[12] Although Mr. Hauser did not provide precise detail about each of the alternatives raised, upon reflection we believe that one of his proposals – the "negative consent agreement" – could be feasible for Fidelity. Indeed, as we understood it, Mr. Hauser's proposed "negative consent agreement" is, in this context, effectively the same thing as our proposed unilateral contract. In both cases, the firm would make a commitment to its investors, and the investors would accept that commitment by continuing to transact business with the firm.[13] Thus, like our proposed unilateral contract, a negative consent agreement would be feasible so long as firms are permitted to choose the most efficient method of delivery.

Mr. Hauser also asked us about another proposal made by some commenters that would still require a written signature, but would shift the timing and permit investors to sign the best interest contract *after* receiving investment advice or guidance, perhaps at the time of account opening for new customers or at the time a trade is placed.[14] Unlike the "negative consent agreement," this proposal is not feasible and would not accomplish the Department's objectives. This proposal could harm investors because, once a Fidelity call center representative provides an investor with advice, that investor may wish to trade immediately. If there is not yet a best interest contract in place, then the investor's trade would have to wait until Fidelity mails a contract and the investor signs the contract and returns it to Fidelity. The resulting delay in trading activity could be harmful to the investor because, for example, it might result in adverse market movement or negative tax consequences.[15] At

[12] *See* Hearing Tr. at 575:8-581:21 (Aug. 11, 2015).

[13] See, e.g., *Ryan, Beck & Co. v. Fakih*, 268 F. Supp.2d 210, 219 (E.D.N.Y. 2003) (plaintiffs' "negative consent" after their receipt of a notice of the transfer of their accounts caused the new client agreements to become the controlling contracts for their accounts); *UBS PaineWebber, Inc. v. Brown,* 880 So.2d 411, 415 (Ala. 2003) (Plaintiff's continuation of his relationship with broker after the transactions at issue "precludes his denial of acceptance of the terms" of the contract communicated to him in "negative consent letters").

[14] *See* Hearing Tr. 576:18-577:8 (Aug. 11, 2015). We understand that, under this proposal, the contract would be made "retroactive" to cover the earlier advice.

[15] Some commenters have suggested that this problem could be solved by allowing execution of the contract to be delayed until *after the investor places his trade*. But this ignores the reality that customers often fail to comply with requests to sign or return documents; and if a customer does not sign the best interest contract, then his earlier trade would be a prohibited transaction. Because firms will not risk – and should not be asked to risk – engaging in a prohibited transaction, this proposal clearly does not work.

the same time, the proposal is not feasible because investors may also choose to wait days, weeks or even months before following an investment recommendation, and firms have no way to know whether or not particular trades placed by an investor are the result of prior investment advice. The only way to avoid unintentionally engaging in a prohibited transaction in this scenario would be for firms to completely freeze an investor's account whenever advice has been provided, and to prohibit *all* trading (whether or not based on advice) until a best interest contract is signed.[16] This result not only would be harmful to investors, it also could be impermissible under the securities law, which generally would prohibit broker-dealers from refusing to process a sell order.

* * *

In summary, Fidelity recommends that the Department adopt a rule that (1) allows advisors to establish the terms and conditions of their engagement outside of the fiduciary context (2) eliminates the contract requirement for ERISA-governed plans and (3) permits firms/advisors to unilaterally establish a legally-binding, best interest commitment to IRA investors. A rule that incorporates such changes would still fully satisfy the Department's objective of binding firms to the best interest standard for investment advice, but it would do so in a way that is far less burdensome than the current proposal.

II. Advisors Should Not Be Required To Bear the Enormous Costs of the BIC Exemption's Transaction and Annual Disclosure Requirements.

Whether or not the Department adopts the general framework of Fidelity's new best interest paradigm, it must eliminate the unduly onerous requirements for complying with the BIC Exemption.

During the Public Hearings the Department asked panelists to provide additional support for their position that the Proposed Regulation and exemptions would be extremely costly to implement.[17] Mr. Hauser requested that commenters break down these expenses, in order to allow the Department to separately weigh costs and benefits for each of the discrete requirements in the Proposed Regulation.[18] In this submission, we provide information that we hope will assist the Department with this endeavor.

Because it was not feasible in the time allotted to prepare a detailed cost assessment for every component of the Proposed Regulation, we have elected to focus on the disclosure requirements in the BIC Exemption.[19] As explained in Fidelity's July 21, 2015 Comment Letter, we do not believe that

[16] Moreover, as we explained during the Public Hearings, for firms like Fidelity that may recommend their own funds, even such a drastic measure would not be sufficient to avoid all risk of engaging in a prohibited transaction, because the retirement investor could simply make the trade in another retirement account, through another broker dealer.

[17] *See*, *e.g.*, Hearing Tr. 83:6-21 (Aug. 10, 2015).

[18] *See*, *e.g.*, Hearing Tr. 81:19-25 (Aug. 10, 2015); Hearing Tr. 520:14-521:9 (Aug. 11, 2015).

[19] Nonetheless, our experience tells us that the Department has vastly underestimated compliance costs across the board, and we hope the Department will extend the concepts and principles set forth in this focused cost analysis as it continues to assess other aspects of the proposed rule.

either the transaction disclosure or the annual disclosure would provide any meaningful benefit to investors, and, thus, we have not included them as part of our new best interest paradigm.[20] In this submission, we add a focused assessment of the costs that would be required to implement the annual disclosure, and a higher level discussion of implementation costs associated with the transaction disclosure. For each proposed disclosure, we then discuss why these costs far outweigh any potential benefit to investors.

A. The Costs of the Annual Disclosure Requirement Substantially Outweigh Any Benefit.

1. The Department Has Vastly Underestimated the Costs of Complying with the Annual Disclosure Requirement.

The BIC Exemption would require firms to provide an annual disclosure to all retirement investors, within 45 days of year-end, that includes (1) a list of every Asset that the Retirement Investor purchased or sold that year, as well as the price paid or received, (2) the total dollar amount of all fees and expenses incurred by the Retirement Investor for each Asset purchased, sold or held during that year, and (3) the total dollar amount of all compensation received by the financial institution and its affiliates, directly or indirectly, from any party, as a result of each asset purchased, sold or held by the retirement investor during that year.

The Department has vastly underestimated the costs of complying with this annual disclosure requirement. In its Paperwork Reduction Act Statement for the BIC Exemption, the Department estimated that, industry-wide, the cost to implement all aspects of the proposed BIC Exemption – including the contract itself, the three disclosure requirements and the data retention requirements – will be $77.4 million during the first year and $29.2 million in subsequent years.[21] The Department attributes all but a tiny fraction of these estimated costs to printing and mailing expenses and presumes that all other implementation costs will be *de minimus*. For example, the Department estimates that the "IT Costs" required for each firm to implement the entire BIC Exemption in year one – again including the contract itself, the three disclosure requirements and the data retention requirements – will be less

[20] Instead, we proposed an alternative disclosure regime that would be far more useful for retirement investors. Our proposed two-tiered approach includes (1) a website that would enable the investor to obtain the estimated cost and compensation associated with all products and services offered by the advisor, and (2) a "static" disclosure provided before recommendations are made that would explain the scope of the advisor's services, describe any material conflicts of interest, and include a link to the website disclosure. *See* Fidelity's July 21 Comment Letter at 6-7.

[21] 80 Fed. Reg. at 21983; DOL, Fiduciary Inv. Advice: Regulatory Impact Analysis, P. 177 (Apr. 14, 2015).

than $8,000.[22] The Department also assumes that there will be zero "IT Costs" relating to the BIC Exemption in subsequent years.[23]

The Department's cost estimate grossly understates what would be required to implement the BIC Exemption in general, and the annual disclosure in particular. **As explained below, we estimate that implementing just the annual disclosure would cost Fidelity alone more than $46 million for the first year, and more than $18 million annually thereafter.** The charts below summarize the breakdown of these expenses:

Start Up and Year One Expenses	
Expense	**Minimum Cost**
Cost to develop functionality for aggregation and processing of data concerning asset purchase price and hard dollar fees	$6 million
Cost to develop functionality for aggregation and processing of data necessary to allocate fund expenses to individual investors/investments	$9.5 million
Cost to develop functionality for aggregation and processing of data necessary to allocate compensation to individual investors/investments	$10 million
Other startup costs[24]	$2 million
Annual expenses for year one (see below)	$18 million
Total Start Up and Year One Expenses	**$46 million**

[22] 80 Fed. Reg. at 21981-82 & n. 50 ("The department estimates that updating computer systems to create the required disclosures, insert the contract provisions into existing contracts, maintain the required records, and publish information on the Web site will require 100 hours of IT staff time during the first year," at a cost of less than $80/hour).

[23] 80 Fed. Reg. at 21982 n.52.

[24] There are numerous additional costs required to implement the annual disclosure that have not been discussed in detail in this letter, including, for example, the cost to develop a template for the annual disclosure, to conduct initial trainings for our representatives on how to answer questions about the annual disclosure, and for our legal and compliance departments to ensure that the disclosure (and the process for generating the disclosure) fully comply with the Department's Proposed Regulation.

Ongoing Annual Expenses	
Expense	**Minimum Cost**
Cost to print and distribute the annual disclosure	$14 million
Cost to respond to questions from customers following receipt of the annual disclosure	$3 million
Cost to maintain the systems and databases used to generate the annual disclosure	$400,000
Cost to store the annual disclosures for at least six years	$400,000
Cost to train new representatives on how to answer questions from investors about the annual disclosure	$150,000
Total Ongoing Annual Expenses	**$18 million**

These estimates are not mere guesswork. They are based on Fidelity's past experiences and the result of a detailed cost assessment process for each area of our business that would be impacted by the Proposed Regulation. Many different types of employees participated in our cost assessment process, including, among others, personnel in finance, technology, risk and compliance, product management, analytics, digital communications, distribution services, and platform support. These personnel were briefed regarding requirements of the annual disclosure that are expected to affect areas within their responsibility, and were tasked with estimating the costs they anticipate from these new requirements based on their knowledge of Fidelity's systems and practices and their experience implementing system changes in the past. Although we are confident that this process resulted in a realistic estimate of implementation costs, our experience tells us that, if Fidelity actually tried to comply with the proposed annual disclosure requirement, we would discover numerous additional costs and complications that could not be anticipated. Accordingly, we consider these cost estimates to be a floor, rather than a ceiling.

a. Fidelity's Estimated Cost To Collect and Process Information about Purchases, Sales and Hard Dollar Fees

The proposed annual disclosure would require firms to report both (1) a list of assets purchased and sold, along with the price for each purchase or sale, and (2) the "total dollar amount" of fees and expenses paid by each investor (directly or indirectly) for each investment in his or her account over the course of the prior year.[25] There are numerous different types of hard dollar fees and expenses that

[25] It is unclear whether the annual disclosure requirement is intended to apply to all investments in the retirement investor's account, or only those that were recommended by the firm. But, because Fidelity has no way to track whether or not a particular investment was the result of advice or made independently, for purposes of this cost analysis we have assumed that all investments in each retirement account would have to be included in the annual disclosure. Also for this reason, we have assumed that Fidelity will need to send annual disclosures to all of its retirement account customers.

would need to be factored into this calculus, including (but certainly not limited to): (1) commissions, (2) concessions, (3) redemption fees, (4) exchange fees, (5) regulatory fees, (6) short term trading fees, (7) stamp duties and other taxes collected on foreign stocks, (8) currency exchange fees, (9) mutual fund low balance fees, (10) fees charged on reorganizations, (11) fees charged on foreign dividends, and (12) at least 6 different types of fees charged on annuities. Although Fidelity maintains information about account holdings, purchase and sales prices, and hard dollar fees, this data is stored across multiple platforms, and not on one central recordkeeping system.[26] Accordingly, we would need to develop functionality that can retrieve this data from multiple systems and aggregate it on an investor-specific and investment-specific level. **We estimate that it would cost Fidelity at least $6 million to develop this functionality**.[27]

b. Fidelity's Estimated Cost To Collect and Process Information about Fund Expense Ratios

Fidelity's recordkeeping systems currently track only those fees that are assessed directly upon investors and not "indirect" fees incurred by individual investors, such as fund expense ratios. Building a new system that is capable of attributing fund expense ratios to individual investors would be an enormous undertaking. Converting a fund's expense ratio into a precise hard dollar amount attributable to a single investor is not a simple matter of multiplying the investor's year-end balance by the fund's year-end expense ratio. Instead, because fund fees are assessed daily, we would have to build an engine that has access to, and can factor in, *daily* values for both (1) the investor's holdings and (2) the fund's expense ratio.[28] For an individual investor who holds three funds (which is about average for our retirement investors), this would require Fidelity to collect and store over 750 separate data points. And, if you multiply that amount by the 26 million-plus retirement investors serviced by Fidelity, that's approximately 1.9 billion data points per year just to capture the necessary holdings information. We would also need to collect and store data from more than 700 different fund complexes reflecting the daily expense ratios for the more than 20,000 different fund share classes sold

[26] Additionally, the data stored on these systems sometimes cannot be linked to a particular investment, as required for the proposed annual disclosure. For example, adjustments to fees might not be linked to any particular investment or prior fee charged.

[27] All expense estimates in this letter include the costs to (1) create data feeds across the multitude of systems that house the data necessary to prepare the annual disclosure (including both Fidelity systems and third-party systems), (2) store the data necessary to prepare the annual disclosure, (3) develop new systems and software capable of allocating fees and compensation to individual investors and investments, and (4) run regression testing on all new software and systems to ensure that they function property and comply with Department requirements.

[28] These amounts will often vary from one day to the next, depending on (1) the amount and timing of the investor's contributions (which are often as frequent as every week), (2) the amount and timing of any exchanges or redemptions made by the investor (including those resulting from regular rebalancing), (3) the amount and timing of any loans taken from the account, or loan repayments made, (4) variations in the fund's expense ratio due to performance adjustments, cash basis fees, daily net asset fluctuations and accrual to payment difference true-ups.

on our platform, adding more than 5 million more data points to the equation.[29] **We estimate that it would cost Fidelity at least $9.5 million to build a system that can collect, store and process the massive amount of data necessary to attribute fund expenses to individual investors.**

c. Fidelity's Estimated Cost To Collect and Process Information about Its Compensation

In addition to requiring disclosure of fees and expenses on a per-investor, per-investment basis, the proposed annual disclosure would also require firms to provide the "total dollar amount" of any compensation that they have received as a result of each investment.[30] To the extent that such compensation stems from fees and expenses paid by the investor to Fidelity or its affiliates, this disclosure requirement may overlap with the "fees and expenses" disclosure, but the overlap is far from complete. For example, expense ratios on non-Fidelity funds and fees paid to unaffiliated subadvisors on Fidelity funds both count towards the investor's fees and expenses but not towards Fidelity's compensation. There are also additional sources of compensation that would have to be factored into this disclosure. Once again, these third-party payments are not currently allocated to individual investors or investments. Fidelity would therefore need to build a new database that can house the complete universe of compensation-related data (which is presently stored on more than a dozen separate systems), as well as data on individual investor account holdings. We would also need to engineer a new system with completely new functionality, based on complicated formulas derived from each relevant third-party agreement, that could allocate third-party payments across individual investors and investments. (To avoid overstating compensation, this system also would need to be capable of backing out third-party payments that are used to pay plan expenses or that are allocated to plan participants.) **We estimate that the cost to build such a system would be at least $10 million.**

d. Fidelity's Estimated Ongoing, Annual Costs

In addition to these and other startup costs, Fidelity would also have ongoing annual costs related to printing and distributing the annual disclosure (approximately $14 million),[31] responding to questions from customers following receipt of the annual disclosure (approximately $3 million), maintaining the systems and databases used to generate the annual disclosure (approximately $400,000), storing the annual disclosures for at least six years (approximately $400,000), and training

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[29] Because Fidelity sometimes provides expense reimbursement to its plans out of the compensation it receives, an investor's costs could be overstated unless Fidelity also pulls in data showing whether such reimbursements were credited to a participant's account and reduces the total cost of each investment by the amount of any associated reimbursement payment).

[30] Although the proposed rule could be construed to also require disclosure of any investment-related compensation paid to individual representatives, the costs of such a disclosure have not been factored into this analysis.

[31] In calculating this figure, Fidelity has followed the Department's assumption in its Paperwork Reduction Act Statement to the BIC Exemption that the annual disclosure will be mailed to 62% of defined contribution plan participants and 50% of IRA holders, and that it will be delivered electronically to all other retirement accountholders. 80 Fed. Reg. at 21982.

our representatives on how to answer questions from investors about the annual disclosure (approximately $150,000).

* * *

All told, we estimate that the annual disclosure alone would cost Fidelity at least $46 million to implement in year one, and at least $18 million annually thereafter.[32] Although we recognize that some of this expense is reflective of Fidelity's size and scale, many of these costs would be equally applicable to smaller firms. For example, every firm that sells mutual funds would have to collect and process massive amounts of data concerning daily holdings and expense ratios for all of the funds they offer in order to calculate the amount that their clients "paid" in fund-related expenses. Similarly, most firms would need to develop and build entirely new functionality capable of tracking the firm's compensation (including changes to compensation arrangements over time) and appropriately allocating that compensation across all of their investors' holdings. There is simply no way to collect all of this data, or build functionality to properly allocate it, without incurring many millions of dollars in implementation costs. We expect these costs may make the BIC Exemption too expensive to implement for many firms, which would result in a significant loss of competition in the marketplace for retirement financial services.

Additionally, we estimate that it would take at least 24 months to design, develop, build, test and populate the new databases and systems required to produce the annual disclosure. This estimate assumes not only that third parties would promptly provide us with necessary data, but also that all of our resources could be devoted to the annual disclosure project. If Fidelity were simultaneously required to build systems and functionality to comply with the other requirements in the Proposed Regulation – including the other two disclosure requirements in the BIC Exemption – then it would take at least three years to complete this project.

2. <u>The Burden of Producing the Annual Disclosure Far Outweighs Any Benefit to Investors.</u>

The immense burden that would be required to comply with the proposed annual disclosure is unwarranted, because the proposed disclosure would add little to the total mix of information about investment-related expenses and compensation that is already available to retirement investors.

For ERISA-governed plans, under the Department's existing regulations (1) plan participants already receive full disclosure of the significant fees and expenses associated with their investments – expressed as both a percentage of assets and as a hard dollar amount for each $1,000 invested, and (2) plan sponsors/administrators already receive full disclosure of compensation paid to service

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[32] On top of these costs, Fidelity will likely need to incur significant additional expense providing information to third-party advisors for accounts custodied by Fidelity, so that these third-party advisors can meet their own annual disclosure requirements. *See* Fidelity's July 21 Comment Letter at C-9.

providers in relation to plan investments, including disclosure of compensation from revenue sharing.[33] Any marginal benefit to participants from receiving the personalized fee and compensation information contemplated by the proposed annual disclosure is greatly outweighed by the extraordinary costs that firms would have to incur in order to compile and produce this information in a manner that is particularized to each investor's annual investment history. Indeed, it is difficult to fathom how the Department could now impose such costs when, just a few years ago, it determined that the new disclosure rules under ERISA §§ 404(a) and 408(b)(2) adequately informed plan sponsors and participants of their fees and expenses, and of the related compensation paid to firms like Fidelity. It was extremely expensive and time consuming for the industry to develop systems to implement those disclosure rules, and there have been no changes over the past three years that would justify the Department's proposal to make firms start the development and implementation process all over again.

The proposed annual disclosure would also offer very little new information to IRA holders. As many commenters have noted, all commissions or concessions earned on trades in an IRA account must already be disclosed on the trade confirmation or through the delivery of a fund prospectus.[34] Moreover, for the approximately 47% of IRA assets that are invested in mutual funds,[35] investors are already required to receive prospectuses that contain detailed information about the funds' expense ratios and other applicable fees. The same disclosure requirements exist for ETFs and closed-end mutual funds; and the vast majority of the remaining assets in IRA accounts are stocks and bonds, which do not typically have any related fees or expenses, other than the commissions that must already be disclosed.[36]

In short, given the mix of information about fees and compensation that is already available to retirement investors and plan sponsors, any marginal benefit that investors might gain from the proposed annual disclosure pales in comparison to the enormous costs that firms would have to bear in order to comply with this disclosure regime.

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[33] *See* 29 CFR 2550.404a-5(c), (d) (2011); 29 CFR 2550.408b-2(c) (2012). Because it is the fiduciary obligation of the plan sponsor/administrator to ensure reasonable compensation on behalf of the plan's participants, the Department has appropriately determined that such compensation-related information need be shared only with plan sponsors/ administrations, and not with individual plan participants. Indeed, in response to argument by commenters "that the burden associated with attempting [to quantify the value of revenue sharing] would be significant and vastly outweigh any potential benefit to participants and beneficiaries," the Department declined to require any quantitative assessment of revenue sharing in the participant fee disclosure rule. 75 Fed. Reg. 64910, 64913-14 (Oct. 20, 2010).

[34] *See* 17 CFR 240.10b-10; FINRA Rule 2210; SEC Form N-1A.

[35] *See* 2015 Investment Company Fact Book, Ch. 7: Retirement and Education Savings, Figure 7.17, Investment Company Institute (2015) (http://www.icifactbook.org/fb_ch7.html#asset).

[36] Approximately 88% of IRA assets are invested in one of the investment vehicles discussed above. The remaining approximately 12% of IRA assets are invested in annuities and bank and thrift deposits, which are subject to their own disclosure regimes. *See* 2015 Investment Company Fact Book, Ch. 7: Retirement and Education Savings, Figure 7.17, Investment Company Institute (2015) (http://www.icifactbook.org/fb_ch7.html#asset); SEC Form N-4; NAIC, Annuity Disclosure Model Regulation (Model 245); 12 CFR 230 (1992) (Regulation DD).

B. The Costs of the Transaction Disclosure Requirement Substantially Outweigh Any Benefits.

1. The Department Has Vastly Underestimated the Costs of Complying with the Transaction Disclosure Requirement.

The BIC Exemption would require firms to provide a transaction-based disclosure to all retirement investors, prior to the time of purchase, that consists of a chart projecting the "Total Cost," in dollars, of each recommended investment, assuming that the Asset is held for 1-, 5- and 10-year periods. Advisors would be required to make "reasonable assumptions" about the amount invested and investment performance over time in calculating these projections.

Although the tight timeframe for submitting supplemental comments did not allow Fidelity to thoroughly assess the costs associated with the proposed transaction disclosure, there is no question that this disclosure would also be far more expensive to implement than the Department anticipates. Implementing the transaction disclosure would, at a minimum, require firms to: (1) collect and compile in one database all available information about nearly every type of fee or expense that could be charged in connection with investments in every single investment vehicle offered to retirement investors; (2) regularly update the information in this database to capture fee changes; (3) develop new software, systems and code that can be used to calculate the required projections, based on the fee and expense information in the database and the various assumptions entered by the representative; (4) spend substantial legal and compliance time developing and carrying out policies and procedure designed to ensure that, in fact, the assumptions being used by representatives to produce the disclosure are reasonable; (5) store all transaction disclosures used for at least six years; and (6) hire additional representatives to service customers, because interactions with investors will take substantially longer if the transaction disclosure is imposed.

Once again, none of these costs is even mentioned by the Department in its Paperwork Reduction Act Statement to the BIC Exemption, which focuses almost exclusively on printing and mailing expenses. Moreover, even that analysis significantly understates the burden that the transaction disclosure would impose. In assessing printing and mailing costs, the Department assumes that all financial institutions, in aggregate, "will send two point-of-sale transaction disclosures each year to 1.1 million defined contribution plans [sic] participants and 20.2 million IRA holders."[37] But, in 2014, Fidelity alone provided investment guidance through our portfolio review tools to plan participants on more than 524,000 separate occasions[38] and to IRA holders on more than 200,000 separate occasions.[39] On average, we presented more than 20 investment options during each guidance

[37] 80 Fed. Reg. 21982.

[38] Although some of these guidance interactions involve asset allocation rather than model fund portfolios, the majority do, in fact, result in guidance concerning specific investment options.

[39] These figures include electronic guidance, on the assumption that investors who previously used electronic guidance tools will switch to seeking telephonic guidance if, as proposed, the final BIC Exemption excludes web-based advice.

interaction with plan participants, and more than 10 investment options during each guidance interaction with IRA holders. Assuming these 2014 numbers hold steady, Fidelity alone would have to provide more than 12 million transaction disclosures each year. Clearly, then, the Department has grossly underestimated the number of transaction disclosures that would be required – and, thus, the burden of making such disclosures, both on firms (who have to prepare and deliver them) and on investors (who will not be permitted to receive advice until they have been prepared and delivered).

There are also several non-monetary costs associated with this disclosure that make it unworkable. First, as many commenters (including FINRA) have noted, the proposed requirement that firms incorporate "reasonable assumptions about investment performance" into their cost projections conflicts with FINRA Rule 2210(d)(1)(F). So, if this proposed disclosure requirement is imposed, broker-dealers will be prohibited by FINRA from complying with the BIC Exemption.

Additionally, because the transaction disclosure must take the form of a chart – and cannot be conveyed orally – it would severely impair the ability of firms to provide guidance over the telephone. In theory, a call center representative could email a link with the chart to an investor while they are conversing. This appears to be what the Department envisions, because it assumes that 75% of these transaction disclosures will be distributed electronically. But customers do not always call from a location where they have easy access to their email. And, even when email access is possible, this requirement would still substantially increase the amount of time required for each call, at the expense of not only the firm, but also the customer's experience.

2. The Burden of Implementing the Transaction Disclosure Far Outweighs Any Benefit to Investors.

In our view, the transaction disclosure requirement offers little, if any, benefit to offset these substantial costs. For one thing, it seems entirely unrelated to the stated purpose of the Proposed Regulation, which is to mitigate conflicts of interest. The contemplated disclosure would simply project the costs that an investor might incur, over time, for whatever investment is recommended. It would say nothing about the advisor's related compensation, which is presumably the basis for the conflict of interest. Moreover, because firms would only be required to prepare cost projections for the funds they are recommending – and not for alternative peer funds – this disclosure would do nothing to advance the Department's stated goal of allowing investors to compare the costs of recommended funds to the costs of other investment alternatives.

Nonetheless, more than 100,000 of these 2014 guidance interactions were, in fact, led by Fidelity representatives, either on the phone or in person. Moreover, in addition to the use of our guidance tools, Fidelity representatives regularly have more informal discussions and respond to questions from customers about investment options. Each of these discussions would also be considered investment advice under the Proposed Regulation and, thus, would require the use of additional transaction disclosures.

In fact, by focusing on cost to the exclusion of all else, this disclosure requirement actually risks harming investors because it suggests that (at least in the eyes of the Department), cost is the only factor that really matters. Consider the following example:

> *Example:* A young college graduate who is just starting his first job calls Fidelity to get advice on how to allocate the contributions he will be making to his 401(k) plan. Our representative suggests a model portfolio for consideration that is appropriately tailored to his age, and that includes substantial investment in several domestic and foreign stock funds, and smaller investments in a stable value fund and company stock. Our representative then sends the investor the required transaction disclosures for each fund, and the investor decides to take some time to think things over. One week later, upon further review of the disclosures – which show substantially lower costs associated with the stable value fund and corporate stock fund – the investor decides to put all of his assets in those two investment options, and none of his money in the diversified stock funds. He logs into his 401(k) account and sets up his contributions accordingly, without considering long-term performance potential, or considering the risks of concentrating a large amount of assets in a single stock.

Although this example may be a hypothetical, the transaction disclosure does, in fact, create a real risk that this scenario will become routine.

Additionally, the transaction disclosure is flawed because it will not provide a reliable measure of the one thing that it actually is intended to reflect – costs and expenses over time. There are simply too many assumptions that need to be factored into the equation. For example, this disclosure would require assumptions about changes over time to: (1) the investor's salary; (2) the percentage of the investor's salary that she contributes; (3) the extent of the employer's matching and/or profit sharing contributions; (4) investment performance; and (5) fund expense ratios.[40] If an advisor makes reasonable changes to even just one or two of these assumptions, it could substantially alter the size of the cost projections included in the disclosure.

The highly variable projections required by the transaction disclosure provide a false sense of certainty for what are, at best, very rough guesses. Moreover, given that plan participants and IRA holders already receive detailed information about fees and expenses associated with their investment options through prospectuses and participant fee disclosures, this additional, and different, disclosure seems more likely to confuse investors than to help them. There is therefore no basis for the Department to subject firms – and ultimately investors – to the substantial costs of implementing this disclosure requirement.[41]

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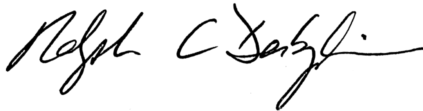
[40] Additionally, given the broad definition of "Total Fees" in the Proposed Regulation, advisors arguably would also have to make assumptions about whether the investor is likely to be charged low balance fees, redemption fees, short-term trading fees and other similar fees that may be assessed upon a mutual fund shareholder.

[41] If the Department insists on including some sort of transaction disclosure in the final regulation, it should embrace a website disclosure requirement like the one we proposed in our July 21, 2015 Comment Letter, which would give investors

* * *

As the Department moves forward with the rulemaking process, we hope it will consider these comments, and we would be pleased to respond to any further questions.

Sincerely,



Ralph C. Derbyshire

cc: **United States Securities and Exchange Commission**
The Honorable Mary Jo White, Chair
The Honorable Luis A. Aguilar, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
The Honorable Kara M. Stein, Commissioner
The Honorable Michael S. Piwowar, Commissioner

Financial Industry Regulatory Authority
Mr. Richard Ketchum, Chairman and Chief Executive Officer, FINRA
Mr. Robert Colby, Chief Legal Officer, FINRA

Treasury Department
J. Mark Iwry, Deputy Assistant Secretary for Retirement and Health Policy

National Economic Council
Jeffrey Zients, Director
Elizabeth A. Kelly, Senior Policy Advisor

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the option of inputting their own assumptions in order to project and compare costs, performance and other factors associated with various investment options that they may be considering, *see* Fidelity's July 21 Comment Letter at A-8.

Attachment A

Fidelity's New Best Interest Paradigm:
Addressing the Misconceptions

In Fidelity's July 21, 2015 Comment Letter, we explained that the Department's proposal suffers from two foundational problems that will prevent advisors like Fidelity from providing the investment assistance that our customers need: (1) an overly broad definition of investment advice and (2) prohibited transaction exemption conditions that advisors will not be able to meet in practice. We also proposed a "new best interest paradigm" that we believe solves these problems while still meeting the Department's goals of ensuring that retirement investment advice is in the best interest of the investor. While we have received positive feedback on our new best interest paradigm, some have criticized the proposal, claiming that it fails to deliver meaningful new protections for investors. These criticisms appear to misunderstand how our new best interest paradigm would work. This Attachment A addresses a number of the misconceptions about both the paradigm and the Department's proposal that have led to this unwarranted criticism.

Under our new best interest paradigm, the establishment of the terms and conditions of a fiduciary relationship would not itself be fiduciary conduct. This is consistent with well-settled and long-standing fiduciary law, and is essential for advice provided in a commercial setting. Within the defined scope of the advice relationship, however, advisors' recommendations would have to be made in their investors' best interest, and investors would have a private right of action to enforce this best interest obligation. Any advisor that is not clear with investors about the scope and nature of the advice relationship would almost certainly fail to meet this best interest obligation and would therefore be subject to liability for engaging in a prohibited transaction. For example, an advisor who sells only annuities would need to be clear with the investor about this limitation up front. If the advisor does not clearly limit the scope of its advice to annuities, then its investment recommendations would have to be compared not only to other annuities, but to *the full universe of investment vehicles* for purposes of determining whether the advisor's recommendations are in the investor's best interest.

Our new paradigm would also modify the BIC Exemption so that it is based on the Department's proposed "Standards of Impartial Conduct." Under our approach, all advisors would be required to:

- provide a clear, simple, up-front statement to investors about the products and services that will be considered in making recommendations, compensation to the adviser and any material conflicts of interest, as well as any other material terms and conditions of the advice relationship;
- make a legally enforceable commitment to act in the investor's best interest in making investment recommendations; and
- charge no more than reasonable compensation.

This approach would provide a true principles-based prohibited transaction exemption – something the Administration has publicly committed to provide.

Misconception No. 1:

The Department's proposal will result in better advice and investor protection than our new paradigm because the proposal imposes a fiduciary standard on advisors' marketing their own advice services and Fidelity's new best interest paradigm does not.

It is widely acknowledged that the Department's proposal makes an advisor a fiduciary with respect to the establishment of its own services and compensation. In so doing, the Department's proposal effectively prohibits all advisors, fee-based as well as commission-based, from marketing their own services and negotiating the terms of their engagement. In Fidelity's July 21, 2015 Comment Letter, we refer to this as the "sales dilemma." Because there is no way to navigate this dilemma in a commercial setting, advisors will be forced out of the market, drastically reducing the availability of investment advice to all retirement investors. Fidelity's new paradigm fixes this fatal flaw while still imposing a fiduciary best interest standard for all investment advice provided to retirement investors.

Some commenters have defended the Department's proposal by suggesting that subjecting marketing and engagement-related activities to a fiduciary standard is a common and workable requirement imposed on all fiduciaries, including trustees, investment advisers, doctors, and lawyers. This is not true. To the contrary, the Department itself has, in the past, declined to impose fiduciary obligations on investment advisors for engagement-related activities: A long-standing Department regulation addressing ERISA § 408(b)(2) provides that if a person who is already providing investment advice to a plan "persuades" a plan fiduciary to extend his contract at a higher fee, the advisor has not engaged in a prohibited transaction because the advisor has not used any of the authority, control or responsibility which makes it a fiduciary to cause the plan to pay an additional fee.

In fact, the Department's proposal is unprecedented in fiduciary law and not commercially viable. Consider the following example:

> *Example 1:* A registered investment adviser develops an expertise in mutual fund investments. She markets her mutual fund advice services for a flat annual fee of $500 per year, and enters into an arrangement on those terms and conditions with two customers. Customer A is 30 years old, actively employed, and is willing to risk the loss of principal in order to obtain capital appreciation. Customer B is 65 years old, retired, and primarily wants to realize income from his savings.
>
> If the RIA were required to act in her customers' best interest in recommending herself to provide advice, she would first have to consider all other RIAs and potential investment advice providers prior to recommending herself, and she would have to recommend another advisor if it would be in the investor's best interest to do so. For example, if there were another advisor that charged less for the same services or had a better performance record, the advisor would need to recommend that competitor. Such a requirement would be antithetical to commercial practice and would not be sustainable in the real world.
>
> Similarly, if the RIA were required to act in her customer's best interest establishing the scope of the investments from which she will make recommendations, the RIA would have to compare her proposed investments, mutual funds, against all other investments to ensure that it was in her customers' best interest to consider only mutual funds in making recommendations, and not those other investments. For example, among other things, the RIA would have to

compare mutual funds to individual equity securities for Customer A and against bank CDs and annuities for Customer B. Taking all possible investments in the world into consideration before making an investment recommendation, as would be required under a best interest standard, would of course be impossible.

Likewise, to act in her customer's best interest, the RIA would be required to negotiate the lowest fee possible on her customer's behalf. Negotiating against oneself for a lower fee would also be antithetical to the commercial environment (isn't it in the best interest of the customer to charge the lowest possible fee, or perhaps provide advice for free?), and the RIA could not remain in business for long if subject to such a requirement.

Our new paradigm solves this problem by drawing a distinction between the establishment of an advice framework and the advice provided within that framework, and by applying a fiduciary standard only to the latter. Under our paradigm, the advisor would not be subject to a fiduciary duty in recommending herself over her competitors or establishing the scope of her services or her own compensation. She would thus avoid all of the obvious problems that arise in the example above. Once she is hired, however, the RIA would be subject to a fiduciary duty and would be required to recommend mutual fund investments in each customer's best interest. So she would presumably be required to recommend high quality equity mutual funds to Customer A and high quality bond or capital preservation mutual funds to Customer B. Under our new paradigm, her compensation of $500 per year would also have to be reasonable in light of the advice services she actually provides. The same analysis also holds true where the advisor's compensation varies based on the transactions and services recommended by the advisor.

Misconception No. 2:

Fidelity's new paradigm fails to apply a best interest standard to the full range of services perceived and relied on as fiduciary investment advice.

This misconception has our paradigm completely backwards. The cornerstone of the paradigm is that the advisor must be clear up front with investors about the terms and conditions of the engagement of the advisor. This will ensure that investors understand the scope of advice services being provided and clearly perceive the range of services that can and should be relied upon as unbiased investment advice. To the extent the advisor creates a perception that any of the services it provides should be relied on by the investor as fiduciary investment advice, our approach subjects those services to the best interest standard.

Misconception No. 3:

Because Fidelity's new paradigm would allow advisors and investors to agree to the scope and terms of the advice relationship outside of a fiduciary context, advisors could simply use those terms and conditions to evade any fiduciary duties.

Fiduciaries have been permitted to freely negotiate the scope and terms of their services in a non-fiduciary capacity under centuries of well-established fiduciary law. Indeed, no other rule is workable in the real world. What does not always happen today, and what Fidelity's new paradigm would mandate, is that advisors be explicit about the scope and terms of their advice so that investors understand the advisor's conflicts, compensation and advice limitations.

By receiving clear disclosure at the outset of an advisory arrangement about the scope of the advisor's services, compensation and material conflicts, investors will understand what advice the advisor is providing in the investor's best interest, and what discussions or negotiations fall outside the advice relationship. According to this misconception, our paradigm creates a "loophole" because investors cannot or will not understand or appreciate such up front disclosure and thus advisors can simply "disclose away" their fiduciary responsibilities. But if investors cannot understand clear disclosures about an advisor's scope of services, compensation, and potential conflicts, what disclosures of any kind could an investor understand? The objection embodied in this misconception is, in actuality, an objection to disclosure as a compliance mechanism in any context. And that objection is belied by the obvious value the Department itself has placed on disclosure in many, many contexts, including the proposal itself and other major regulatory projects under ERISA Section 408(b)(2) and 404(a) in recent years.

Misconception No. 4:

Fidelity's new paradigm allows advisors to act on any conflicts of interest as long as they are disclosed. Similarly, Fidelity's paradigm fails to take meaningful steps to curb industry practices that encourage advice that is not in the best interest of the retirement saver.

Fidelity's new paradigm would impose a legally binding obligation on all advisors to act in the investor's best interest in making investment recommendations, regardless of the advisors' potential conflicts of interest. Moreover, it is inconceivable that an advisor could meet this legally binding obligation while incenting its individual representatives to act contrary to the investor's best interest.

What our alternative would not do is impose a multitude of specific requirements that every advisor in every context and every business model must meet (some of which are at best tangentially related to ensuring that the advisor is acting in the investor's best interest). In our view, micromanaging such requirements through regulation as the Department has proposed is counter-productive and would serve only to discourage advisors from serving retirement investors. It would do nothing to further protect retirement investors.

Misconception No. 5:

Fidelity proposes that the advisor's recommendations would be subject to a best interest standard, but its conflicted compensation would not.

Conflicts do not harm investors solely because an advisor's compensation can vary. They harm investors when and if such variation can result in recommendations made *in the advisor's own interest*. Fidelity's new paradigm would forbid an advisor to act in its own interest and would thus prohibit acting on such conflicts.

This misconception confuses the process of establishing an advisor's compensation with allowing that compensation to influence the advisor's investment advice. As explained above, our new paradigm would not impose a fiduciary duty on the establishment of the advisor's compensation – that is, our paradigm would not require an advisor to negotiate with itself for a lower fee. But once the investor agreed to an advisor's compensation arrangement, our paradigm would prohibit the advisor from taking its compensation into account when providing the investor with advice.

> *Example 2:* Attorneys have a fiduciary obligation to provide legal advice that is in the best interest of their clients. As with investment advice, there may be some relationship between the

advice offered and the attorney's compensation. For example, when charging an hourly rate it might be in an attorney's interest to prolong litigation, while the client's interests might be better served by settling the lawsuit early. The attorney has a fiduciary obligation to put his or her self-interest aside and advise the course of action that is in the best interest of the client, which, in this example, might include settlement. The lawyer is not, however, required to set aside his or her own interests when negotiating the hourly rate that the client will pay for those services or other terms and conditions of the attorney's engagement. The same reasoning holds for doctors, trustees, and other types of fiduciaries, and there is no reason why it cannot or should not hold for investment advisors.

Misconception No. 6:

If an advisor recommends that a participant rollover her plan balance to an IRA, the advisor has necessarily provided fiduciary investment advice with respect to the entire rollover transaction.

This misconception likely springs from ambiguity in the Department's proposed definition of "fee or other compensation, direct or indirect." The proposal defines that term to mean "any fee or compensation for the advice received by the person (or by an affiliate) from any source and any fee or compensation *incident to the transaction in which the investment advice has been rendered or will be rendered*." The italicized language is ambiguous, however, because it is unclear what "transaction" it references.

If an advisor advises a plan participant to roll over his 401k balance from his employer's plan to an IRA sponsored by the advisor, one might argue that a single "transaction" has occurred. And if this constitutes a single transaction, then so long as the advisor receives compensation with respect to some aspect of the rollover, then the compensation requirement is satisfied, and all advice concerning the rollover would have to meet the best interest requirement.

But this analysis fails to recognize that a rollover actually consists of at least three separate transactions – a distribution from the plan, a rollover to the IRA and the investment of the proceeds within the IRA (which itself may be a series of transactions). Each transaction involves a separate recommendation, each of which may independently constitute investment advice. Therefore, each recommendation must be analyzed separately to determine whether the recommendation is "in exchange for a fee or other compensation" so as to constitute a fiduciary recommendation. This interpretation is more consistent with the other provisions of the proposed regulation and the language of ERISA Section 3(21)(A)(ii).

Misconception No. 7:

***A recommendation to "stay in the plan," without more,
would constitute fiduciary investment advice under the proposal.***

Statements that do not refer to investments (or investment advisors or managers) cannot be investment advice as defined in the Department's proposal, so a recommendation to a plan participant to stay in the plan without any recommendation as to the participant's plan investments would not constitute fiduciary investment advice under the proposal.

Investment advice is defined under the proposal as

> "the following types of advice in exchange for a fee or other compensation, whether direct or indirect: (i) A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property, including a recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA, (ii) A recommendation as to the management of securities or other property, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA, (iii) [an appraisal, fairness opinion or similar statement], and (iv) A recommendation of a person who is also going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (i) through (iii), [which recommendations also meet certain other requirements]."

As formulated, "distributions" are included in the definition of investment advice as an example of advice about "acquiring, holding, disposing or exchanging securities of other property." Presumably, this is true because taking a distribution necessarily involves disposing of the interest in the plan which, in most cases, requires the sale of the investments held in the plan.

A simple recommendation to "stay in the plan" is not included in any of the types of recommendations described in this advice definition, however. Looking solely at the wording of the definition, it covers only a "recommendation … *to take* a distribution of benefits." A recommendation to stay in plan is actually a recommendation *not to take* a distribution of benefits. More importantly, though, a recommendation to stay in plan does not constitute a recommendation with respect to the "advisability of acquiring, holding, disposing or exchanging securities or other property" held in the plan. The acquisition, holding, disposition or exchange of securities in connection with a participant staying in the plan would depend solely upon the participant's separately taking or refraining to take a course of action with respect to his or her securities or other property, e.g., the participant must separately decide whether to hold, exchange, or sell his or her plan securities or other property. Since the advisor has not made a suggestion that the participant engage in or refrain from engaging in or refraining from taking a particular course of action with respect to the securities or other property, the advisor has not made a recommendation that constitutes investment advice within the meaning of the Department's proposal.

Similarly, Fidelity's new paradigm does not create a rollover recommendation loophole. It simply recognizes that conversations that do not refer to investments cannot be investment advice under the Department's proposal, even if those conversations may refer to rollovers.

Misconception No. 8:

The Department's proposal is business model neutral.

Assuming the Department solves the "sales dilemma" described above, advisors that charge a fixed fee for advice are not subject to any new requirements under the proposal, including any requirement to act in the best interest of IRA owners. Advisors with commission-based and other variable fee arrangements, however, are subject to dozens of new requirements under the proposed BIC Exemption. The Proposed Regulation therefore clearly favors one business model over another.

It is clear that the rule would not create any new requirements for fixed-fee based advisors as a practical matter. Once engaged by an investor, any investment advice recommendations by an advisor that charges a fixed fee would not give rise to a prohibited transaction. Therefore, there would be no

need for the advisor to satisfy any of the proposed BIC Exemption requirements, including the requirement to enter into a best interest contract with the investor. Without the best interest contract requirement, the advisor would not be subject to a best interest obligation under the rule with respect to any recommendations to IRA owners. And while the advisor would owe a plan sponsor or participant a best interest obligation under the rule, that obligation already exists under ERISA and thus would not be a new requirement under the proposed rule.

By imposing no new requirements on fixed-fee based advisors and dozens of burdensome new requirements on variable-fee advisors, the rule clearly incents advisors to choose a fixed-fee based model. In many cases, however, changing from a variable-fee based model to a fixed-fee based model will result in higher costs for investors. An example illustrates this point:

> *Example 3:* Suppose an advisor receives compensation from the investments she recommends that varies between 25 and 40 basis points. Such an arrangement would give rise to a prohibited transaction under ERISA and the Code because the advisor's recommendations would influence the amount of the advisor's compensation. To avoid a prohibited transaction, the advisor could simply charge a flat fee of 40 basis points on total assets and then offset any compensation received from the investments against the fee. In that case, however, the investor would almost certainly pay more for the advice than if the compensation were permitted to vary.

One way to level the playing field and remove the rule's incentive to adopt higher cost fixed fee arrangements while still benefitting investors and protecting them from conflicts would be to clarify that, for purposes of the prohibited transaction rules under ERISA and the Code, a variable fee that is subject to a reasonable, disclosed and agreed upon cap would be treated the same as a non-variable fixed fee, so long as the advisor's recommendations are required to be made in the investor's best interest.

> *Example 4:* The advisor and investor in the example above could agree in advance that the advisor would charge a fixed fee of 40 basis points and offset any compensation received from investments, but to the extent such investment compensation did not fully offset the 40 basis point fee, any shortfall would be waived. In other words, the advisor's fee would be capped at 40 basis points, but the investor would not actually pay 40 basis points, and the advisor would not necessarily receive the full 40 basis points. Although the amount of the fee waiver could vary depending on the investments made, the advisor would be required to make investment recommendations in the investor's best interest, and, no matter what, the investor would always be as well or better off than if he were simply paying the fixed 40 basis point fee.

Because a fee cap could be adopted by most commission-based and other variable fee advisors, clarifying the rule to treat fixed-fee arrangements and fee-capped arrangements equally for purposes of the prohibited transaction rules would have the effect of leveling the playing field for all business models. In this way, the rule could be made truly business model neutral.

Attachment B

New Best Interest Paradigm Language

§ 2510.3-21 Definition of "Fiduciary."

(a) Investment advice. For purposes of section 3(21)(A)(ii) of the Employee Retirement Income Security Act of 1974 (Act) and section 4975(e)(3)(B) of the Internal Revenue Code (Code), except as provided in paragraphs (b) or (c) of this section, a person renders investment advice with respect to moneys or other property of a plan or IRA described in paragraph (e)(2) or (3) of this section if –

(1) Such person provides, directly to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner the following types of advice in exchange for a fee or other compensation, direct or indirect:

(i) A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property, including a recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA;

(ii) A recommendation as to the management of securities or other property, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA;

(iii) A recommendation of a person who is also going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (a)(1)(i) or (ii) of this section.

(2) A person who is a fiduciary with respect to an employee benefit plan or IRA by reason of rendering investment advice (as defined in paragraph (a)(1) of this section) shall not be deemed to be a fiduciary with respect to:

(i) The terms and conditions of engagement of the person, including the scope of the obligation to provide advice, the products or services with respect to which advice is provided and the compensation payable to the person, provided the plan fiduciary, participant or beneficiary, or IRA owner has consented to the terms and conditions of the engagement after disclosure of all material aspects of such terms and conditions, including material conflicts of interest; or

(ii) Any assets of the plan or IRA with respect to which such person does not have any discretionary authority, discretionary control or discretionary responsibility, does not exercise any authority or control, does not render investment advice (as defined in paragraph (a)(1) of this section) for a fee or other compensation, and does not have any authority or responsibility to render such investment advice.

(3) Nothing in this paragraph shall be deemed to:

(i) Exempt such person from the provisions of section 405(a) of the Act concerning liability for fiduciary breaches by other fiduciaries with respect to any assets of the plan; or

(ii) Exclude such person from the definition of the term "party in interest" (as set forth in section 3(14)(B) of the Act or "disqualified person" as set forth in section 4975(e)(2) of the Code) with respect to a plan.

(b) Investment education. Notwithstanding paragraph (a) of this section, a person shall not be a fiduciary by reason of rendering investment advice (as defined in paragraph (a)(1) of this section) to the extent such person furnishes or makes available any of the following categories of investment related information and materials to a plan, plan fiduciary, participant or beneficiary, IRA or IRA owner, irrespective of who provides or makes available the information and materials (*e.g.,* plan sponsor, fiduciary or service provider), the frequency with which the information and materials are provided, the form in which the information and materials are provided (*e.g.,* on an individual or group basis, in writing or orally, or via call center, video or computer software), or whether an identified category of information and materials is furnished or made available alone or in combination with other categories of information and materials, provided that such person does not represent or acknowledge that he is acting as a fiduciary in furnishing or making available such information and materials. The foregoing is not affected by the fact that a plan or IRA offers only one investment alternative in a particular asset class identified in an asset allocation model.

(1) – (5) [*Same as section (b)(6)(i) – (v) of the Proposed Regulation, except omit* "or a particular participant or beneficiary or IRA owner," *from section (b)(6)(i) and replace section (b)(6)(iii)(C) and (b)(6)(iv)(E) with the following:* "To the extent that an asset allocation model identifies any specific investment alternative available under the plan or IRA, the model is accompanied by a statement indicating that other investment alternatives having similar risk and return characteristics may be available under the plan or IRA and identifying where information on those investment alternatives may be obtained; and".]

(c) Execution of securities transactions. [*Same as section (d) of the Proposed Regulation*.]

(d) Internal Revenue Code. [*Same as section (e) of the Proposed Regulation*.]

(e) Definitions. For purposes of this section—

(1) ''*Recommendation*'' means a communication that, based on its content, context, and presentation, would reasonably be relied upon as unbiased by the recipient in making investment or management decisions.

(i) A communication shall be deemed to be a recommendation if made by a person who (A) represents or acknowledges himself to be making such communication as a fiduciary within the meaning of the Act, or (B) otherwise holds himself out in making such communication, either through a title or other identifying description, as performing an advisory function.

(ii) Unless paragraph (e)(1)(i) of this section applies, a communication shall be deemed not to be a recommendation if accompanied by a statement that fairly informs the communication recipient of the existence and nature of the communicator's financial interests in the transaction and that such communication is not intended to constitute impartial investment advice to the communication recipient.

(2) ''*Plan*'' means any employee benefit plan described in section 3(3) of the Act and any plan described in section 4975(e)(1)(A) of the Code.

(3) ‘‘*IRA*’’ means any trust, account or annuity described in Code section 4975(e)(1)(B) or (C).
(4) ‘‘*Plan participant*’’ means for a plan described in section 3(3) of the Act, a person described in section 3(7) of the Act.
(5) ‘‘*IRA owner*’’ means with respect to an IRA either the person who is the owner of the IRA or the person for whose benefit the IRA was established.
(6) ‘‘*Plan fiduciary*’’ means a person described in section (3)(21) of the Act and 4975(e)(3) of the Code.
(7) ‘‘*Fee or other compensation, direct or indirect*’’ for purposes of this section and section 3(21)(A)(ii) of the Act, means any fee or compensation received by the person (or by an affiliate) from any source

(i) for a recommendation set forth in paragraph (a)(1), and
(ii) incident to the specific transaction that is the subject of a recommendation.

The term fee or other compensation includes, for example, brokerage fees, mutual fund and insurance sales commissions. For purposes of this definition, a person may specify which transactions are excluded from the scope of its advice for purposes of determining whether a fee or other compensation is payable with respect to that advice.
(8) ‘‘*Affiliate*’’ includes any person directly or indirectly, through one or more intermediaries, controlling, controlled by, or under common control with such person; any officer, director, partner, employee or relative (as defined in section 3(15) of the Act) of such person; and any corporation or partnership of which such person is an officer, director or partner.
(9) ‘‘*Control*’’ for purposes of paragraph (e)(8) of this section means the power to exercise a controlling influence over the management or policies of a person other than an individual.

Best Interest Contract Exemption:

Section I – Best Interest Contract Exemption.

(a) *In general.* ERISA and the Internal Revenue Code prohibit fiduciary advisers to employee benefit plans (Plans) and individual retirement plans (IRAs) from receiving compensation that varies based on their investment recommendations. Similarly, fiduciary advisers are prohibited from receiving compensation from third parties in connection with their advice. This exemption permits certain persons who provide investment advice, and their associated financial institutions, affiliates and other related entities, to receive such otherwise prohibited compensation as described below.

(b) *Covered transactions.* This exemption permits Advisers, Financial Institutions, and their Affiliates and Related Entities to receive compensation for services provided in connection with investment advice within the meaning of ERISA section 3(21)(A)(ii). The exemption provides relief from the restrictions of ERISA section 406(a)(1)(D) and 406(b) and the sanctions imposed by Code section 4975(a) and (b), by reason of Code section 4975(c)(1)(D), (E) and (F). The Adviser and Financial Institution must comply with the conditions of Sections II–V to rely on this exemption.

(c) *Exclusions.* This exemption does not apply with respect to any transaction where the Adviser (1) exercises any discretionary authority or discretionary control respecting management of the Plan or IRA assets involved in the transaction or exercises any authority or control respecting management or disposition of the assets, or (2) has any discretionary authority or discretionary responsibility in the administration of the Plan or IRA.

Section II – Standards of Impartial Conduct.

If the fiduciary is a fiduciary within the meaning of ERISA section 3(21)(A)(i) or (ii), or Code section 4975(e)(3)(A) or (B), with respect to the assets of a plan or IRA involved in the transaction, the fiduciary must comply with the following conditions with respect to the transaction:

(a) The fiduciary is subject to a legally binding commitment to provide advice that is in the Best Interest of the plan or IRA.

(b) All compensation received by the fiduciary and its Affiliates in connection with the transaction is reasonable in relation to the total services the fiduciary and its Affiliates provide to the plan or IRA.

(c) The fiduciary's statements about recommended investments, fees, Material Conflicts of Interest, and any other matters relevant to a plan's or IRA owner's investment decisions, are not misleading.

For purposes of Section II(a), the legally binding commitment shall not contain (1) exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a violation of the commitment's terms, or (2) a provision under which the Plan, IRA or advice recipient waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution.

Section III – Disclosure Requirements.

(a) The Financial Institution shall disclose at or before the time a recommendation is made

(1) the scope of the Financial Institution's services and its potential conflicts of interest applicable to the recommendation, including that it may receive different compensation based on the recommended investments, if applicable, and

(2) a website address where the advice recipient may obtain specific information about the cost to the Plan, participant or beneficiary, or IRA owner and compensation to the Financial Institution associated with the products and services recommended to the advice recipient. Information available on the website shall be updated no less frequently than quarterly and shall be presented in a format that will allow the advice recipient to make comparisons of such cost and compensation with respect to all other products and services available through the Adviser and Financial Institution sharing the same characteristics as the products and services recommended to the advice recipient, including without limitation by making available a schedule of fees and other compensation with respect to all products and services sharing the same characteristics as a recommended product or service. Information available on the website with respect to specific investment recommendations shall be provided to the advice recipient in paper format upon request.

(b) If applicable with respect to any recommendation, the Financial Institution shall notify the advice recipient at the time of such recommendation that such recommendation is not sufficiently broad to meet the advice recipient's needs. The foregoing shall not apply with respect to recommendations to participants in ERISA-covered participant directed individual account Plans in which the menu of investment options is selected by an Independent Plan fiduciary, provided the Adviser and Financial Institution have not provided investment advice to such Independent Plan fiduciary with respect to such menu.

Section IV —Exemption for Pre-Existing Transactions

(a) *In general.* ERISA and the Internal Revenue Code prohibit Advisers, Financial Institutions and their Affiliates and Related entities from receiving variable or third-party compensation as a result of the Adviser's and Financial Institution's advice to a Plan, participant or beneficiary, or IRA owner. Some Advisers and Financial Institutions did not consider themselves fiduciaries within the meaning of 29 CFR 2510– 3.21 before the applicability date of the amendment to 29 CFR 2510–3.21 (the Applicability Date). Other Advisers and Financial Institutions entered into transactions involving Plans, participant or beneficiary accounts, or IRAs before the Applicability Date, in accordance with the terms of a prohibited transaction exemption that has since been amended. This exemption permits Advisers, Financial Institutions, and their Affiliates and Related Entities, to receive compensation, such as 12b–1 fees, in connection with the purchase, sale or holding of a security or other property by a Plan, participant or beneficiary account, or an IRA, as a result of the Adviser's and Financial Institution's advice, that occurred prior to the Applicability Date, as described and limited below.

(b) *Covered transaction.* Subject to the applicable conditions described below, the restrictions of ERISA section 406(a)(1)(D) and 406(b) and the sanctions imposed by Code section 4975(a) and (b) by reason of Code section 4975(c)(1)(D), (E) and (F) shall not apply to the receipt of compensation by an Adviser, Financial Institution, and any Affiliate and Related Entity, for services provided in connection with the purchase, holding or sale of a security or other property, as a result of the Adviser's and Financial Institution's advice, that was purchased, sold, or held by a Plan, participant or beneficiary account, or an IRA before the Applicability Date if:

(1) The compensation is not excluded pursuant to Section I(c) of the Best Interest Contract Exemption;

(2) The compensation is received pursuant to an agreement, arrangement or understanding that was entered into prior to the Applicability Date; and

(3) The purchase or sale of the security or other property was not a non-exempt prohibited transaction pursuant to ERISA section 406 and Code section 4975 on the date it occurred.

Section V—Definitions

For purposes of these exemptions, terms shall have the meanings set forth in [the Regulation], unless otherwise defined below:

(a) ''Adviser'' means an individual who:

(1) Is a fiduciary of a Plan or IRA solely by reason of the provision of investment advice described in ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B), or both, and the applicable regulations, with respect to the securities or other property involved in the transaction;

(2) Is an employee, independent contractor, agent, or registered representative of a Financial Institution; and

(3) Satisfies the applicable federal and state regulatory and licensing requirements of insurance, banking, and securities laws with respect to the covered transaction.

(b) ''Affiliate'' of an Adviser or Financial Institution means—

(1) Any person directly or indirectly through one or more intermediaries, controlling, controlled by, or under common control with the Adviser or Financial Institution. For this purpose, ''control'' means the power to exercise a controlling influence over the management or policies of a person other than an individual;

(2) Any officer, director, employee, agent, registered representative, relative (as defined in ERISA section 3(15)), member of family (as defined in Code section 4975(e)(6)) of, or partner in, the Adviser or Financial Institution; and

(3) Any corporation or partnership of which the Adviser or Financial Institution is an officer, director or employee or in which the Adviser or Financial Institution is a partner.

(c) Investment advice is in the ''Best Interest'' of the advice recipient when the Adviser and Financial Institution providing the advice act 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 advice recipient, without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party.

(d) ''Financial Institution'' means the entity that employs the Adviser or otherwise retains such individual as an independent contractor, agent or registered representative and that is:

(1) Registered as an investment adviser under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 *et seq.*) or under the laws of the state in which the adviser maintains its principal office and place of business;

(2) A bank or similar financial institution supervised by the United States or state, or a savings association (as defined in section 3(b)(1) of the Federal Deposit Insurance Act (12 U.S.C. 1813(b)(1)), but only if the advice resulting in the compensation is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by federal or state banking authorities;

(3) An insurance company qualified to do business under the laws of a state, provided that such insurance company:

(A) Has obtained a Certificate of Authority from the insurance commissioner of its domiciliary state which has neither been revoked nor suspended,

(B) Has undergone and shall continue to undergo an examination by an Independent certified public accountant for its last completed taxable year or has undergone a financial examination (within the meaning of the law of its domiciliary state) by the state's insurance commissioner within the preceding 5 years, and

(C) Is domiciled in a state whose law requires that actuarial review of reserves be conducted annually by an Independent firm of actuaries and reported to the appropriate regulatory authority; or

(4) A broker or dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a *et seq.*).

(e) ''Independent'' means a person that:

(1) Is not the Adviser, the Financial Institution or any Affiliate relying on the exemption,

(2) Does not receive compensation or other consideration for his or her own account from the Adviser, the Financial Institution or Affiliate; and

(3) Does not have a relationship to or an interest in the Adviser, the Financial Institution or Affiliate that might affect the exercise of the person's best judgment in connection with transactions described in this exemption.

(f) A ''Material Conflict of Interest'' exists when an Adviser or Financial Institution has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering investment advice.

(g) ''Related Entity'' means any entity other than an Affiliate in which the Adviser or Financial Institution has an interest which may affect the exercise of its best judgment as a fiduciary.