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By Electronic Delivery

The Office of Regulations and Interpretations  
Employment Benefits Security Administration  
Attn: Definition of Fiduciary Proposed Rule  
R N-5655  
U.S. Department of Labor  
200 Constitution Avenue, N.W.  
Washington, DC 20210

Dear Sir or Madam:

The Insured Retirement Institute (IRI) <sup>1</sup> appreciates the opportunity to provide comments regarding the Department of Labor's ("Department") proposed regulation defining an investment advice fiduciary under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 ("Code") which applies to both employer-sponsored plans governed by ERISA and individual retirement arrangements ("IRAs").

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<sup>1</sup> The Insured Retirement Institute (IRI) is a non-profit organization dedicated to the growth and better understanding of guaranteed lifetime income products. IRI represents the entire supply chain of the annuity, insured retirement product and retirement planning industries with over 300 member organizations, including insurance companies representing over 85% of the market, distribution firms, including broker-dealers and banks, investment management firms, and industry service providers. IRI's mission is to promote consumer confidence in the value and viability of insured retirement strategies by: supporting and encouraging industry adherence to high ethical standards; promoting better understanding of the insured retirement value proposition; developing and promoting best practice standards to improve value delivery; and advocating before public policy makers on critical issues affecting insured retirement strategies.

Given the broad impact of these rules on the retail marketplace, we are concerned that these rules have not been harmonized with regulations expected to be issued by the Securities and Exchange Commission (“SEC”) which are expected to create a fiduciary standard for broker-dealers and other financial professionals. We urge the Department to coordinate its efforts with the SEC and the Financial Industry Regulatory Authority (“FINRA”) to establish a consistent set of rules that apply to financial professionals who work with clients holding investments in 401(k) plans, IRAs and non-qualified accounts. We are concerned that applying two different fiduciary standards to the exact same recommendations will be incredibly confusing for clients who naturally expect the same level of service with respect to all of their investment accounts. And since assets are fungible, it will be impossible to ensure that recommendations relating to a non-qualified account are not followed with respect to a retirement account. We fear that the result of these regulations will be to take away the freedom IRA and small business owners have today to make their own investment choices. Our experience is that IRA owners prefer to control their own accounts and maintain the ability to work with the financial professional of their choice. We believe that a strong retirement system must encourage private savings outside of a publicly managed pension system. We agree with the World Bank that it is important for capital formation and economic growth to have a privately managed, voluntary funded retirement system (referred to as the “third pillar”) in addition to a public retirement system. We oppose any regulatory effort that would discourage private retirement saving and correspondingly negatively impact the economy and jobs.

We believe that, particularly in light of the sweeping coverage of this proposed regulation, clarity and certainty will be even more important for all market participants. For that reason, we hope that the final guidance would provide clarity on the following broader points: that nothing in the regulation is intended to suggest that the parties—generally, the plan sponsor and a designated plan fiduciary—cannot continue to define the scope of the fiduciary’s responsibilities in their agreements. Thus: a trustee may still be either directed or discretionary; and a party may be an investment advisor to one participant while providing non-fiduciary education and guidance to another and/or sales recommendations to another; or to the same participant at different times or for different purposes.

We look forward to working with the Department to make modifications to the proposal that will ensure that participants, plan sponsors, and IRA owners have access to the services and information they need to make informed decisions and avoid major increases in the costs and litigation that could be a result of the proposed rule.

## Impacts upon 401(k) Plan Participants and IRA Owners

Overall we are concerned about the unintended consequences of the proposed regulations - less choice, reduced access, and increased costs for products and services needed by 401(k) plan participants and individual retirement account (“IRA”) owners:

- Clients will have limited or no access to financial planning and commission-based products, including annuities and loaded mutual funds. This is especially true for IRA clients who do not have a plan fiduciary to assist them. Annuities often have a lifetime income component, so they are buy and hold investments that are usually best paid for via a commission or transaction based compensation, versus an ongoing wrap fee, which is calculated and recalculated upon the value of the same assets, plus any earnings.
- Clients will likely be required to enter into a wrap program in order to receive advice or do without advice altogether:
  - Since advisory-fee based accounts typically require minimum investment of amounts between \$50,000 to \$250,000 (depending upon the services and whether it is a retirement account), commission-based programs are often the only way in which investors with less to invest can obtain any form of investment advice.<sup>2</sup>
  - Wrap programs, which charge ongoing fees based upon assets under management, can be more expensive and are generally not a good choice for buy and hold investors, such as those investors who seek options for rolling over and obtaining investment advice for their accumulated 401(k) assets.
  - Indeed, FINRA and the SEC do not consider wrap programs suitable for investors who do not trade very often. Firms are directed to move such investors to brokerage accounts making the Department’s regulations unworkable under existing SEC and FINRA regulations.
  - Annuities are generally sold on a commission basis and will not be sold in a wrap, decreasing a client’s opportunity for guaranteed retirement income.
- Clients will no longer be able to engage in principal trading, which will increase costs for them. Principal trading is often beneficial to clients who would otherwise pay both a mark-up and commission for agency trades.
- Clients should not be limited in making IRA rollover decisions and requiring broker-dealer advisors and insurance company agents to become fiduciaries will limit assistance.

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<sup>2</sup> According to the Employee Benefit Research Institute and the Investment Company Institute analysis of 4.3 million consistent 401(k) participants, the median 401(k) account held \$59,831 at the end of 2009, up from \$46,338 in 2008. However, over half (52%) of 401(k) participants have less than \$20,000 in their accounts, while 17% have more than \$100,000 saved for retirement.

IRA owners should be permitted to work with the financial professional of their choice, which in many cases may be the one associated with their retirement plan.

- Clients should not be deprived of recommendations on product types, e.g., whether to invest assets in an annuity versus mutual fund versus wrap account.
  - Recommendations among product types, but not of a particular product, is much more analogous to the types of asset class information described in IB 96-1, than to specific investment recommendations contemplate by the regulation. If a recommendation on product types is considered advice, the regulations are not workable.
  - With reference to the PPA investment advice rules, we are not aware of any computer model available or possible that can choose amongst different types of products and nor do we believe it is likely to be possible in most instances to make product compensation level across different product types.
  
- Overreaching in the scope of investment advice fiduciary status can have additional unintended consequences. For example, clients may face higher fees for sweep accounts if sweeping uninvested cash into an account is considered investment advice.
  - Charging a wrap fee on a sweep account will be much higher than the current pricing in a brokerage account.
  - The Department has recognized that sweep accounts provide clients with a beneficial method for handling uninvested cash.
  - Bank sweep products are particularly beneficial to clients as they offer FDIC protection but the new regulations will make it difficult for brokers to offer these accounts if they are deemed to be a fiduciary.
  
- Clients should have access to the best options within discretionary accounts, which options may be limited under the proposed regulations.
  - The common practice of the “soft-offset” is more administratively feasible for firms, thereby keeping client costs lower.
  - A dollar for dollar “hard offset” increases the advisor’s conflict rather than reducing it. It deters the advisor from recommending affiliated mutual funds even if they are the best choice for the client.
  
- Advisors should be able to seek strategies and advice from wholesalers in order to offer the best investment choices to the client.
  - There is no workable solution allowing for important wholesaler support if they are considered fiduciaries.

- Clients understand that company wholesalers are “biased” toward their own company’s products. For example, a client is not surprised to be sold a Ford when visiting a Ford dealership.
- Clients should be able to receive valuations of hard-to-value securities, which may not be included on client statements if their inclusion makes an investment provider a fiduciary.
  - We believe that final guidance should clarify that merely putting a value of a hard-to-value assets received from a third party on a client statement should not be considered “advice.”
  - If doing so results in fiduciary status, IRA custodians will not permit an IRA owner to hold hard-to-value securities or they will charge fees that may be prohibitively expensive to clients.

## **I. There should be separate rules for IRAs and Keogh Plans**

### **A. IRAs and Keogh Plans are fundamentally different – there is no plan fiduciary limiting choice**

The Department’s proposed regulations appear to be designed with employer sponsored 401(k) plans in mind. Such plans generally contain a limited number of investment options and have a plan fiduciary separate from the plan participant who is responsible for narrowing the universe of funds and other investments available to the plan participant. Contrast that structure with IRAs and Keogh Plans. For these plans, there is no plan fiduciary that narrows the universe of funds available to the IRA owner or Keogh owner. Instead, the account owner either chooses a product with a pre-defined investment lineup, or chooses from a virtually unlimited universe of product offerings. When that universe of investments is virtually unlimited, it also can be nearly impossible to design a computer model to take into account that whole universe or to construct a level compensation structure across all investment alternatives. Furthermore, IRA owners are protected by way of their individual rights in their agreements and direct relationships with financial institutions. We would also point out that since these plans are not subject to ERISA’s fiduciary standards, the only impact of the regulations would be to subject service providers to the Internal Revenue Code’s complex prohibited transaction rules. We would note that the Department has no jurisdiction to enforce these rules nor are we aware of any request by the Department of Treasury to expand the reach of the prohibited transaction rules.

### **B. The definition of advice does not fit neatly into the IRA and Keogh Plan marketplace**

Under the proposed regulations, there are three types of recommendations or advice that can result in investment advice fiduciary status: (1) advice, appraisals or fairness opinions

concerning the value of securities or property, (2) recommendations as to the advisability of investing in, purchasing, holding or selling securities or other property, and (3) providing advice or recommendations as to the management of securities or other property. These categories do not fit squarely with the reality of working with IRA owners. Generally, a broker or agent would sit down with a client or prospect and discuss the client's goals and objectives. Based on that conversation, the broker might explain the pros and cons of various investment vehicles including variable annuities, mutual funds, brokerage accounts, banking products, fixed annuities, alternative investments and several types of advisory accounts. Within each of these types of securities and property, brokers can usually recommend several different specific securities that may have different features. Although extremely difficult, it is feasible in some cases to design different product types so that they pay brokers the same compensation. It is virtually impossible to do so across product types. For instance, the commissions paid for executing a stock trade are much different than for selling a variable annuity to a client.

If it is the Department's intent to require fee leveling across product types, then the new regulations would eliminate the ability of brokers to offer products on a commission basis. We saw nothing in the preamble to the regulations and the economic impact analysis that suggested that the intent of the regulations was to end all commission-based sales. We would suggest that a generic recommendation to invest in mutual funds or to open a brokerage account should not be considered a recommendation to purchase a specific security but rather a recommendation to purchase a type of security or open a type of account.

With respect to the 401(k) plan marketplace, the Department has provided considerable guidance regarding the line between activities that would result in fiduciary investment advice as opposed to activities that would be deemed non-fiduciary investment education. The proposed regulation specifically references Interpretive Bulletin 96-1 (29 CFR 2509.96-1) to preserve this safe-harbor for ERISA individual account plans. Some commentators may suggest that this safe harbor be expanded to include IRAs. We feel that this action would not sufficiently address the problem. Interpretive Bulletin 96-1 was drafted under the assumption that the investment education being provided related to an ERISA individual account plan with a limited number of investment options. It speaks of asset allocation recommendations but does not discuss choices between annuity products, mutual funds, REITs, brokerage accounts, or an advisory wrap program to name just a few of the products offered in the IRA and Keogh plan marketplace. We believe that providing recommendations at a "product" level should be viewed as "investment education" rather than investment advice, and that it would be beneficial to the entire marketplace if this were clarified by the Department both in respect to accumulation and decumulation (spend down) under the plan or IRA. At a minimum, we believe it is fundamentally unfair for the Department to issue regulations impacting the \$4.2 trillion IRA marketplace without fully addressing this issue. We would request that prior to issuing final regulations that apply to the IRA and Keogh plan marketplace, the Department further study this marketplace and issue

additional guidance specifically addressing investment education in the IRA and Keogh plan marketplace. At the very least, the Department should clarify that all of the limitations that apply to individual account plans (including the platform safe harbor) also apply to IRAs. It would make no sense and the Department has provided no rationale to justify the result that the exact same recommendations be considered to be fiduciary advice when provided to an IRA owner but not when provided to a 401(k) participant.

These regulations could also have a dramatic impact on the ability of financial service providers to provide comprehensive financial planning to retail clients. To be effective, such financial plans should cover all elements of a client's financial situation including cash, protection, taxes, and investments to name a few. We have heard some commentators recommend that such financial plans could simply ignore the client's 401(k) and IRA assets. For most clients, ignoring their 401(k) plan or IRA account or IRA annuity would be to ignore a significant portion of their assets. The proposed regulations should clarify that recommendations around product types and asset classes would not be deemed to be investment advice when provided as part of a general financial plan. This is particularly important because even though the cost of the financial plan may be a fixed fee that does not vary depending on the recommendations, clients will often choose to implement the plan by purchasing products and services from the financial advisor who provided the financial plan.

### **C. The application of prior exemptions and the issuance of new exemptions must be clarified prior to issuing final regulations**

It is impossible to accurately reflect the economic impact this rule would have without first understanding which exemptions can be relied upon in order to sell products within an IRA account or Keogh plan. First, the Department has issued letters that place into doubt whether a broker can sell third party and affiliated mutual funds under CPTe 75-1, 84-24 and 86-128. With respect to unaffiliated mutual funds, it would appear that CPTe 75-1 should be available and cover all types of compensation received by a broker-dealer (including loads, 12b-1s, commissions and revenue sharing). However, it is unclear whether the exemption applies to mutual fund sales that are not completed on a principal basis. Since open-end mutual funds do not have a finite number of shares, determining whether the sale is on a principal or agency basis is an irrelevant and pointless exercise except to the extent that the Department believes it is determinative as to whether the exemption is available. If the sale is determined to be on an agency basis, CPTe 86-128 would apply but it is unclear whether that exemption would apply to revenue sharing payments. Finally, for affiliated mutual funds, the Department provided a specific exemption (CPTe 84-24) but issued a letter suggesting that the exemption only covers commissions and does not cover any other fees including advisory fees. Although it is unclear what the Department's intent was when writing this letter, the literal reading would suggest that the exemption would only work for cases where a broker sold a mutual fund with an affiliated

principal underwriter and an unaffiliated mutual fund investment manager. Although that situation might arise occasionally, it was neither common back in 1984 when the exemption was granted nor is it common today. Without clarification regarding how these exemptions apply to mutual fund sales, it is impossible for brokers to determine the impact of this regulation on their business models. We believe any economic impact assessment would be incomplete without an assumption as to whether brokers would be able to rely on these exemptions for sales of affiliated and third party mutual funds.

Another product that brokers sell to IRA owners is annuities. Again, the Department has provided what appears to be a broad exemption for their sale (CPTA 84-24). We would appreciate the Department's confirmation that this exemption is still available and would cover sales of affiliated and unaffiliated annuities as well as any compensation received by an affiliated insurance company, affiliated money managers of variable annuity subaccounts, and any revenue sharing paid to the broker.

A very popular program for cash sweep accounts is the so-called deposit sweep program, which sweeps idle cash to bank deposits of multiple firms so that all deposits are covered by FDIC insurance. Given recent economic turbulence, one can understand why investors (including IRA owners and Keogh plan owners) would desire and benefit from unlimited FDIC insurance coverage. Under such a program, the broker receives a spread from the interest paid. As a fiduciary, it would not be able to receive that fee, so clients would be foreclosed from this alternative. Another alternative for cash sweep is the free credit balance, where the broker pays interest on idle cash in the account. Because the free credit balance program is a use of plan assets, a fiduciary may not permit a plan or IRA account to participate in the program. The likely result of this is that IRA owners and Keogh plans will be presented only with a money market fund cash sweep alternative. In today's market, the very low rate of interest generally available on cash will fall to almost imperceptible returns for plans and IRAs, unless the Department provides exemptions for such programs. Worse still, brokers would likely need to charge an administrative fee in order to recoup part of the revenue lost from other sweep options. The end result would be higher costs and less insurance coverage for individual investors. The Department has provided one exemption for a free credit balance program and we would urge the Department to provide a class exemption for both free credit balance and deposit sweep insurance programs prior to finalizing these regulations, at least to the extent that the regulations cover IRAs and Keogh plans.

We would point out that the last time a new fiduciary standard was created to govern sales of products by brokers and other investment advisers (i.e., 1974), the Department responded by immediately issuing a number of exemptions applicable to broker-dealer activity to prevent the potential economic collapse that would have likely resulted from the new standard. We believe that this new regulatory effort by the Department should be viewed similarly. As the Department



points out in its preambles, brokers and other investment professionals have been designing their compliance programs to protect against being held to a fiduciary standard and acting as a party in interest for the past 35 years. Creating a bright-line test to determine who is an advice fiduciary is a laudable goal. However, the bright-line test should not end at the determination of who is a fiduciary but rather extend to the determination as to whether such advice creates a prohibited transaction when the broker or other financial professional receives fully disclosed direct or indirect compensation from such sale or service.

#### **D. Fee Leveling and Computer Models do not work in the IRA and Keogh Plan marketplace**

As mentioned above, it is virtually impossible for brokers and other investment professionals to charge level fees across different product types. Even if the Department determines that recommendations regarding product types (i.e., mutual funds versus annuities) is not investment advice, it would still be difficult or impossible to make compensation level at the advisor level. With respect to annuities, each insurance company offers several different products with differing compensation schedules depending on the features selected and the length of time surrender charges are assessed. With respect to mutual funds, it is virtually impossible to make loaded mutual funds into a fee level product. For one thing, front-end and back-end loads vary from fund family to fund family. Even if mutual fund companies moved to a uniform fee, rights of accumulation or “break-points” will advantage the pricing of mutual funds already held by the client or the client’s household.

#### **E. Conclusion**

While we respect the Department’s authority to issue guidance related to the IRA and Keogh plan marketplace, we note that the Department has not devoted much attention to this marketplace over the past 35 years. Rather than treat this marketplace as an afterthought, the Department should either defer to other regulators who better understand it (i.e., the SEC) or invest significant time and energy into developing regulations specifically tailored to it. Assuming the Department decides to do the latter and does not want to significantly delay the issuance of these regulations on the ERISA-governed marketplace, we would ask the Department to consider removing IRAs and Keogh plans from the scope of the regulations until such time as the Department has (i) considered the economic impact on the non-ERISA marketplace, (ii) educated itself on the structure of this marketplace, (iii) provided a meaningful investment education safe harbor tailored to this marketplace, and (iv) clarified the application of existing exemptions and/or issued new exemptions tailored to this marketplace. We believe that this would be similar to the Department’s decision to remove welfare benefit plans from the recently issued 408(b)(2) regulations. We understand that the Department has held hearings and is close

to issuing newly proposed regulations governing fee disclosure for welfare benefit plans. We see no reason why the same approach would not also work for IRAs and Keogh plans.

## **II. We need a broad seller's exception that encompasses agency trading as well as the sale of advisory services**

### **A. The proposed rule does not provide sufficient certainty**

We applaud the Department's goal of providing more certainty so that service providers know whether they are acting in a fiduciary capacity. We believe increased clarity around who is an investment advice fiduciary and how advice can be provided in a fiduciary capacity is essential to ensure a level playing field for all advisers. We believe that the regulations accomplish this clear line in a thoughtful way. For those who acknowledge fiduciary status they will be a fiduciary. For those who are acting in a selling capacity, they will disclaim fiduciary status. Market factors will determine whether employers, plan participants and IRA owners will choose to pay a separate fee for fiduciary advice or work with a commission-based broker or agent. However, the proposed regulation does not facilitate this type of certainty.

### **B. A broad Seller's Exception is consistent with securities law requirements**

We were pleased to see that the Department provided for a seller's exception to fiduciary status in paragraph (c)(2)(i) (the "seller's exception"). The seller's exception recognizes that sellers and agents of sellers provide information and recommendations to buyers and that such advice should not cause the seller or the seller's agent to become a fiduciary. Brokers often act as the agent for mutual fund and life insurance companies and receive a commission for those sales. With proper disclosure, this selling activity should not be viewed as fiduciary advice under ERISA. We are concerned however, that some may interpret the seller's exception more narrowly. For instance, there is not universal alignment as to whether a sale of shares of an open-end mutual fund is done on an agency or principal basis. In the open-end mutual fund context, the distinction between an agency sale and a principal sale is irrelevant since the mutual fund company simply creates more shares when an investor makes a purchase. We are also concerned that the seller's exception might not apply to agency trades of stocks and bonds where the broker is purchasing the securities on the open market.<sup>3</sup> It is not clear that the broker would be viewed as an agent of the seller in that circumstance. We would urge the Department to clarify that the seller's exception applies to all situations where a broker sells a product or

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<sup>3</sup> We note that the Department has issued a class prohibited transaction exemption that permits brokers to receive commissions for the sale of securities even if the broker is acting in a fiduciary capacity. If the Department were to narrow the seller's exemption with the result being to turn brokers into fiduciaries with respect to agency trades, we would request the Department to clarify that CPTe 86-128 would be available for brokers and would cover any compensation received by the broker as long as the conditions are met.

security and receives a commission for the sale, regardless of whether the sale is on an agency or principal basis.

### **C. Narrowing the Seller’s Exception would have a negative impact on small employers, participants with small account balances and IRA owners**

We understand that the Department is considering narrowing the seller’s exception. We think this would be a mistake and have an enormous impact on capital markets, the likelihood of small employers to adopt retirement plans, and the ability of rank-and-file participants and IRA owners to receive assistance in making investment decisions. We urge the Department to leave the Seller’s exception broad. In the event that the Department were to decide to narrow the Seller’s exception we would expect to see three things (i) such a massive change should result in the regulations being re-proposed so that brokers, insurance agents and other impacted service providers would have an opportunity to comment; (ii) that the DOL would reassess the economic impact of such a dramatic change; and (iii) that the Effective Date would be moved out from 6 months to at least 2 years to provide brokers and insurance agents an opportunity to restructure every commission-based account they currently have and to create a new business model going forward.

Without a carve-out for broker-dealers and insurance agents, commission-based sales would be in jeopardy. Although the Department may believe that an asset-based advisory fee contains fewer inherent conflicts, commission-based sales are often less expensive for retail clients<sup>4</sup> and are generally the only option for small plans and participants with small accounts.

Small employers work with brokers to establish retirement plans for their employees. Small employers generally are unwilling to pay thousands of dollars to a fee-only advisor to help them establish a plan for their employees. If the selling exception were to be eliminated for brokers, fewer small employers would establish retirement plans for their employees.

Once a plan is established, brokers often provide investment education to plan participants. Typically this is the only interaction that plan participants have with a human being that is knowledgeable about the funds available within the plan. The reality is that plan participants do not want investment education any more than the typical consumer wants car repair education when they take their car to the mechanic. For a typical participant that has an account balance of less than \$25,000, the only assistance they can access is the assistance that the broker is able to provide. Most brokers are eager to provide as much help as they legally can without creating a prohibited transaction or an ongoing duty to monitor any recommendations they make.

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<sup>4</sup> An Oliver Wyman Study entitled “Standard of Care Harmonization: Impact Assessment for SEC” that was completed in October 2010, found that costs for clients to switch from commissions-based accounts to advisory-based accounts would be 23-27 bps.

Preventing such brokers from receiving IRA rollovers from participants would be another way to ensure that brokers do not help participants. Rather than “fix” a problem that does not exist, we are hopeful that these new regulations would permit brokers to do more to help plan participants with their investment decisions.

With respect to brokers who provide education and guidance to 401(k) plan participants, the Department has not shown any actual harm from such “conflicted” advice. For example, let’s assume that the broker receives 50 bps if the participant invests in Fund A (a large cap growth fund), 25 bps if the participant invests in Fund B (a bond fund) or 0 bps if the participant invests in Fund C (a money market account). The Department seems to believe that brokers are steering participants into Fund A even when it may be better for the participant to invest in a more conservative portfolio. The reality is that most participants do not have enough saved in their retirement plan to create a meaningful conflict. Consider a typical participant who has \$10,000 in her account. A recommendation to put all assets into Fund A would result in compensation of \$50 to the advisor. A balanced portfolio of 60% stocks and 40% bonds would result in compensation to the advisor of \$40. Does the Department believe that brokers are steering participants to Fund A for an extra \$10? If the Department were to narrow the seller’s exception, the broker will not provide any advice at all to the participant who will then have to decide where to put his or her money without any professional assistance. In that case, the participant will likely place all of her account in the money market account resulting in lower fees but also a lower return. Alternatively, the participant could pay a fee-only advisor \$500 to get the same recommendations the broker would have provided for \$50. The economics of small plans and small accounts make it so that the only advice that participants can afford is the incidental advice provided by brokers. It is hard to see how the average participant would not be significantly harmed by the Department’s attempt to eliminate advice provided by brokers to participants.

We have a hard time understanding why the Department would permit those with the greatest conflict to provide advice after giving a disclaimer but would not permit this same treatment to those with a lesser conflict. When sales are made on a principal basis from a dealer’s inventory, there clearly is conflict and potential for abuse. Because of these issues, the SEC requires disclosure and consent for principal sales made within an advisory account. The SEC recognizes that principal sales need closer regulation and the Department’s proposal would carve those sales out entirely while placing a higher standard of care on agency based trades. This inconsistency does not make sense to us. We believe that a broad seller’s exception is appropriate for everyone.

We are also concerned that if a seller’s exception is limited to principal trades that insurance companies, brokers and other financial professionals would be incentivized to only offer proprietary products which may be considered to be sold on a principal basis. We think this would be detrimental to retirement plan clients who benefit from open platforms.

**D. We believe that employers, plan participants and IRA owners should be given a choice**

Under the Department's 408(b)(2) regulations, plan fiduciaries will have to determine if the services provided by brokers are reasonable in light of the services the broker provides. Many commentators have speculated that the new 408(b)(2) regulations will force brokers to acknowledge fiduciary status in order to compete with RIAs. We believe that in most cases, brokers and insurance agents will be a better solution for small employers and middle class retail investors due to the lack of scale in these markets. Small employers and small investors cannot afford to pay a fee-only adviser's fixed rate fee. That fact will not change even if the Department removes commission-based brokers from contention. Fee-only planners are very excited about the potential to remove brokers from the playing field, but not so they can start competing with small employers and small investors. Fee-only planners want to be able to get a larger market share of the larger employers and larger investors.

We would urge the Department to consider the impact of these regulations on small employers and middle income individuals who often have account balances of less than \$25,000 in their 401(k) or IRA. Brokers and insurance agents have developed a business model that permits them to provide assistance to these two groups in an economical, professional and efficient manner. To make that possible, member firms receive commissions, investment management fees from proprietary products, and revenue sharing from non-proprietary products that desire to be on their platform. If a client desires to pay for an advisory relationship, they charge a basis point advisory fee or a fixed rate and offset this revenue. Many clients do not choose an advisory relationship because they are "buy-and-hold" investors and do not wish to pay an ongoing advice fee which may be more expensive over the long term. In fact, the SEC and FINRA prohibit member firms from pushing clients to an advisory fee relationship because a commission-based relationship is often less costly to buy-and-hold investors. Many investors who are saving for retirement would fit in that category. The upshot for retail investors if the selling exception is narrowed would be higher fees for the same investment strategy.

**E. The Seller's Exception should be expanded to include recommendations to hire money managers**

While we understand why the Department wants to expand the definition of investment advice to include money manager recommendations, this expansion creates some unintended problems that need to be resolved within the regulations. For instance, if a fee only investment adviser recommends that a plan hire him or her, presumably the Department did not intend to make the investment adviser a fiduciary prior to being hired. However, it is hard to see how the recommendation to hire oneself as a money manager is not a prohibited transaction under this

regulation. Certainly recommending oneself to be hired would be recommending the “management of securities or other property”. So under the regulation, this recommendation would potentially trigger fiduciary status. Furthermore, the advice provider would likely be an RIA so that would conclusively make the recommendation a fiduciary act under the Department’s proposed regulations. Recommending oneself to act as a money manager clearly is conflicted advice since the prospective money manager receives more compensation if he or she is hired by the plan. We are aware of no prohibited transaction exemption to cover this newly created prohibited transaction.<sup>5</sup> The solution, it seems to us, would be to broaden the seller’s exception to cover the “sale” of advisory services.

Broadening the seller’s exception to cover advisory services would also permit brokers to help IRA clients choose between a loaded mutual fund account and an advisory wrap account. With respect to those recommendations, the SEC, FINRA, and state regulators already supervise RIAs, brokers and insurance agents relating to product recommendations. There are comprehensive SEC/FINRA requirements for the recommendation of an investment product. Among other requirements, a financial professional must have a reasonable basis to conclude that a product is “suitable” for the client based upon very specific information that the financial professional is required to gather from the client. In addition to the SEC and FINRA requirements, it is important to note the wide range of state regulations and protections. Many of these state regulations address similar issues of customer protection including requirements for full disclosure about the risks of products, regulation of sales practices, and extensive supervision of financial professionals. In some cases, financial professionals can be subject to all three levels of requirements depending on the types of products and services they offer.

Some bundled 401(k) providers have suggested that plan sponsors hire an independent investment manager (i.e. an investment manager not affiliated with any of the funds and who receives no compensation from third parties) who will select the fund line-up and monitor it as a “3(38)” fiduciary. Such an arrangement would seem to meet the Department’s goal of removing conflicts. However, under the proposed regulations, if a broker or recordkeeper recommended hiring the investment manager that would trigger fiduciary status. We would like to see a carve-out for investment managers who are hired to select investment options for a plan.

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<sup>5</sup> One might argue that advice provided before being hired by the plan or participant is not covered by a fiduciary standard. Even if one subscribes to this theory, it does not help where the money manager is already providing services to the plan or is competing with other money managers to keep his or her job. What an interesting dynamic that would make where the challengers are able to recommend themselves and the incumbent cannot.

**F. The Seller's Exception should be modified to change the burden of proof and more accurately disclose the potential conflicts**

Although we strongly support a broad seller's exception, we believe that it needs to be modified slightly in order to be useful to brokers, insurance agents and other financial professionals. To begin with, the proposal places the burden of proof on the financial professional to prove what the client "reasonably understood". This subjective standard does not fit within the Department's stated goal of providing bright lines. We would propose that instead, the exception require that the financial professional disclose that he or she is paid to sell products and services and is not paid if the client does not purchase products or services from the financial professional. The disclosure would also need to state that the financial professional is not providing fiduciary advice and that the financial professional's compensation varies depending on the product or service purchased by the client. This disclosure should be provided at time of sale in a prominent manner. Once the disclosure is provided, the financial professional should be able to rely conclusively on the seller's exception unless the financial professional has acknowledged fiduciary status in another document.

One problem with the proposal is that it requires that the client reasonably understand that the seller's interests are "adverse" to the clients. We believe that this would overstate the case in many instances. For instance, where a financial professional recommends an annuity and is paid a commission, the financial professional's interests are not adverse to the client's. In fact it would often be in the best interests of the client to purchase an annuity. We are concerned that the SEC will soon be issuing a regulation that will subject brokers and other financial professionals to a fiduciary standard of care.<sup>6</sup> It is not clear to us whether a broker would be permitted to sell products to clients under the SEC's fiduciary standard of care if it were determined that the broker's interests were adverse to the clients. It seems unlikely. Therefore, the end result is that if the broker's interest must be adverse and the broker is held to a fiduciary standard of care then the seller's exception would be unavailable to brokers under the SEC's new standard of care. This would be exactly opposite of the result Congress intended. Congress, after careful consideration, has directed the SEC to study whether brokers should be held to a fiduciary standard of care. If the SEC does decide to issue such regulations, Congress has directed that such a fiduciary standard of care should permit brokers to sell proprietary products and sell securities on a principal basis. Therefore, it seems unlikely that Congress viewed a broker's interest as being "adverse" to its clients. We would request that the word "adverse" be stricken from the proposal and that the financial professional simply disclose that it is not acting as a fiduciary and only receives compensation by selling products and services.

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<sup>6</sup> Congress, after careful consideration, has directed the SEC to issue regulations creating a fiduciary standard of care that would explicitly permit brokers to sell proprietary products and sell securities on a principal basis.

## **G. The investment advice exemptions provided under the Pension Protection Act are not sufficient**

Without a broad Seller's Exception, the new investment advice fiduciary definition will turn brokers and insurance agents into fiduciaries. The Department may believe that brokers can rely on the investment advice exemption that was included as part of the Pension Protection Act of 2006. Unfortunately, that exemption has three significant limitations.

First, it does not apply to discretionary advice. This can be problematic for advisors who use a discretionary wrap product that may utilize some proprietary products.

Second, it does not apply to advice provided to employers. This is particularly problematic in the owner-only context where the owner is both the employer and the participant. It also creates a problem for brokers affiliated with mutual fund complexes who wish to offer their proprietary funds on a level playing field. If the advisor is a fiduciary and if the proprietary fund is the cheapest and best performing alternative, recommending the proprietary fund would be a prohibited transaction, at least based on the Department's guidance. The only way the advisor could recommend the proprietary fund would be if the advisor offsets the management fee against the advisor's fees. Advisors are often paid 25 bps to help an employer choose and monitor its investment line-up. It is hard (and unfair) to require the advisor to offset a management fee that may be 50 bps or higher against a 25 bps advisory fee. If the fee-leveling exemption were available for advice provided to the employer, then the advisor would not have to offset the management fee within the proprietary mutual fund. Unfortunately, that is not the case.

Third, a computer model will not work in the retail marketplace and most IRA owners and plan participants are not comfortable relying on them. Last year, Charles Schwab released a study entitled "The New Rules for Engagement for 401(k) Success" which combined an in-depth behavioral analysis of 401(k) plans serviced by Schwab and a nationwide attitudinal survey of more than 1,000 participants. According to the study, the majority of 401(k) investors surveyed say they prefer a personalized touch over online tools. There is nothing wrong with computer models. However, most employers, retirement plan participants and IRA owners are not comfortable relying solely on a computer model. Computer models became a popular "must-have" feature for retirement plans shortly after the Department's SunAmerica advisory opinion back in 2001. In the mid-2000's companies sponsoring a large market retirement plan bundled product began adding this feature to their plans. Although plan sponsors preferred to permit participants to choose whether to pay for the service, none of the providers would permit them to do so. Why? Because the uptake rate was so low that it would not be economical for the provider to price it that way. In fact, their experience was that even when a computer model was made available "for free" (i.e., the cost was already built into the investments), about 1% of the



plan participants used the computer model. Even for those participants who want to use a computer model, most would want to discuss the results with a human being, especially when the markets are turbulent. When the Dow drops 20%, you can't call a computer model and ask it what to do.

## **H. Conclusion**

With respect to the ERISA-governed marketplace, we would respectfully request that the Department re-propose the regulations after incorporating our comments. We believe re-proposing the regulations is necessary given the number of issues raised by us and other groups, the flaws in the economic impact assessment we have pointed out, and the dramatic impact these regulations would have on the IRA and ERISA-governed marketplace.

## **III. There should be one standard regardless of status**

The Department's proposal would create a separate standard for investment recommendations depending on the status of the person making the recommendation or the status of the person's affiliates. For persons who are, or are affiliated with someone who is, an RIA or already an ERISA fiduciary to the plan in some capacity, recommendations automatically become investment advice without regard to whether the recommendations are individualized or there is any mutual understanding that the recommendations will form any basis for the individual's investment decisions. For instance, under the proposal, if an RIA sends out a newsletter to paid subscribers that includes buy, sell or hold recommendations relating to a particular security, that would be fiduciary investment advice under the regulation. Furthermore, if a broker provides buy, sell, hold recommendations for stocks on its website, that broker would automatically be considered a fiduciary with respect to any clients who happen to have IRAs with the broker if the client followed any of those recommendations and the broker was either affiliated with another RIA or was dually registered as an RIA and a broker-dealer. We would recommend that the Department consider the guidance provided by its own Assistant Secretary on January 4, 2011 and focus its regulation on the functional activity rather than labels such as RIA: "the primary focus of the proposal is on function – providing investment advice and recommendations – and not labels such as lawyers, accountants and brokers." We would recommend that the regulations be revised to remove the status test completely and apply one universal standard regardless of whether the person providing a recommendation is an RIA, affiliated with an RIA, an ERISA fiduciary or affiliated with an ERISA fiduciary, the recommendation would not be considered advice unless it is both individualized to the recipient and there is a mutual understanding that the recommendation is to be used as a basis for the recipient's investment decisions.

#### **IV. Distributions**

The Department's proposal excludes from the types of activities that may result in invest advice recommendations relating to distributions. The Department specifically requested comments on this point. We believe that the Department has correctly interpreted the statute to limit investment advice to advice regarding investments rather than distributions. We are not aware of any legislative history nor any plain reading of the statute that would suggest that a recommendation to take a distribution from a plan is advice relating to an investment.

In addition to excluding recommendations regarding distribution requests, we urge the Department to provide much needed clarity with respect to its position expressed in Advisory Opinion 2005-23a (the "Deseret letter"). In that letter, the Department suggests that while IRA distribution advice is not generally investment advice giving rise to fiduciary status, if the person providing the recommendation is already a fiduciary to the plan and recommends an IRA rollover to an affiliated IRA, the transaction might be a self-dealing transaction. In the small plan marketplace serviced today primarily by brokers, the Deseret letter has had the unfortunate impact of preventing brokers from providing fiduciary services to employers and plan participants.

To resolve the issues left unanswered by the Deseret letter, we would suggest that the Department clarify that the Seller's exception would be available to financial professionals if the conditions of the exception are met and the financial professional has not acknowledged fiduciary status to the participant who is receiving the recommendation. In other words, if the financial professional acknowledges fiduciary status with respect to recommendations made to the plan sponsor regarding which investment options to make available to participants, the same financial professional should be able to disclaim fiduciary status to plan participants under the Seller's exception with respect to recommendations made with respect to both IRA rollovers and mutual fund investments.

#### **IV. Valuation issue under proposed definition of "fiduciary"**

The proposed regulation would for the first time make appraisals a fiduciary act. It is hard to see how the term "investment advice" could be construed to cover appraisals and we are not aware of any legislative intent to suggest otherwise. Therefore, it is not clear to us that the Department has statutory authority to expand investment advice to cover appraisals. However, even if the Department does have such authority, we believe that the structure of the current proposed regulations would lead to unintended consequences that would have a negative impact on the plan participants and IRA owners the Department seeks to protect. Such an expansion would be bad policy for the reasons discussed below. Therefore, we would ask the Department to remove the changes regarding "valuation" made to the proposed regulation (both in (c)(1)(i)(2) and the "limitation" in (c)(2)(iii)) and reserve them for addressing the issue in a separate DOL

rulemaking. This will allow additional time to review the scope of proposed regulation and address the apparent unintended consequences discussed below.

With respect to life insurance separate accounts and other ERISA “plan asset” vehicles that invest in real estate, the proposal would have the effect of making real estate appraisers into ERISA fiduciaries. For this reason, appraisers are threatening to stop doing appraisals for ERISA plans and those that continue to provide appraisals will surely increase their fees given their increased liability. If this occurs, there would be severe market disruption for both plans seeking to invest in real estate and insurers. At the very least, the cost to manage these funds will increase and therefore the returns enjoyed by plan participants and IRA owners will decrease. Furthermore, in many cases there is already a plan fiduciary that has a duty to ensure that the fund does not overpay for real estate investments. Under the existing rules, if a discretionary money manager overpays for a real estate investment then that money manager will have breached its fiduciary duty.

The same issues apply to ERISA “plan asset” vehicles that invest in other hard-to-value property such as collateralized debt obligations, structured notes, and thinly traded or closely held stock to name a few. Again, the money manager already has a fiduciary duty to prudently manage these funds which would include not overpaying for these assets. What this regulation would do is merely drive up the cost of managing these funds as appraisers, sub-custodians and others who provide values would become a fiduciary to the plan and charge higher fees due to this increased liability.

The Department has included a limitation for service providers who provide values as part of “general reports...provided for purposes of compliance with the reporting and disclosure requirements”. This limitation is potentially very narrow. Many insurers provide reports and statements more frequently than ERISA reporting requirements strictly require (e.g., daily online account value access to plan participants, interim reports provided to plan investment committees). Second, and more importantly, the limitation does not cover reports on assets for which there is “not a generally recognized market” if the value is used as a basis on which a plan makes distributions.

In addition to insurers, the proposal would also appear to sweep into the fiduciary world custodians and recordkeepers who report the value of these investments on quarterly statements and on year-end reports. The values that they report come from unrelated third parties. These parties do not advise the plan to buy, sell or hold these hard-to-value investments and do not currently view themselves as fiduciaries with respect to the investments or their value. There is no basis for making these entities fiduciaries and the result will be that many will refuse to hold these assets or increase their fees at the expense of the investment returns enjoyed by plan participants and IRA owners.

## V. Conclusion

We would like to applaud the Department for its announcement of a public hearing on the proposed regulations and for extending the period during which the comments will be accepted before the hearing. While we will be providing a formal request to testify at the hearing, we would like to take this opportunity to express our interest in participating in the hearing. We believe that the Department's proposed regulations address a wide range of important issues and urge you to consider all of the potential implications for consumers and capital markets as this important policy dialog continues to move forward. Please feel free to contact me or John Little, our Senior Vice President for Federal Affairs with any questions regarding our comments.

Sincerely,

A handwritten signature in blue ink, appearing to read "Cathy Weatherford". The signature is fluid and cursive, with a large loop at the end.

Cathy Weatherford  
President & CEO