Business Law Section
AMERICAN BAR ASSOCIATION

321 North Clark Street
Chicago, IL 60654
(312) 988-5588
Fax: (312)988-5578
www.ababusinesslaw.org
businesslaw@abanet.org

February 3, 2011

By Electronic Mail and Regular Mail

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Definition of Fiduciary Proposed Rule
Room N–5655
U.S. Department of Labor,
200 Constitution Avenue NW
Washington, DC 20210

Re: Definition of the Term "Fiduciary", 29 CFR Part 2510

Ladies and Gentlemen:

This letter is submitted on behalf of the Committee on Federal Regulation of Securities (the "Committee") of the Section of Business Law of the American Bar Association (the "ABA") in response to the request for comments on the proposal by the Department of Labor, Employee Benefits Security Administration (the "Department") to expand the definition of the term "fiduciary" under the Employee Retirement Income Security Act (ERISA).[1] This letter was prepared by members of the Committee's Subcommittee on Trading and Markets, with input from other members of the Committee.

The comments expressed in this letter represent the views of the Committee only and have not been approved by the ABA's House of Delegates or Board of Governors and therefore do not represent the official position of the ABA. In addition, these comments do not represent the official position of the ABA Section of the Business Law.

The Committee thanks the Department for this opportunity to comment on the Proposed Rule. Because, as discussed below, we write to urge the Department to defer its proposed changes until the U.S. Securities and Exchange Commission (the "Commission" or the "SEC") has promulgated final rules relating to the fiduciary duties that may apply to investment advisers and broker-dealers, we are sending copies of this letter to the Director of the SEC's Division of Trading and Markets and the Director of the SEC's Division of Investment Management on this letter. The Staff of the Commission has recently recommended that all investment advisers and broker-dealers who provide personalized investment advice to retail customers be treated as fiduciaries to those

1 See 75 Fed. Reg. 65,263 (Oct. 22, 2010) (the "Proposing Release").

customers.[2] The SEC Staff recommended that the Commission engage in rulemaking that would apply fiduciary standards expressly and uniformly to such investment advisers and broker-dealers, and would harmonize the regulatory regimes applicable to broker-dealers and investment advisers. The SEC Staff Study provides a comprehensive roadmap with respect to the regulatory and interpretative changes that would be necessary in order to implement an expansion of the fiduciary duty concept, including changes to the regulation of finders and solicitors, advertising, supervision, customer remedies, supervision, licensing of firms, licensing of individuals, continuing education requirements, principal trading and books and records, and interpretative guidance concerning permissible investor education, personalized investment advice, and the application of the duty of care and the duty of loyalty.

Many of the issues associated with the Department's proposed changes to the definition of the term "fiduciary" parallel the issues relating to fiduciary duty addressed in the SEC Staff Study. Because of the direct and indirect implications the proposed expansion of the definition may have to financial services professionals, we write to urge the Department to postpone its proposed rulemaking with respect to the definition of the term "fiduciary" until after the SEC has promulgated final rules with respect to investment adviser and broker-dealer fiduciary duties, and then to proceed with rulemaking in conjunction with exemptive or other relief under ERISA in order to permit investment advisers (and to the extent the SEC rules so provide, broker-dealers) to implement of the final SEC rules without such compliance constituting a breach of the prohibitions under ERISA. The ERISA definition of "fiduciary" has developed over the past 35 years against the backdrop of the prohibited transaction provisions of ERISA and the prohibited transaction exemptions that the Department has granted. For example, we understand that the current five-part test for fiduciary status in 29 CFR § 2510.3–21(c) was developed in close consultation with the Staff of the SEC. The current definition was intended to prevent the ERISA provisions from disrupting longstanding and well-accepted practices by which financial services firms provide investment advice to customers.[3] We urge the Department to work closely again with the Staff of the SEC to consider the potential effects of expanding the fiduciary definition. The roadmap of regulatory and interpretative issues identified in the SEC Staff Study in connection with the SEC's consideration of an expansion of the scope of fiduciary duties in the provision of personalized investment advice to retail investors provides, in our view, an excellent model

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[2] Staff of the Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers (January 2011) (available at http://www.sec.gov/news/studies/2011/913studyfinal.pdf).

[3] The "individualized advice" prong of the current definition of fiduciary status raises different issues. We believe it is vitally important that the Department encourage generalized education and information about investment alternatives. Studies regularly show that the "financial literacy" of many Americans is lower than they need to make well-informed financial decisions. Imposing ERISA liability for generalized educational and informational materials could have the unintended consequence of making both employers and financial services firms less willing to offer much-needed general educational materials about investing. We urge the Department to make it clear that generalized educational and informational materials, which clearly disclose that they are not tailored to a specific customer's financial situation, do not give rise to fiduciary obligations. The proposed changes to the definition contain an exception for "investment education" but only in the context of "individual account plans," and we urge the Department to consider whether this exception is sufficiently broad.

for the Department's evaluation of any similar expansion of its definition of fiduciary status. Such a process will assist the Department's efforts to address any needed changes to the prohibited transactions rules and exemptions necessary as a result of any change to the definition of fiduciary.

As the Department is no doubt aware, the effect of being deemed a fiduciary under ERISA is substantially different from the consequence of an investment adviser being deemed a fiduciary under the Investment Advisers Act of 1940 (the "Advisers Act"), or (as suggested by the SEC Staff) for a broker-dealer under the Exchange Act.[4] Under the Advisers Act, the concept of fiduciary duty carries with it a limited number of broad principles-based responsibilities: a duty of care, which includes a duty to become fully informed on behalf of the client; a duty of loyalty to the client; a duty of honesty to the client; and a duty of good faith to act solely in the best interests of the client, which incorporates a substantive "prudent investor" standard. By contrast, ERISA treats a number of relationships as "prohibited transactions" which are entirely forbidden to ERISA fiduciaries. Many of those same relationships are permissible for investment advisers under the Advisers Act, and would be permissible for broker-dealers under the Exchange Act, so long as they are fully and fairly disclosed to clients, the clients consent to those relationships in advance, and the fiduciary makes a reasonable and good faith determination that the relationship is in the best interests of the clients.

In order to ameliorate the unintended harsh effects of the categorical proscriptions contained in the prohibited transactions provisions, the Department has used its regulatory authority to develop a series of carefully balanced exemptions from the prohibited transactions under ERISA. Over the years, the financial services industry has successfully adjusted to the various ERISA restrictions and exemptions. However, many of those exemptions in turn depend on the party relying on the exemptions not itself being an ERISA fiduciary. We are concerned that an expansion of the definition of the term "fiduciary" under ERISA, without a corresponding change to the scope of the prohibited transaction exemptions, would significantly disrupt some long-settled arrangements which may be in the best interests of clients. For these reasons, we urge the Department to defer consideration of revisions to the definition of the term "fiduciary" until the SEC has promulgated final rules regarding the fiduciary duties of investment advisers and broker-dealers. Following such final rulemaking, we also urge the Department not to adopt an expanded definition of the term "fiduciary" unless it has also conducted a thorough reexamination of the exemptions from the scope of prohibited transactions, as currently relied upon by the financial services industry. Absent these accommodations, and as discuss in more detail below, we believe that there will be significant market disruption to the financial services industry, and that quality investment

[4] The SEC Staff Study recommends rejecting the alternative of repealing the brokerage exception to the definition of "investment adviser" in Section 202(a)(11) of the Investment Advisers Act, an alternative, which if adopted, would have the effect of treating both broker-dealers and investment advisers as subject to the Investment Advisers Act when they give personalized advice to retail clients.

advice could become less available to many American investors, particularly retail investors without significant investment experience and investors with smaller amounts to invest.

It may be useful to provide some concrete examples of our concerns. Under the Advisers Act, it is permissible for a financial services professional to receive what are known as Rule 12b-1 fees from mutual fund advisers. In part, these fees compensate the financial services professional for providing advice to clients, and in part, they compensate the financial services professional for performing servicing functions (statements, confirmations, mailings, etc.) that would otherwise fall on the mutual fund company. The SEC recently proposed reforming (and renaming) Rule 12b-1 fees.[5] However, the SEC concluded that it was not appropriate to ban entirely continuing payments from mutual fund advisers to financial professionals. Allowing those payments in appropriate circumstances creates an alternative method that allows some retail investors - notably many investors with IRA accounts - to pay for investment advice. By contrast, under ERISA, the acceptance by a fiduciary of payments from a party other than the client generally constitutes a prohibited transaction. ERISA fiduciaries typically either do not accept Rule 12b-1 payments from mutual fund advisers, or rebate those payments to clients (usually as an offset against the client's investment advisory fees). The Department's redefinition of fiduciary could being some financial services professionals within the scope of the term fiduciary. Unless the Department adjusts its prohibited transaction exemptions, the redefinition could eliminate the ability of such professionals to be compensated (through 12b-1 fees) for investment advice they have provided. As a result, retail investors may be denied the ability to pay their financial professionals for investment advice through periodic payments from mutual fund advisers. Some retail investors, who are unable to pay investment advisory fees or for whom such fees would be cost-prohibitive, might be unable to obtain quality investment advice at all.[6] Were the Department to determine to treat financial services professionals as fiduciaries, we believe it would be critically important for the Department to make corresponding changes to the exemptions from the prohibited transactions rules that would become effective at the same time as the definitional change.

As another example, Section 206(3) of the Advisers Act permits an investment adviser to transact as principal with a client, so long as the investment adviser gives the client full and fair disclosure of the terms of the transaction and obtains the written consent of the client. In some situations, for some securities, SEC Temporary Rule 206(3)-3T allows investment advisers to obtain this consent on a blanket basis (as opposed to a transaction-by-transaction basis). The SEC adopted, and recently extended, this temporary rule because it was concerned that otherwise, investment advisers might not be able to obtain best execution for

[5] Securities Act Rel. No. 9128 (July 21, 2010) (available at http://www.sec.gov/rules/proposed/2010/33-9128.pdf).

[6] Many beginning investors, and investors with smaller amounts to invest, either do not have sufficient assets to qualify for investment advice based on an assets-under-management fee, or such a fee would be prohibitively expensive for them. For these investors, their only practical access to investment advice may be through mutual funds that pay their investment professional an ongoing fee.

retail clients in some securities. Specifically, investment grade fixed-income securities (government, corporate and municipal bonds) typically trade at better prices in block transactions in the inter-dealer market than they do in retail-sized transactions.[7] Without the ability to trade such securities as principal, financial services providers may not be able to provide these better inter-dealer prices to retail customers. By contrast, under ERISA, the prohibited transaction rules typically forbid a fiduciary from trading with a client as principal at all.[8] Thus, as we understand it, ERISA bars investment professionals who are deemed to be fiduciaries from conducting principal trades with clients in circumstances where the SEC has determined that principal trades may actually provide the clients with best execution for their transactions. We believe that this issue deserves to be debated on the merits, as part of a comprehensive analysis of the implications of the Department's proposed change to the definition of the term "fiduciary."

The above are only two of many possible examples. Our larger point is that any consideration of a change to the definition of the term "fiduciary" should also encompass an analysis of the implications of the change to financial services professionals. Because this analysis will not be possible until the SEC has determined what changes are required to the application of fiduciary duty concepts to investment advisers and broker-dealers, we believe it is critical that the Department defer consideration of its proposed definitional change until the SEC has promulgated its final rules regarding fiduciary duty. Only against this backdrop will the implications of the Department's proposed definitional change become clear, as will the need for changes to the applicable exemptions so as not to disrupt a system that has functioned for many years in the best interests of investors. We therefore strongly urge the Department to defer its current rulemaking proposal. We are concerned that the Department's rulemaking at this time, prior to SEC rulemaking, will work to the detriment of both the financial services industry and the investing public.

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We appreciate the opportunity to comment on the Department's proposed changes to the definition of the term "fiduciary". Members of the Committee would be pleased to meet with the Department or its staff to discuss these important issues further. If you should have any questions regarding this comment letter, please contact W. Hardy Callcott, Chair of our

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7 See Investment Advisers Act Rel. No. 3128 (Dec. 28, 2010) (available at http://www.sec.gov/rules/final/2010/ia-3128.pdf).

8 We note that the Proposing Release contains an exception where "the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in its capacity as a purchaser or seller of a security or other property, . . . whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice." But as we understand it, this exception would not be available to anyone who "represents or acknowledges that [he or she] is acting as a fiduciary within the meaning of the Act with respect to providing advice or making recommendations" and is substantially more limited that the treatment of principal trades under the Investment Advisers Act.

Subcommittee on Trading and Markets, by email at hardy.callcott@bingham.com or by telephone at (415) 393-2310.

Sincerely yours,

/s/ Jeffrey W. Rubin
Jeffrey W. Rubin, Chair, Committee on
Federal Regulation of Securities

cc:

Robert Cook, Director, SEC Division of Trading and Markets
Eileen Rominger, Director, SEC Division of Investment Management