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Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Definition of Fiduciary Proposed Rule

Ladies and Gentlemen:

Thank you for the opportunity to comment on the Department's proposed rule expanding the definition of "fiduciary" under ERISA. The proposed rule, if adopted, would sweep many routine broker-dealer transactions with qualified plans and individual retirement accounts into the prohibited transaction restrictions in ERISA. Although we strongly support the goal of enhancing investor protection, we believe the Department's proposal would, inadvertently, have an extremely harmful unintended impact on retirement plan investors.

In particular, by prohibiting routine financial transactions that have worked well for retirement and non-retirement investors alike for more than a century, the proposal would greatly reduce the choice of investments, limit the ability of retirement investors with modest assets to get advice, significantly increase costs to many retirement investors for the advice they do receive, reduce investor returns, and damage capital formation, which has long served as the engine of growth for the U.S. economy. It will break a system that is working well for retirement and non-retirement investors alike.

We also believe the Department and SEC – two agencies highly focused on the goal of investor protection -- should have a more coordinated approach, and not adopt rules that result in vastly different application for investors' retirement plan accounts and non-retirement accounts. For these reasons, we urge the Department not to adopt the rule as proposed.

BACKGROUND

UBS Wealth Management Americas is dually registered as a broker-dealer and an investment adviser. It is one of the largest securities firms in the United States and part of one of the largest wealth managers in the world. UBS has been a wealth manager globally for more than 140 years, and its more than 60,000 employees serve investors in over 50 countries.

Retirement assets are one of the largest asset classes served by UBS, and, indeed, by virtually all major broker-dealer firms. As noted in the Investment Company Institute's recent report entitled, "The U.S. Retirement Market, 2009," retirement savings vehicles account for more than one-third of the $45.1 trillion of U.S. household financial assets and are "integral to Americans' overall retirement planning and preparedness."[1] U.S. retirement assets as of the end of 2009 totaled $15.6 trillion, of which $4.2 trillion were in IRAs, $4.1 trillion in employer-sponsored defined contribution plans, and $2.8 trillion in 401(k) plans. Typically, these assets are held at broker-dealer firms, such as UBS.

[1] ICI Research Fundamentals, "The U.S. Retirement Market, 2009," (May 2010) at 5.

In a traditional brokerage account, firms like UBS receive transactional compensation. For example, a single plan account may hold mutual fund investments, government or corporate fixed income securities, and individual stocks. The compensation UBS receives on mutual fund transactions might include a commission on the sale and an ongoing asset based trail paid by the fund. On fixed income securities, UBS receives a commission if the securities are purchased on an agency basis or a mark up if they are purchased on a principal basis. Compensation for equity securities is also typically a sales commission or a mark up if effected on a principal basis. Accounts with this type of compensation, which form the cornerstone of the financial services relationships that plans have with their brokerage firms, would result in a series of prohibited transactions if the brokerage firm and its representatives are considered ERISA fiduciaries unless each transaction can fit into one of the existing statutory or class exemptions issued by the Department.[2]

A far smaller number of accounts are so-called ERISA fiduciary accounts. After 35 years of experience with ERISA, the financial services industry has concluded that an ERISA fiduciary advice relationship is viable only in an investment advisory account. In these relationships, firms generally charge a wrap fee on all of the assets in the account to cover transactions and services provided. These investment advisory accounts are suitable and appropriate for many plans. On the other hand, far more retirement investors choose the traditional brokerage account, which does not involve an advisory fee, because they find that type of account is more suitable to their needs.

The broker-dealer industry is as comprehensively regulated as any industry in the United States. Indeed, the recent SEC Study on Investment Advisers and Broker-Dealers ("SEC Study") required more than 40 pages just to describe the myriad statutes, rules, judicial decisions and interpretations that regulate almost every aspect of a broker-dealer's conduct, the multitude of remedies available whenever there is a violation and the parallel regulatory regime under state law.[3] In addition, if the SEC Staff's proposal is adopted, broker-dealers will be subject to an additional "best interest" standard that will further elevate the applicable standard of conduct without prohibiting any of the routine transactions that now occur between broker-dealers and their clients. The SEC Study also points out that the SEC-commissioned RAND study found that "generally investors were satisfied with their financial professional."[4]

Historically, transactions with broker-dealers (as opposed to transactions with ERISA fiduciaries, who charge an asset-based fee) have not been subject to the principal trading restrictions in the Investment Advisers Act or the broader prohibited transaction provisions in Section 406(b) of ERISA. As a result, retirement investors who have selected brokerage accounts have been able to buy securities from and sell securities to broker-dealers; purchase certificates of deposit, government securities, corporate bonds, IPO's, secondary public offerings, and other investments even though they are sold on a dealer basis; and paid lower transaction fees because of the multiple streams of income (such as mutual fund 12b-1 fees) that broker-dealers receive from other sources. If the Department changes the standards and subjects normal transactions with broker-dealers to the prohibited transaction provisions in Section 406(b), much of this would be prohibited. As a result, retirement investors would generally be barred from purchasing securities

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[2] We recognize that ERISA includes several statutory exemptions and that the Department has issued a variety of class exemptions that may be relied upon to avoid prohibited transactions in fiduciary accounts. The detailed conditions for most of them, however, and the fact that they cover only limited financial products and are not available to permit principal trading limit their usefulness in continuing a commercially viable brokerage relationship with retirement plan customers under the proposed rule. We believe that if the Department chooses to go forward with its rule proposal, it should first issue comprehensive and commercially reasonable exemptions from the prohibited transaction provisions to preserve customer choice of investment alternatives and account alternatives.

[3] "Study on Investment Advises and Broker-Dealers," at 46-80, 80-83, and 88-91. For example, broker-dealers have to register through a Form BD that requires an detailed information about the broker-dealer, its owners and other controlling persons; they are required to "deal fairly" with their customers consistent with the standards of the profession; they must "observe high standards of commercial honor and just and equitable principles of trade;" they may not engage in deceptive conduct; they are subject to conflict of interest disclosure requirements including disclosing when they are acting as a principal with respect to a recommended security; they are prohibited from providing gifts or gratuities to employees of another person to influence the award of securities business; they can only make recommendations that meet prescribed suitability standards; they have obligations of due diligence; they can only charge "fair prices;" they are required to achieve "best execution;" their communications with the public must be fair and balanced; they are required to maintain and be able to promptly produce prescribed books and records; they must meet financial responsibility requirements such as maintaining minimum amounts of liquid assets and having strong procedures for safeguarding customer funds and securities; and they are subject to elaborate supervisory and compliance requirements, as well as regular inspections by securities regulators.

[4] SEC Study at 99.

that can often only be purchased on a principal basis – including certificates of deposit, many bonds, IPOs, secondary offerings, and alternative investments.

ANALYSIS

UBS opposes adoption of the rule as proposed for the following reasons:

First, by subjecting ordinary transactions with broker-dealers to the prohibited transaction provisions of ERISA, the Department would severely circumscribe investment opportunities for IRAs and other retirement investment vehicles. As the SEC Staff observed in its study, broker-dealers typically offer a variety of products in which they act as principal. Thus, they may offer to both retirement and non-retirement accounts:

> a variety of dealer (*i.e.,* principal) services and products to retail customers, including, but not limited to: selling securities (such as bonds) out of inventory; buying securities from customers; selling proprietary products (*e.g.,* products such as affiliated mutual funds, structured products, private equity and other alternative investments); selling initial and follow-on public offerings; selling other underwritten offerings; acting as principal in Individual Retirement Accounts; acting as a market maker; and otherwise acting as a dealer. Broker-dealers may offer solely proprietary products, a limited range of products, or a diverse range of products.
>
> In addition to these broker and dealer activities, broker-dealers often provide ancillary services, such as lending, bill paying, cash sweeps, and debit cards. Broker-dealers may also refer investors to affiliates for non-securities related financial offerings, such as mortgages, insurance, credit cards or bank deposits.[5]

If routine transactions with broker-dealers are subject to the prohibited transaction provisions, however, then many of these transactions would be prohibited and retirement plan investors would be denied access to a huge number of investment opportunities and services now available to them. This would apply to plain vanilla debt products, like certificates of deposit, government securities, and corporate bonds, as well as to IPOs, secondary offerings, and many other securities. As set forth in the SEC Study:

> [T]he debt market is a dealer market and the costs associated with purchasing certain securities, particularly less liquid securities, as agent, may increase execution costs for some investors, namely those customers of broker-dealers who otherwise had maintained inventories of such securities.[6]

Moreover:

> [A]ny self-imposed restrictions on selling securities out of firm inventory, as chosen by the broker-dealer with the aim of avoiding conflicts of interest and adhering to a new standard, may increase costs to retail investors. If, as a result of such restriction, firms decide not to sell securities as principal that can potentially lower the quality of execution of transactions. As a result of any new conflicts of interest restriction, broker-dealers may stop trading on a principal basis in certain securities, such as bonds that are not exchange traded, potentially depriving investors of the best possible execution.[7]

The proposed rule, by subjecting ordinary dealer transactions to the prohibited-transaction provisions in ERISA, would produce the very consequences that led the SEC Staff to recommend *against* subjecting such transactions to the principal trading restrictions in the Investment Advisers Act.

Second, because it would not be economical for broker-dealers to service commission-based retirement accounts in which principal trading and multiple revenue sources were prohibited, they would be strongly incented to offer services to retirement plans only in advisory accounts with asset-based fees. While

[5] SEC Study at 10.
[6] SEC Study at 161.
[7] SEC Study at 159-60.

appropriate for many investors, asset-based fees can be far more expensive for buy and hold accounts or other accounts that have only a small number of transactions.

The SEC Staff, in its study, stated that one of the reasons it chose not to prohibit principal transactions involving broker-dealers is that it wanted to preserve investor choice with regard to "how to pay for these services and products (*e.g.*, by preserving commission-based accounts, episodic advice, principal trading and the ability to offer only proprietary products to customers").[8] It stated that imposing the requirements of the Advisers Act, whose principal trading restrictions are less restrictive than the prohibited transaction provisions in ERISA, would have an adverse impact on "how investors pay for these products and services ...."[9] For example, "to the extent that accounts were converted from commission-based accounts to fee-based accounts, investors would become susceptible to higher costs in certain circumstances, depending on how the broker-dealers elected to re-price their service."[10] Likewise, "if, in response to the elimination of the broker-dealer exclusion, broker-dealers elected to convert their brokerage accounts from commission-based accounts to fee-based accounts, certain retail customers might face increased costs, and consequently the profitability of their investment decisions could be eroded, especially accounts that are not actively traded, *e.g.*, fee-based accounts that trade so infrequently that they would have incurred lower costs for the investors had the accounts been commission-based."[11]

Ultimately, after months of consideration and the receipt of more than 3,000 comments, the SEC Staff recommended a standard that was designed to "minimize cost and disruption and assure that retail investors continue to have access to various investment products and choice among compensation schemes to pay for advice."[12] While we recognize that the Department needs to reach its own independent conclusion regarding what is in the best interest of investors in retirement accounts, we are hopeful that further analysis will demonstrate that it is not in the best interests of retirement investors to greatly restrict their choices with regard to both investment products and compensation alternatives.

<u>Third</u>, equally damaging to retirement investors, the Department's proposed rule would encourage some firms to stop giving advice altogether to small retirement plan accounts and require such accounts to completely self-direct their accounts in order to avoid being subject to ERISA's prohibited transaction provisions. That too would be damaging rather than beneficial to investors.

The median 401(k) account balance at year-end 2009 was $59,381.[13] In 2010, households owning IRAs for 20 years or more (and thus having relatively greater account balances than the general IRA owning population) had median account balances of $87,500. That number dropped to $30,000 for households owning IRAs for 10 to 19 years, and $18,000 for households owning IRAs for less than 10 years.[14] Investment advisory accounts may not make sense for accounts with assets in this range and firms may not want to offer investment advisory accounts for such limited account balances in any event.

The need for investment assistance even for small accounts is unquestioned. The Department itself has acknowledged that plans and plan participants need help with plan investments. As importantly, plan sponsors and plan participants themselves recognize, and have urgently sought, such help. Under defined contribution plans, moreover, the need for investment assistance doesn't end with retirement. Participants need help in deciding how to spend their retirement savings and how to manage those savings over a potentially long retirement period. These problems are particularly significant now, as the large number of baby boomers near retirement. Adopting a rule that incents firms to provide no advice disserves the very investors that the Department is trying to protect.

[8] SEC Study at 113.
[9] SEC Study at 144.
[10] SEC Study at 151-52.
[11] SEC Study at 152.
[12] SEC Study at 166.
[13] Investment Company Institute, 401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2009 (2010), *available at* http://www.ici.org/pdf/per16-03.pdf.
[14] Investment Company Institute, The Role of IRAs in U.S. Households' Saving for Retirement, 2010 (2010), *available at* http://www.ici.org/pdf/fm-v19n8.pdf.

Fourth, the application of the prohibited transaction provisions of ERISA to IPO's and secondary offerings will inhibit capital formation, which has been a critical engine of growth for the U.S. economy almost since its birth. As discussed above, retirement assets represent nearly a third of the total household wealth in the United States, and IRA accounts are the largest segment of retirement assets. To put this in perspective, last year IPO volume totaled $269 billion and follow-on offerings totaled $496 billion.[15] If trillions of dollars of assets become subject to the prohibited transaction provisions of ERISA and are suddenly disqualified from being invested in new and innovative companies seeking to raise capital, then both retirement investors and the economy will suffer.

Fifth, the application of the prohibited transaction provisions of ERISA appears to have played no significant role in the Department's motivation underlying the rule. The rule proposal itself focuses principally on the difficulty the Department has had in proving that lightly regulated appraisers and pension consultants (neither of whom are broker-dealers) are fiduciaries. It contains no analysis of the impact of the prohibited transaction provisions on broker-dealers or their clients under the proposed rule. In the on-the-record conference call with Assistant Secretary of EBSA Phyllis Borzi on the impact of the proposed rule, Ms. Borzi was specifically asked (towards the end of the call) to comment on the concern that if the rule were adopted, broker-dealers would stop providing investment advice to IRA's and other retirement accounts. She responded:

> If it dries up the schlocky advice that we're getting, I don't have a problem with that. People who are giving good solid advice, they don't have anything to worry about because they will be fulfilling their fiduciary duties.

We are as opposed to bad advice as the Department is and there are already powerful remedies under federal and state law against broker-dealers who provide it. The problem is that because of the application of the prohibited transaction provisions in ERISA, the proposed rule, if adopted, would have a very damaging effect on investors and fiduciaries regardless of whether broker-dealers are giving good solid advice. We believe that was not the Department's intent, but it would be the clear effect of the proposed rule because of the way the prohibited transaction provisions would be applied to ordinary broker-dealer transactions.

Sixth, we are concerned about the apparent lack of serious coordination between the SEC and the Department as they seek to address the critically important issue of what fiduciary standards, if any, should be applied to broker-dealers. Investors with retirement assets are central to the mission of both the SEC and the Department. The SEC Study, which involved a massive effort by the agency, led to conclusions that are diametrically opposed to the Department's rule proposal. We recognize that the Department needs to reach its own independent conclusions about how best to protect retirement investors. Nevertheless, retirement investors and those who help them with those investments should be entitled to a fully coordinated approach on issues of this magnitude.

Finally, while the Department might have intended the so-called "disclosure safe harbor" to provide protection to broker-dealers, as a practical matter it will have no effect whatsoever in mitigating the problems described above. Conceivably a disclosure safe harbor could possibly work if the Department set forth exactly what a broker-dealer had to disclose to avoid the application of the prohibited transaction provisions and such disclosure was practical.

Instead, however, the Department has proposed an exceptionally amorphous standard that places the burden on the broker-dealer to demonstrate the plan participant knows or should know "that the person providing the advice or recommendation in its capacity as a purchaser or seller of a security or other property, or as an agent of, or appraiser for, such purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and the person is not undertaking to provide impartial investment advice."

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[15] Press Release, Thompson Reuters Releases Full-Year 2010 Global Investment Banking Review, Jan. 10, 2011, http://thomsonreuters.com/content/press_room/financial/2011_01_10_investment_banking_review

It is difficult to ascertain what that standard even means in practice, and there is no way a firm could risk liability for engaging in prohibited transactions in the hope that it might one day convince a court that it had satisfied its burden of proving that the disclosure safe harbor had been met.

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CONCLUSION

We applaud and support the Department's effort to enhance investor protection and fully support the best interest standard recently proposed in the SEC Study. Nevertheless, we believe that the standard in the Department's proposed rule will inadvertently have exactly the opposite effect. The proposed rule would actually prohibit an enormous number of transactions, as well as compensation arrangements, that are in the best interests of retirement investors.

We would, of course, welcome the opportunity to help craft a rule that satisfies the Department's objectives without having the adverse consequences described above. For example, the Department could adopt a broad class exemption from the prohibited transaction provisions to avoid these problems. We respectfully urge the Department not to adopt the rule as proposed, however, and indeed not to adopt any rule that would leave retirement investors with significantly reduced investment opportunities, a smaller number of fee structures to pay for the advice that they receive, and a greater risk that investment advice will be unavailable to retirement investors with modest assets.

Very truly yours,

Jonathan Eisenberg

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