AMERICAN BENEFITS COUNCIL

February 3, 2011

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: RIN 1210-AB32, Definition of Fiduciary Proposed Rule

Dear Sir or Madam:

On behalf of the American Benefits Council (the "Council"), I am writing today with respect to the proposed regulations addressing the definition of a fiduciary.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

The Council has requested to testify at the hearing scheduled for March 1, 2011 and, if necessary, March 2, 2011. We thank the Department of Labor (the "Department") for scheduling the hearing and for extending the comment period. We believe that those were important steps in ensuring a full public policy dialogue with respect to this critical proposed regulation.

We understand the desire of the Department to update and improve the regulatory definition of a fiduciary. We agree that the retirement community would benefit from rules that establish clear lines between fiduciary advice, on the one hand, and non-fiduciary education, marketing, and selling on the other hand. However, we believe that the proposed regulations create too broad a definition of fiduciary. As discussed in more detail below, we are very concerned that an overly broad definition would actually have a very adverse effect on retirement savings by raising costs, inhibiting investment education and guidance for plans and participants, and significantly shrinking the pool of service providers willing to provide such investment education and guidance.

We know that the Department does not have any intent to create an overly broad definition that would adversely affect retirement savings or trigger burdensome and unnecessary costs that will be borne in whole or in part by participants. Accordingly, we look forward to a very constructive dialogue on the critical issues raised by the proposed regulations.

Defined contribution plan participants and individual retirement account or annuity ("IRA") owners have generally been given the opportunity and responsibility to make their own investment decisions and to design their own path toward retirement security. This is an enormous challenge for individuals who are not investment professionals and may not be familiar with the investment markets. The public policy challenge is how to facilitate participant education and engagement with respect to effective investment strategies, while at the same time protecting participants from misleading self-interested advice. Finding a balance between these two goals should, in our view, be the core objective of the new definition of a fiduciary.

Moreover, as discussed further below, it is essential that the Department's proposed regulations be coordinated with guidance issued by the Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority regarding the standard of conduct applicable to brokers and dealers. Without coordination, brokers and dealers would be subject to different and conflicting standards with respect to the same advice, reducing their ability to provide clear sound advice to participants.

The proposed regulations would also pose great challenges for defined benefit plan sponsors seeking investment information and valuation services. In particular, it is critical that the proposed regulations be coordinated with specificity with the Commodity Futures Trading Commission's "business conduct" regulations regarding swaps; without clear coordination, the Department's regulations could render swaps unavailable to plans, with devastating results.

The importance of coordinating among Federal agencies has recently been strongly emphasized by the President in a January 18, 2011 Executive Order:

> Some sectors and industries face a significant number of regulatory requirements, some of which may be redundant, inconsistent or, overlapping. Greater coordination across

> agencies could reduce these requirements, thus reducing costs and simplifying and harmonizing rules. In developing regulatory actions and identifying appropriate approaches, each agency shall attempt to promote such coordination, simplification, and harmonization.

Finally, as discussed below, we strongly urge the Department to provide broad transition relief to avoid significant disruption of the retirement plan world.

Because of the length of this letter, a table of contents is provided below:

ENSURING THE CONTINUED AVAILABILITY OF INVESTMENT EDUCATION AND GUIDANCE AND SERVICES TO RETIREMENT PLANS.

The Department's regulations could have very significant effects on the provision of services to plan sponsors, and on the provision of investment education and guidance to plans, plan participants, and IRA owners. In this regard, the regulations could cause certain established means of providing such services, education, and guidance to cease, which could leave plans and participants with less access to investment education and guidance. That is clearly undesirable.

We have the following recommendations with respect to avoiding this result:

> **Substantive modifications.** There are certain modifications to the proposed regulations that would be consistent with the Department's objectives but would not unnecessarily disrupt established and successful

means of providing investment education and guidance. The remainder of this letter addresses those issues.

Effective date. The regulations are proposed to be effective within 180 days of finalization. That is not enough time. These regulations could cause portions of the investment advice industry to be restructured or eliminated. For example, in some cases, advisors may need to alter the type of education and guidance they provide or possibly eliminate certain services in order to avoid fiduciary status. These advisors will need significant training. In other cases, advisors will become fiduciaries, and this may require restructuring their compensation packages, as well as the fee structures of their employer. Even if existing agreements are grandfathered (as discussed below), new agreements regarding investment services will need to be developed. And potentially far more entities and persons will need to be insured as fiduciaries. All of this requires a substantial amount of time, especially at a time when administrative frameworks and systems are being strained by adjustments to broad new disclosure regimes. A transition period of at least 12 months following finalization of the regulations (and implementation of any necessary prohibited transaction exemptions) is critical to avoid periods when investment information is materially less available for plans and IRAs.

In addition, we urge the Department not to disrupt existing agreements. For example, a plan sponsor may have an existing agreement with a consultant to provide non-fiduciary investment information regarding the plan's investment options as well as other investment options that could be offered to plan participants. It would be very disruptive to cause that agreement to be terminated prior to its expiration by reason of the fact that the new rules would transform the arrangement into a fiduciary relationship. It may not be possible to renegotiate a different agreement under the new rules with the same service provider; it may even be the case that for a period of time, no service provider is prepared to provide services under the new rules. In this context, the forced termination of existing arrangements would certainly not be appropriate.

Other existing arrangements may raise even more difficult problems. For example, swap agreements set out long-term financial and contractual obligations that cannot be modified without extensive and expensive renegotiations. The proposed regulations have great potential to force such renegotiations by, for example, treating certain valuations under typical agreements as fiduciary advice, which would, in turn, trigger prohibited transaction issues and termination provisions in swap agreements.

We are still gathering information on the extent of the adverse effects on existing arrangements, but what we have uncovered to date convinces us that there is a great need not to disrupt existing arrangements that may be very difficult to modify or replace, especially in the short term.

Coordination with other guidance. If certain established means of providing investment information cease to be workable, members of the retirement plan community will be looking for alternative means of providing such information. In this regard, it is critical that all available tools be ready and available when investment information delivery systems are being redesigned. This means that the finalization of the proposed regulations should be coordinated with other rulemaking that could affect investment information delivery systems. For example, the proposed regulations implementing the prohibited transaction exemptions under the Pension Protection Act of 2006 (the "PPA") should be finalized at least 12 months before the effective date of the fiduciary definition regulations, so that during the 12-month period, the plan community can explore whether use of the exemptions can provide a workable way to provide investment information.

It is important that the Department clarify that all currently applicable prohibited transaction exemptions would remain in effect. In that regard, if the Department is planning, in light of the regulation, to revisit any exemptions affecting the investment advice area, it is critical that this be coordinated with the finalization of the fiduciary definition regulations, so that all available means of providing investment information can be evaluated prior to the effective date of the new rules.

Coordination with the SEC is very important, as discussed further below. If the Department's regulations are finalized and effective at a time when broker/dealers' obligations under the securities laws are not settled, this will result in broker/dealers being unable to redesign their investment information delivery systems due to ongoing uncertainty. This could have a devastating effect on the availability of investment information from broker/dealers, which traditionally have been a very important source of such information, especially for small businesses and IRA owners.

Coordination with the CFTC and the SEC regarding swaps is also critical. If the Department's proposed regulations and the CFTC's proposed business standards were finalized in their current state, plans would effectively be forced to cease using swaps, with devastating results, as discussed further below.

<u>CLARIFICATION OF THE BASIC DEFINITION OF "FIDUCIARY".</u>

<u>Individualized Specific Advice Should be Required in All Cases.</u>

<u>In general.</u> We are very concerned that the furnishing of investment recommendations may, under the proposed regulations, be treated as a fiduciary act even if the recommendations are not specific or individualized. For example, assume that an investment adviser (within the meaning of section 202(a)(11) of Investment Advisers Act of 1940) ("Investment Adviser") provides a firm newsletter to an IRA owner customer. The firm newsletter provides a discussion of the general market outlook, including a discussion of which industry sectors may be gaining or losing strength in the near future.

Arguably, the newsletter is providing recommendations regarding the "advisability of investing in, purchasing, holding, or selling securities." If so, the newsletter would appear to be fiduciary advice under the proposed regulation since (1) the newsletter is provided to an IRA owner, (2) the newsletter is provided by an Investment Adviser, (3) the newsletter does not appear to be covered by any of the "limitations" in § 2510.3-21(c)(2), and (4) compensation, such as brokerage commissions, would be earned in connection with purchases or sales of securities. Furthermore, under the proposed regulations, affiliates of the Investment Adviser' employer would also appear to be fiduciaries with respect to the matters addressed in the newsletter.

Clearly, the newsletter should not be treated as fiduciary advice. The newsletter is simply an effort to educate and engage individuals with respect to market trends. Such education should not be inhibited and we do not believe that the Department intended this result. (Of course, if a newsletter were sold that provides specific investment advice on particular investments that participants should buy or sell within a specific plan, the newsletter should be treated as fiduciary advice.)

The proposed regulations should be clarified so that in order to constitute fiduciary advice, recommendations must in all cases (1) be individualized to the needs of the plan, plan fiduciary, or participant or beneficiary, and (2) address the purchase, sale, or holding of specific securities, rather than market trends or asset allocations. This should apply in the case of subclauses (A), (B), and (C) of § 2510.3-21(c)(1)(ii), in addition to applying for purposes of subclause (D).

<u>Interaction with Interpretive Bulletin 96-1.</u> Without the clarification described above, the meaning of Interpretive Bulletin 96-1 ("IB 96-1") would be cast into doubt. It is true that the proposed regulations specifically provide that the provision of investment education and materials within the meaning of IB 96-1 does not give rise to fiduciary status. But IB 96-1 has generally been read to permit education about investments that does not involve individualized advice regarding specific securities.

The proposed regulations would call that interpretation into question by clearly implying that at least some non-individualized non-specific market guidance can constitute fiduciary advice.

If finalized in their current form, the proposed regulations would thus put a significant chill on investment education. Any non-individualized investment education that is not precisely addressed in IB 96-1 would be called into question and thus may cease to be provided. This would have a very adverse effect on critical educational tools currently in effect, leaving participants with far less information, especially low and middle-income participants who may not be able to afford to acquire investment assistance elsewhere. In addition, this structure will clearly stifle any future innovation with respect to investment education, such as the application of IB 96-1 to plans (in addition to plan participants) as discussed below. We do not believe that the Department intended these results, which can be avoided by clarifying the regulations in the manner recommended above.

<u>Fiduciary Relationship: "May Be Considered" is Too Low a Threshold to Trigger Fiduciary Duties and Liabilities</u>

As discussed above, recommendations should be fiduciary advice only if individualized and specific. However, that alone is not enough. For example, assume that a plan participant has done extensive research and consulted with an advisor, and has decided tentatively to invest in a group of mutual funds available under the plan. As a last-minute check, the individual asks a friend in the employer's human resources department if the participant's fund selections make sense for an individual in his situation. The human resources employee says she is not an expert but the choices make sense to her and are consistent with what many others are doing. Under the regulation, that reaction may be investment advice if the human resources employee is compensated in part for dealing with plan-related questions.

Alternatively, instead of calling the human resources employee, the employee calls a friend who is an Investment Adviser of an affiliate of the financial institution offering some of the funds under the plan. The Investment Adviser has nothing to do with the plan and his affiliate operates completely independently of the institution offering some of the plan's funds. The Independent Adviser says that he cannot give the participant investment advice, but the choices seem generally appropriate for someone in the participant's position. That reaction is clearly investment advice under the proposed regulations (and would thus be a prohibited transaction).

These examples are not real investment advice. These are situations where individuals receive very incidental comfort regarding decisions made independently by them. Yet the proposed regulations would turn this into investment advice that triggers personal liability and, in the case of the Investment Adviser, a prohibited transaction. This is not the right result.

A fiduciary relationship should not be treated as existing unless:

> There is a mutual understanding that the recommendations or advice being provided in connection with a plan or IRA:
> (1) will play a significant role in the recipient's decision-making, and
> (2) will reflect the considered judgment of the adviser.

The "may be considered" standard is such a low threshold that almost any casual discussion of investments will satisfy it. An ERISA fiduciary relationship is a very serious relationship with the highest fiduciary standard under the law, including (1) application of the prudent expert standard, (2) a duty to act solely in the interest of the participants and beneficiaries, and (3) very significant potential liability. In that context, fiduciary status should not be triggered by casual discussions but only by serious communications that reflect a mutual understanding that an adviser/advisee relationship exists.

Thus, we urge the Department to replace the "may be considered" standard with the standard described above. Moreover, no recommendations should be treated as giving rise to fiduciary status unless such recommendations meet this standard. Thus, this standard should be a part of subclauses (A), (B), and (C) of § 2510.3-21(c)(1)(ii), in addition to being part of subclause (D).

Requiring Individualized Specific Advice and Raising the "May Be Considered" Threshold Would Address Other Concerns.

A number of concerns have been identified regarding the proposed regulations' "status" rules under which an adviser may, for example, become a fiduciary by reason of being a fiduciary for another purpose, an Investment Adviser, or in some cases an affiliate of an entity that meets one of these "status" requirements. (If the Investment Adviser "status" rule is retained, it should be clarified that the exclusions under section 202(a)(11) of the Investment Advisers Act of 1940 apply in determining who is an Investment Adviser for purposes of the regulation.) For example, if a financial institution serves as a directed trustee, any discussion of the market by an affiliate of the financial institution, however benign the discussion, could arguably be treated as fiduciary advice under the proposed regulations solely by reason of the conceptually irrelevant point that the affiliated financial institution serves as a directed trustee. This inappropriate result is avoided if the proposed regulations are modified, in accordance with the suggestions set forth above, to provide that advice is treated as giving rise to fiduciary status if and only if:

(1) There is a mutual understanding that the recommendations or advice being provided in connection with a plan or IRA:
    (a) will play a significant role in the recipient's decision-making, and
    (b) will reflect the considered judgment of the adviser, and
(2) The recommendations or advice is individualized to the needs of the plan, plan fiduciary, or participant or beneficiary.

Thus, proposed regulation § 2510.3-21(c)(1)(ii) should be revised so that a person cannot be a fiduciary by reason of providing investment advice unless the person's recommendations or advice satisfies the above requirements.

"Management of Securities or Other Property": the Proposed Regulations Would Transform Contract Reviews and Other Non-Investment Advice Into Investment Advice.

The proposed regulations would include within the definition of "investment advice" the following: "advice…or recommendations as to the management of securities or other property." The preamble states that:

> This would include, for instance, advice and recommendations as to the exercise of rights appurtenant to shares of stock (e.g., voting proxies), and as to selection of persons to manage plan investments.

The broad language of the proposed regulations raises many questions:

- A plan decides to change trustees, chooses a new trustee, and begins negotiating a trust agreement with the new trustee. The plan asks for advice with respect to the terms of the trust agreement from the plan sponsor's internal and external ERISA and contract attorneys, as well as the plan sponsor's compliance personnel, human resources department, and tax department. The trustee is involved in the "management" of plan assets, and the terms of the trust agreement affect that management. Does that mean that all of the above personnel advising the plan with respect to the trust agreement are fiduciaries? If it does, the cost of trust agreements and many other routine plan actions will increase exponentially with the imposition of new duties and large potential liabilities. Also, many of the above persons may refuse to work on the project without a full indemnification from the plan sponsor. We do not believe that this type of cost increase and disruption was intended.

  What about the persons working on the agreement for the new trustee? If such persons make any "recommendations" to the plan in the course of negotiations, they would become fiduciaries because the seller exemption, on its face, only appears to apply to sales of property and not services. Any such recommendations would thus trigger fiduciary status and corresponding prohibited transactions. Theoretically, this could chill all meaningful give-and-take during the negotiations, and many institutions may be unwilling to act as trustee. Again, we do not think that this was intended.

- A plan has decided to enter into a swap and must execute a swap agreement. The terms of the swap agreement will have a significant effect on the plan's rights with respect to the swap. The plan asks its internal and outside securities counsel to work on the swap agreement, and to consult with the plan's internal and outside ERISA counsel. The plan also asks its investment manager for input on the types of provisions that are important for plans to include (or exclude) in swap agreements. The plan accountant is also asked to review the agreement. Finally, the company's own compliance personnel, contract experts, and finance department also review the agreement.

  The terms of the swap agreement affect the "management" of the swap. So do all of the above personnel become fiduciaries under the proposed regulations? If the answer is yes, plans' cost of investments will skyrocket, as an enormous new set of individuals and companies that have little material role in plan investments become fiduciaries, with far greater potential liability and a higher standard to meet. In addition, as noted above, many persons would likely refuse to review the agreement absent a full indemnification by the plan sponsor.

- A plan negotiates a loan agreement in connection with an ESOP. Is everyone who works on the loan agreement a fiduciary? Could individuals working on the loan agreement for the lender become fiduciaries if they make any "recommendations" during negotiations?

- Are Board recommendations regarding proxy voting on employer securities a fiduciary act? They could be under the proposed regulations.

To avoid the inappropriate results described above and many other similar results, we strongly urge you to provide a precise and appropriately narrow definition of "management" in the regulations. Under the definition, "management" would include:

- The selection of persons to manage investments;
- <u>Individualized</u> advice as to the exercise of rights appurtenant to shares of stock; and
- Any exercise of discretion to alter the terms of a plan investment in a way that affects the rights of the plan, unless such exercise of discretion has been specifically reviewed and agreed to by a plan fiduciary. In the swap context, for example, swap terms can be modified without plan review and consent by, for example, swap data repositories. If any such changes are made, anyone making

those changes is acting for the plan and should be treated as a fiduciary. Moreover, such treatment is necessary in order to prevent harm to the plan.

This would target the actions identified by the Department in the preamble and would give the Department the flexibility to identify additional forms of "management". But it would not have the inappropriately broad consequences illustrated above.

Even Without the Management Issue, the Proposed Regulations Would Transform Legal Advice and Other Non-Investment Advice Into Investment Advice.

Assume that the definition of "management" is revised in accordance with our suggestion. Let us go back to the swap example set forth above.

- Assume that ERISA counsel advises the plan that entering into a swap with the particular dealer would raise prohibited transaction issues and counsels the plan not to enter into the swap for that reason. Under the proposed regulations, that would clearly constitute investment advice, making the ERISA attorney a fiduciary.
- Assume that the plan sponsor's contract experts determine that, separate from any investment issue, the swap agreement gives the dealer too much discretion in interpreting critical terms and advises the plan not to enter into the swap. That internal contract expert would be rendering investment advice under the proposed regulations and thus would also clearly be a fiduciary.
- Assume that the plan sponsor's compliance personnel are concerned about whether the swap, as structured by the dealer, would comply with the law and advise the plan not to enter into the swap for that reason. Again these internal compliance personnel would be rendering investment advice under the proposed regulations and thus would be fiduciaries.

These inappropriate results can be avoided by adding an additional exception to the regulations. Under this exception, advice would not be treated as investment advice if it relates to the compliance of the investment with applicable law or relates to risks separate from the advisability of the underlying investment.

Clarity: Permitting the Parties' Agreement to Clarify Fiduciary Status.

Both plan sponsors and service providers have emphasized to the Council the importance of clarity with respect to who is and who is not a fiduciary. We know that similarly this is an important issue for the Department. In this regard, we remain concerned that, even with our suggested changes, it would be difficult in many circumstances to determine whether a fiduciary relationship exists.

Accordingly, we recommend that the regulations provide that a service provider, adviser, or appraiser is not a fiduciary if the parties agree in writing to that effect. (This rule would apply separately from, and in addition to, the seller exemption.) We also propose the following safeguards be adopted as part of the rule we are suggesting:

- The agreement would have to describe the type of advice that the parties agree is not fiduciary advice. For example, assume that a plan uses a particular investment manager ("Manager A") for Pacific Rim investments. The agreement could provide that any advice not related to Pacific Rim investments is not fiduciary advice.
- The agreement would also have to describe how the decisions on which the non-fiduciary advice may be given would be made. Under the agreement between Manager A and the plan, for example, Manager A agrees to be available to discuss investment opportunities outside the Pacific Rim, but the agreement specifies that the plan relies on different investment managers with respect to such other investments. The plan wants Manager A to be available as a sounding board and as a source of questions for the other investment managers, but the plan does not make such other investment decisions based on Manager A's advice. In these circumstances, Manager A would not be a fiduciary with respect to the advice it renders regarding such other investments.
- Similarly, if a swap counterparty provides information to a pension plan as required by the terms of a financial instrument or if requested by a fiduciary to a pension plan prior to entering into a financial instrument, the fiduciary to the a pension plan and the counterparty should be able to agree that the plan is relying on other advisors and that counterparty is not a fiduciary to the pension plan.

On a separate but related point, we urge the Department to clarify that an advisor is not treated as having acknowledged fiduciary status under Proposed Regulations § 2510.3-21(c)(1)(ii)(A) unless such acknowledgement is made in writing. Clarity with respect to fiduciary status is critical, and the regulations should not make fiduciary status turn on oral, informal discussions.

<u>Plan-Level Education: Application of IB 96-1.</u>

We believe that there is no legal or conceptual reason why the principles of IB 96-1 regarding investment education should not be extended to defined benefit and defined contribution plans. The provision of investment education to defined benefit and defined contribution plan fiduciaries should not give rise to fiduciary status.

<u>Plan Sponsor and Advisor Employees: Who Should Be a Fiduciary?</u>

By very significantly lowering the threshold for fiduciary status, the proposed regulations raise serious questions regarding which plan sponsor and advisor employees may be treated as fiduciaries. For example, it is, of course, common for a plan sponsor to form a committee of senior executives to oversee plan issues, including plan investment issues. It is certainly clear that such committee has fiduciary status. But plan sponsors have expressed concern about the status of other employees who perform the research and analysis necessary to present investment issues for the committee's review and resolution.

Such other employees may provide recommendations for the committee to consider. This is simply how companies work. Middle-level employees frame issues for senior employees to resolve; issues are best presented in the context of a recommendation based on the advantages and disadvantages of any decision, so that senior employees can quickly appreciate the relevant factors. Many employees may participate in the research and the preparation of the recommendations to the committee. If all of these employees were fiduciaries, the effects would be severely negative.

- The cost of fiduciary insurance would skyrocket, if such insurance would be available at all for such employees.
- It would certainly become more difficult to get employees to work on these projects in the face of potentially staggering liabilities and lawsuits.
- Creative work and recommendations would likely be stifled as middle-level employees propose conservative approaches with less downside (and correspondingly less upside).

The bottom line is that the employees preparing the reports for the plan committee are not the decision-makers. They are the researchers who prepare recommendations based on objective criteria for the committee members to evaluate and resolve. And the proposed regulations could potentially sweep in a huge number of employees, since the middle-managers formulate their recommendations based on the work of employees who in turn work for them.

As noted, this issue applies to third-party advisors as well as to plan sponsors. Recommendations by advisors may be formulated by a team of employees employed by the advisor. It would not make sense to treat the entire team of individuals as fiduciaries.

Accordingly, we ask that you clarify the regulations to address the situation where a company or committee within a company serves as a fiduciary with respect to investment decisions or recommendations. In that case, the employees who help the company or committee make those decisions or recommendations should not be fiduciaries. Otherwise, we could have a real problem as potentially hundreds of employees without decision-making power become fiduciaries. This is not to suggest that employees of a fiduciary company cannot be a fiduciary. For example, an advisor company's employee may have the advisory relationship with a plan or participant and may become a fiduciary by reason of that relationship. Or an employee newsletter might be sold to the company employees making very specific recommendations regarding the investments available under the company's plan in which the employees should invest. But these cases are different. In these cases, employees involved are making direct investment recommendations that are not filtered through supervisors or entities that are fiduciaries.

SELLER/PURCHASER EXEMPTION.

Scope of the Exemption.

The deletion of the "regular basis" and "primary basis" requirements from the existing regulation puts enormous pressure on establishing a workable distinction between selling and advice. If a one-time recommendation can give rise to fiduciary status, it is essential to distinguish between fiduciary recommendations and the selling of investment products or services. In both cases, the participant or plan is provided with in-depth recommendations regarding investment decisions. But clearly in the case of selling, there is no fiduciary relationship nor would the commercial world be workable if such a fiduciary relationship were imposed.

Thus, we applaud the Department for including an exemption for persons acting as, or on behalf of, purchasers or sellers. However, it is critical that the scope of this exemption be clarified. Consider, for example, the following situations:

- A plan offers 40 mutual funds sponsored by fund families X, Y, and Z, as well as target date funds sponsored by fund families X and Y. A representative of X meets with a participant to promote her firm's target date funds. The representative makes all appropriate disclosures regarding her self-interest. The recommendations made by the representative seem clearly covered by the proposed seller exemption, as they should be.
- Same plan as above. A representative of Z meets with a participant and provides the participant with an illustrative portfolio consisting of Z funds. This representative also makes all the appropriate disclosures and recommends the illustrative portfolio as better than X and Y's target date funds. This recommendation should clearly be covered by the seller exemption. Otherwise, the law would be, without justification, favoring target date funds over a group of funds that can perform the same function.
- Same plan. An Investment Adviser with a commercial relationship with Y meets with a participant to promote Y's target date funds. The Investment Adviser states in writing that she receives compensation for selling Y's funds, and makes all other appropriate disclosures. Again, the proposed seller exemption should clearly cover this arrangement. The Investment Adviser discloses the compensation arrangement with Y and makes all other appropriate disclosures necessary to alert the participant to the Investment Adviser's self-interest. There is no reason for such an arrangement not to be covered by the seller exemption.

- Pursuant to an RFP, a plan interviews three investment consultants to review the plan's mutual fund offerings on an ongoing basis. As part of the interview process, the plan asks all three to come prepared with a review of the plan's current offerings, together with recommendations for any changes. This is a very common part of the RFP process and it should be clarified that responses to RFPs (and similar marketing initiatives) do not constitute fiduciary advice.
- IRA account. A representative of Z (a financial institution) meets with a client who indicates that he would like to roll over his section 401(k) account plan balance to an IRA. After discussing the client's goals and assets, the representative of Z recommends that the client open an IRA custodial account with specific investments. The representative not only recommends products manufactured by Z but also by firms Y, X and V with whom Z has selling agreements. The representative makes all appropriate disclosures regarding her self-interest. All of these recommendations should be covered by the proposed seller exemption. The fact that Z makes other firms' investments available (i.e., an "open architecture firm") versus solely its own manufactured products should not affect the analysis. Both open architecture firms and those that only sell their own proprietary products should be able to avail themselves of the seller's exemption with the appropriate disclosures.
- A pension plan fiduciary is contacted by an investment bank to discuss potential trades with the investment bank as a counterparty, the investment bank provides information in advance of the trade to the pension plan fiduciary. The parties agree in writing either at the establishment of the counterparty relationship, or in the terms of the trade, that the plan fiduciary (and not the investment bank) is the fiduciary to the pension plan with respect to any dealings with such investment bank and that any information provided by the investment bank is not provided on a "fiduciary" basis to the pension plan. The information provided to the plan fiduciary should not be viewed as a "recommendation" or "investment advice" even if specific to the pension plan. Instead, the parties should be able to rely on the investment expertise of the plan's investment manager, and not the investment bank counterparty which clearly has a conflict of interest. Otherwise, dealers will either refuse to deal with pension plans and plan fiduciaries or provide only "generic" information to potential pension plan counterparties which will put pension plan fiduciaries at an information disadvantage.
- A defined benefit plan asks an asset manager for information regarding liability-driven investing. The manager provides white papers it has drafted on the topic and shares some general approaches on how defined benefit plans can implement liability-driven investing. The manager offers its services to the plan fiduciaries, which could be in the form of managing a separate account to a liability benchmark and/or investing in a liability-driven fund offered by the asset manager. It is unclear whether the seller exemption would cover this selling of investment services, but it clearly should if the manager discloses its potential self-interest in the separate account and fund contexts.

We ask the Department to clarify the purchaser/seller exception in accordance with the above discussion. The seller exemption should apply in any case where the entity providing a recommendation has a self-interest in the decision to be made by the plan or participants, and that self-interest is clearly and effectively communicated. Conceptually, it does not make sense to distinguish among sellers of an investment product, providers of an investment-related service, and any other entities that have a financial interest in the decision made by the plan or participant. The fundamental principle is clear: any person with an interest in an investment decision to be made by a plan or participant should be entitled to promote products and services as long as such person makes his or her self-interest clear. Any other rule would effectively prohibit marketing, promotion, and selling, which is not ERISA's purpose.

See also the discussion of the seller exemption in the context of distribution advice below.

Disclosure.

Under the proposed regulations, the seller/purchaser exception only applies if 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.* **[emphasis added]**

We have several comments regarding this language. First, the reference to "adverse" interests should be deleted. The relationship between a seller of investment products and an investor is by no means "adverse". The seller's objective is to establish a long-term mutually beneficial relationship. If the investor is not happy with the product or the service or feels somehow misled or taken advantage of, that will result in a short-term relationship and unhelpful word-of-mouth for the seller. It is certainly true that sellers of investment products profit by selling, but that is true of all product and service providers, including doctors, lawyers, counselors, etc. In short, the term "adverse" is inaccurate and unduly negative, and it does not provide the recipient of the disclosure with any meaningful information.

Second, the reference to "not undertaking to provide impartial advice" is not necessarily correct. Sellers may in many circumstances be impartial because their objective is not short-term profits, but a long-term relationship.

In lieu of the "adverse" and "not…impartial advice" references, the proposed regulations should be modified to be more accurate and precise. Regulation § 2510.3-21(c)(2)(i) should be amended by deleting all the words starting with "whose interests are" replacing them with the following:

> who has a financial interest in the transaction to which the recommendation or other information provided relates.

This is an accurate portrayal of the relationship between a seller and investor, much more accurate than the description in the proposed regulations. It would be a disservice to both the seller and the investor to describe their relationship inaccurately.

Finally, we believe that the regulation should make clear that disclosures of the seller/purchaser's relationship to the investor, as described above, should satisfy the "knows or reasonably should know" standard. So if a seller/purchaser were to make the above disclosure in writing, and provide a general description of the financial interest, that should satisfy the seller/purchaser exception.

PLAN MENU OF INVESTMENT OPTIONS.

The proposed regulations would confirm that the offering of a service provider menu of investment options does not constitute fiduciary advice. It should be clarified that this treatment does not turn on the service provider menu meeting any requirements regarding the number or nature of investment options. The critical issue, however, is: how does an employer select a plan menu of investment options from the broader service provider menu? In that regard, the proposed regulations clarify that "the provision of general financial information and data" to assist the employer in selecting a plan menu is not fiduciary advice.

Today, one of our greatest challenges in the retirement security area is broadening the retirement plan coverage among small businesses. It is critical that we step back and consider this proposed rule in that context. Small businesses will generally adopt a retirement plan only if the process is simple and inexpensive. If the process is burdensome, complicated, or costly, small businesses simply will not adopt retirement plans. In this context, imagine the hardware store owner who would like to adopt a plan for his 12 employees. Assume that the service provider presents its menu of 300 investment options, provides objective data regarding all 300, and tells the hardware store owner (1) to decide how many to offer and (2) to pick the right options for his employees, subject to fiduciary liability if he picks imprudently. Alternatively, the hardware store owner can find some independent consultants, interview them, choose one (subject to fiduciary liability), and pay that consultant a substantial amount of money to pick and monitor the plan menu.

Needless to say, if that is the message that the hardware store owner receives, he will not adopt a plan for his employees. So if the rule set forth in the proposed regulations is finalized without further clarification, we may well see a marked decline in retirement plan coverage.

Service providers need a way to provide employers with help in choosing the plan menu so that the process is simple and inexpensive. In this regard, we urge you to treat all of the following as not triggering fiduciary status:

- The service provider may provide the plan fiduciary with objective factors that others commonly use in selecting plan menus, such as fund ratings, past performance (measured against competitive funds), risk measurements, fees, and manager tenure.
- The service provider may screen funds based on objective criteria that are provided by the plan fiduciary or that are commonly used in the industry. For example, if the plan fiduciary establishes criteria based on fund ratings, past performance (measured against competitive funds), fees, risk, and manager tenure, the service provider may screen the available funds based on such criteria and provide the plan fiduciary with fund options that meet the plan fiduciary's criteria. Within each investment category, there would generally be multiple funds for the plan fiduciary to choose from, but in some circumstances, there could be a single fund.
- The service provider may present non-individualized model plan menus that other similar businesses have chosen or that reflect a conservative, moderate, or aggressive investment approach, with an explanation of objective differences between the menus.
- In the context of responding to an RFP, it is very common for service providers to provide a non-individualized model plan menu of investment options. This is necessary for pricing purposes and it is made very clear that the model menu is not being recommended. This should not give rise to fiduciary status.
- The service provider may provide objective reasons that a plan fiduciary might choose one fund over another or might choose one model portfolio over another.
- In some cases, a plan fiduciary may have decided to remove an investment option and may ask a service provider for a replacement fund that is, based on objective criteria, very similar to the fund being removed. Responding to this request with objectively similar funds—or a single fund if only one is objectively similar—should not give rise to fiduciary status.
- In some cases, the service provider encourages a plan to have at least one investment option in every specified asset class and to have a set of target date funds (or similar investments).
- A service provider might design its arrangements so that all "mapping" is done to the plan's QDIA.

- The service provider may also use the seller exemption. It makes little sense to prohibit a service provider from using the seller exemption in situations where the service provider is selling a particular plan menu.

Finally, the disclosures regarding "not undertaking to provide impartial investment advice" need to be modified to be accurate, as discussed above. The disclosure with respect to the service provider menu should provide as follows:

> The investment alternatives available were selected based on various criteria, including past performance, fees, quality of management, popularity, reputation, stability, financial relationships with the service provider, and/or compatibility with the service provider's administrative systems.

The disclosure with respect to assistance in selecting the plan menu should be modified as follows:

> The service provider may have a financial interest in the investment alternatives that are offered under the plan.

VALUATION.

We have multiple concerns regarding the proposed position that, subject to a narrow exception, asset valuations are fiduciary acts.

Transaction-Based Distinction.

We believe that it is critical that the regulations draw a distinction between two very different types of valuations. On the one hand, there are valuations that affect the amount of money that a plan pays or receives for the asset being valued. For example, if a plan is buying or selling real estate or closely held securities, a valuation may be relevant in determining how much a plan pays or receives. These valuations can materially affect the total amount of plan assets available to provide benefits to participants. This letter refers to such valuations as "Transaction-Based Valuations."

On the other hand, there are valuations that do not affect the total amount of plan assets available to pay benefits to participants. For example:

- A plan must value annuity contracts, separate accounts, GICs, and other assets without a readily ascertainable value in order to determine the required minimum distributions ("RMDs") that must be made under section 401(a)(9) of the Internal Revenue Code (the "Code").

- All defined benefit plan assets must be valued in order to determine the plan sponsor's funding obligations, as well as for purposes of applying the various benefit restrictions applicable under ERISA section 206(g) and Code section 430. These benefit restrictions include restrictions on a plan's ability to pay benefits in certain forms, such as lump sums.
- In many circumstances, a participant's defined contribution plan account may hold an interest in an asset such as a separate account, a GIC, an annuity contract, collective investment fund, or another asset without a readily ascertainable market value. In order to determine the amount payable to a terminating participant, it may be necessary to value such assets.

Though these valuations could affect the timing or form of distribution and/or the relative benefits paid to different participants, the valuations have no effect on the total assets available to pay benefits to participants. There is thus no risk that total plan assets may be inappropriately reduced by such valuations. On the contrary, these are everyday valuations that are necessary to the normal operation of a plan.

Moreover, if these valuations give rise to fiduciary status, holding these types of assets in plans will at the very least become much more expensive by reason of (1) the significant additional liability assumed by the person valuing the asset, and (2) the fact that many service providers will cease providing valuations due to the potential liability. In fact, it is very possible that the prohibited transaction rules would preclude many investment product providers from valuing their own products.

In addition, persons performing routine valuations would be forced to engage in new and difficult legal analyses. For example, in valuing assets for purposes of the RMD rules, what is a fiduciary's duty? To minimize the value to preserve as much as possible in the plan? To maximize the value to avoid possible plan disqualification and/or participant excise tax problems? In valuing assets for purposes of funding determinations, is there a duty to minimize the value to increase funding obligations? Or is there a duty to maximize the value to permit the continued availability of all forms of distributions? Or should the appraiser be concerned that lump sums could drain the plan of assets, so that the valuation should be minimized?

In addition to sharply increased costs, we envision this regulation creating extremely difficult new issues for which there are no answers, like the issues noted above. Thus, routine plan operations will be thrown into question, and many service providers may simply refuse to provide such routine valuations, leaving plan sponsors without a means to operate their plans. And what purpose would be served by the additional cost, legal uncertainty, and operational chaos? None that we can think of. No problem has been identified that would justify the enormous disruption triggered by imposing fiduciary status by reason of performing routine valuations that do not affect total plan assets.

Other "Non-Transaction-Based" Issues.

We are very concerned that we have barely scratched the surface of all the issues that could arise if the proposed regulations' treatment of valuations were finalized. For example, even custodians that simply report valuations prepared by others could be swept into fiduciary status. Similarly, service providers that value managed or unitized investment options (such as a fund of funds) based on third-party values could be treated as fiduciaries. Clearly neither of these results would be appropriate.

But it may be particularly helpful to explore the "non-transaction-based" issues in the context of one example: investment in uncleared swaps. (Similar issues may exist with respect to cleared swaps.) In the case of uncleared swaps (which will still exist in large numbers after the Dodd-Frank Act), a swap has to be valued frequently—often daily—in order to adjust the collateral posted by one or the other parties to secure the obligation under the swap agreement. Generally, it is the "dealer" that performs the valuation, subject to review and possible contestation by the plan (or other end user). The valuation by the dealer may be a fiduciary act under the proposed regulations:

- The valuation is an appraisal of property;
- The valuation is provided to a plan or plan fiduciary;
- The valuation is performed pursuant to a written agreement that it may be considered in connection with making decisions regarding management of assets (i.e., the posting of collateral), and the valuation is individualized to the needs of the plan; and
- Neither the seller exemption nor the valuation technically exemption applies. (In our view, the seller exemption should clearly apply, as discussed above, but in its current form, the exemption may not apply since the valuation is not performed in the context of a sale.)

If the dealer's valuation is a fiduciary act, then the valuation is also a prohibited transaction that runs afoul of ERISA section 406(b), since the dealer's interest is adverse to the plan's. One might argue that the dealer should not perform the valuation due to its self-interest and that all valuations should be performed by independent third parties. But that would cause very significant disruption in the swaps market. Moreover, the plan reviews the dealer's valuation and has the right to challenge it, so the conflicted nature of the dealer's valuation is not of concern. But most importantly, the Dodd-Frank Act <u>requires</u> the dealer to make the valuation available to the plan. See section 731 of the Dodd-Frank, adding section 4s(h)(3)(B)(iii)(II) of the Commodity Exchange Act. So the option of solely using an independent third party to value the swap is simply unavailable.

Even if this problem could be solved, an additional problem exists. As noted above, the plan has the right to contest the dealer's valuation and rely instead on an independent party's valuation. This system would no longer be available under the proposed regulations. By reason of performing the valuation, the independent appraiser would become a fiduciary with an exclusive duty of loyalty to the plan. Accordingly, the appraiser would cease to be independent, leaving the dealer and the plan with no way to resolve their valuation dispute.

Thus, the proposed regulations would create unworkable conflicts in the law with respect to swaps. How many more conflicts or problems are lurking out there with respect to this valuation issue? We do not know, nor does anyone. And that is our point. This valuation issue needs far more study and work before it moves forward. This is clearly true with respect to Non-Transaction-Based Valuations, since no problems or issues have been identified that would justify the disruption and cost that would be triggered by finalization of the proposed regulations.

Transaction-Based Valuations.

Transaction-Based Valuations, such as in the context of ESOPs, seem to have provided the impetus for including valuations in the proposed regulations as fiduciary acts. The preamble to the regulations specifically states that "a common problem identified in the Department's recent ESOP national enforcement project involves the incorrect valuation of employer securities."

We have two concerns with respect to Transaction-Based Valuations. First, as in the case of Non-Transaction-Based Valuations, we are very uncertain what the fiduciaries' duties would be. In the preamble, the Department states that it:

> would expect a fiduciary appraiser's determination of value to be unbiased, fair, and objective, and to be made in good faith and based on a prudent investigation under the prevailing circumstances then known to the appraiser.

If this is truly the standard, it needs to be reflected in the regulations, because that would not be how we read the law. A fiduciary is required by law to "discharge its duties with respect to a plan solely in the interest of the participants and beneficiaries." A fiduciary is required by law not to be unbiased and objective; on the contrary, a fiduciary is required to represent the participants. For example, in negotiating with a service provider over fees, a fiduciary is required to solely represent the plan's interests, not to be an unbiased and objective arbiter of what level of fees are "fair" for both parties. [1]

Without further regulatory clarification, an appraiser's duty would be to minimize a plan's purchase price and maximize a plan's sales price. That would mean

[1] See generally Bedrick By & Through Humrickhouse v. Travelers Ins. Co., 93 F.3d 149, 154 (4th Cir. 1996) ("[t]here is no balancing of interests; ERISA commands undivided loyalty to plan participants").

that the opposing party would be required to hire a second appraiser, doubling the cost, and then there could well be a further negotiation based on the disparate valuations and, as in the case of swaps, possibly the need to hire an independent appraiser. Moreover, as discussed, by requiring that appraisers be plan fiduciaries, the proposed regulations would prohibit such "independent" party from being truly independent, leaving the plan without a mechanism to resolve the dispute. This could possibly also leave many ESOPs without a means to satisfy the "independent appraiser" requirement of Code section 401(a)(28)(C).

In short, applying a true fiduciary duty to an appraiser would be very disruptive, as well as unworkable, with respect to all Transaction-Based Valuations. Yet the preamble indicates that that is not what the Department intended. In fact, the result intended by the Department—a fair and objective valuation—may not be achievable through fiduciary status, which imposes wholly different obligations. Thus, we urge the Department to revisit this issue, so as to achieve the worthy objective described in the preamble.

Second, appraisals do not fall within the statutory definition of fiduciary advice. Appraisals are not "investment advice" under ERISA section 3(21)(A)(ii). As aptly discussed in Advisory Opinion 76-65, an appraiser is not rendering a view as the advisability of an investment decision; an appraiser is simply providing an opinion as the value of property.

In short, we urge the Department to pursue its worthy objectives with respect to the valuation of employer securities through a different approach that is workable and consistent with the statute.

COORDINATION WITH OTHER AGENCIES.

As noted above, on January 18, 2011 the President issued an Executive Order emphasizing the importance of agency coordination. This means far more than agencies letting each other know about regulatory projects being developed. In the President's words, coordination means "harmonizing rules" and avoiding "inconsistent" or "overlapping" rules. Such coordination among the Department, the SEC, and the CFTC is essential as described below.

Broker/Dealers: Coordination Between the Department and the SEC.

Under the proposed regulations, a very large number of brokers and dealers will become fiduciaries, such as a broker or dealer who gives individualized advice to a customer regarding IRA investment. This could present a major problem in light of the broker/dealer's compensation structure. As a fiduciary, the broker/dealer's opportunity to receive commissions or other compensation in connection with the advice would in many cases, absent an applicable exemption, cause the broker/dealer to have committed a prohibited transaction solely by reason of the fact that the customers' trading practices could affect the broker/dealer's compensation. We recognize that the Department's regulations are only proposed, but in their current state, they would generally provide broker/dealers with a choice: restructure an entire industry's compensation arrangements or cease providing certain essential services to customers.[2] Thus, the Department's proposed regulations could have a very adverse effect on the provision of investment assistance to participants, which is exactly the opposite of what is needed.

The SEC's Study. The SEC's staff ("Staff") recently completed the study required by section 913 of the Dodd-Frank Act regarding the standards of care applicable to broker/dealers and investment advisers with respect to the provision of investment advice to retail customers (the "Study"). The Dodd-Frank Act specifically directs the SEC to study the effects of subjecting broker/dealers to the rules applicable to investment advisers. In addition, the SEC is authorized to issue regulations subjecting broker/dealers to such rules.

The Dodd-Frank Act is, however, clear that, unlike the Department's proposed regulations, any possible change in the standard of care applicable to broker/dealers is not intended to require "standard compensation" arrangements to be restructured: the "receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer." On the contrary, the Dodd-Frank Act clearly emphasizes addressing broker/dealers' compensation structures through disclosures of "material conflicts of interest."

In the Study, the Staff recommended:

> the consideration of rulemakings that would apply expressly and uniformly to both broker-dealers and investment advisers, when providing personalized investment advice about securities to retail customers, a fiduciary standard no less stringent than currently applied to investment advisers. . . .

Study at v-vi.

[2] In fact, in order to avoid having to restructure its entire compensation structure, a broker/dealer that is not an investment adviser may in some cases have to refrain from providing individualized advice with respect to plans and IRAs. This would result in far less advice being available to investors, especially in the IRA context. In addition, other broker/dealers may decline to seek investment adviser status just so as to enable them to continue to provide non-individualized advice with respect to plans and IRAs. Again, this would not appear to be a favorable development from a public policy perspective. These approaches, however, may not be possible under the upcoming guidance from the SEC, as discussed below.

The Staff's reasoning for this conclusion included the following:

> a harmonization of regulation – where such harmonization adds meaningful investor protection – would offer several advantages, including that it would provide retail investors the same or substantially similar protections when obtaining the same or substantially similar services from investment advisers and broker-dealers. . . .
>
> [R]etail customers do not understand and are confused by the roles played by investment advisers and broker-dealers, and more importantly, the standards of care applicable to investment advisers and broker-dealers when providing personalized investment advice and recommendations about securities.

Study at viii, 101.

Coordination. The regulatory projects undertaken by the Department and the SEC have enormous overlap; i.e., they overlap with respect to all retail customers saving for retirement under arrangements subject to the Department's regulations. Yet neither the Study nor the Department's proposed regulations indicate that there will be any coordination with the other project. The Study states that "the requirements of ERISA are beyond the scope of the Study." Study at 87. The Department's proposed regulations do not mention the upcoming Study, despite the fact that it addresses the same issue.

This lack of coordination is of great concern for many reasons:

- **Executive Order.** This lack of coordination is directly contrary to the Executive Order issued by the President on January 18, 2011, which requires coordination, not simply notifying other agencies of pending projects. The Order is critical of regulatory requirements that are "inconsistent or overlapping" and requires agencies to attempt to promote "coordination, simplification, and harmonization."

- **Inconsistent with the Study.** The Study concludes that the existence of differing standards harms and confuses investors. Yet without coordination between the two agencies, we appear to be moving toward enshrining a system whereby broker/dealers providing advice to the same customer would be subject to two very different standards with respect to different parts of the customer's portfolio.

The Study also emphasizes "business model neutrality" by not prohibiting any business model and thus preserving "investor choice among… services and products and 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)." Study at 113. The Department's proposed regulations would directly conflict with the Study's business model neutrality.

The Executive Order also stresses that, consistent with the law and regulatory objectives, it is important to "reduce burdens and maintain flexibility and freedom of choice for the public."

- **Significance of the Regulations.** These two regulatory projects have great potential to modify the investment information available to millions of Americans and to have enormous effects on the financial industry. Projects of this magnitude deserve coordinated, careful consideration. In this regard, a Presidential Memorandum issued concurrently with the Executive Order states that, "[i]n the current economic environment, it is especially important for agencies to design regulations in a cost-effective manner consistent with the goals of promoting economic growth, innovation, competitiveness, and job creation." President Obama echoed this sentiment in the recent State of the Union address.

- **Small Businesses.** Without coordination, there is a great risk that IRA owners and employees of small businesses in particular will be cut off from a main source of investment advice, since broker/dealers provide substantial assistance in these areas. This is not what anyone wants. The President has made clear that his objective is "to promote innovation" – not eliminate business opportunities. Moreover, the Presidential Memorandum places emphasis on "ensuring that regulations are designed with careful consideration of their effects . . . on small businesses." The lack of coordination with respect to broker/dealers does not reflect consideration of small business interests.

Recommendation. The Department and the SEC should coordinate and articulate a single standard of conduct applicable to brokers and dealers in providing investment advice. That single standard should apply with respect to (1) the retirement savings of "retail customers" (as defined for purposes of the Dodd-Frank Act) and (2) any other advice related to retirement savings to which the SEC applies the retail customer standard. Having a single standard is critical because it would not serve investors well to have their advisors subject to inconsistent and overlapping rules.

In developing that single standard, the Department and the SEC will need to work within the statutory framework of the Dodd-Frank Act, which permits brokers and dealers to receive “standard compensation”. Standard compensation should be interpreted to include, for example, commissions, sales incentives, and the benefits of principal trading. Under the Dodd-Frank Act, any issue related to such compensation is to be addressed through disclosure of “material conflicts of interests”.

<u>Interaction with the Business Conduct Standards Regarding Swaps Proposed by the CFTC.</u>

On December 22, 2010, the CFTC published proposed business conduct regulations regarding swaps. Those proposed regulations have very significant interactions with the Department’s proposed regulations, rendering coordination acutely necessary. If both sets of regulations were finalized in their current state, swap dealers and major swap participants (“MSPs”) that enter into swaps with plans would become plan fiduciaries solely by reason of complying with the business conduct regulations. This would create automatic prohibited transactions, so that the end result would be that retirement plans would cease to be able to use swaps, which would have a devastating effect on plans and on the swap market.

The solution is clear. In addition to the specific changes recommended below, the Department’s regulations need to state that no action <u>required</u> by the CFTC’s business conduct standards shall transform a plan’s counterparty into a plan fiduciary. Otherwise, the two sets of regulations would be in irreconcilable conflict.

Defined benefit plans use swaps to hedge their asset and liability risks. Without swaps, plan assets and liabilities would be far more volatile, leading to greatly increased funding volatility. Increased funding volatility would, in turn, force plan sponsors to set aside much greater reserves to address possible future funding obligations. Those reserves would directly reduce money available to invest in jobs and in the economic recovery. In short, making swaps far less available would have far-reaching adverse effects throughout the economy. In addition, without swaps, the greatly increased volatility with respect to funding adequacy would undermine the security of participants’ benefits.

<u>Risk analysis.</u> Under the CFTC’s proposed regulations, if a plan enters into a swap with a swap dealer or MSP, the swap dealer or MSP must provide the plan with “material information concerning the swap in a manner reasonably designed to allow the [plan] to assess…[t]he material risks of the particular swap,…[t]he material characteristics of the particular swap,…and…[t]he material incentives and conflicts of interest that the swap dealer or [MSP] may have in connection with the particular swap.” Moreover, in the case of a high-risk complex bilateral swap, the swap dealer or MSP must provide the plan with:

> a scenario analysis designed in consultation with the [plan] to allow the [plan] to assess its potential exposure in

> connection with the swap. The scenario analysis shall be done over a range of assumptions, including severe downturn stress scenarios that would result in significant loss.

Prop. Reg. § 23.431(a). The definition of a high-risk complex bilateral swap is not entirely clear, but it appears likely broad enough to sweep in many swaps commonly entered into by plans. Even if the swap is not a high-risk complex bilateral swap, but it is a bilateral swap that is not available for trading on a designated contract market or swap execution facility, the swap dealer or MSP must provide the plan with a scenario analysis upon request.

Unless the seller exemption applies, it is clear that a swap dealer or MSP that complies with the above would be a fiduciary under the Department's proposed regulations: (1) the swap dealer or MSP would be providing a plan with individualized investment advice regarding investment risks, (2) the advice "may be considered" by the plan, and (3) the swap dealer or MSP would receive compensation under the swap agreement. Some have taken the position that the swap dealer or MSP's advice is not really advice, but rather the provision of objective data and thus would not trigger fiduciary status under the proposed regulations. We question this position for two reasons. First, risk analyses are not rote exercises based on universally accepted facts; they can be highly subjective and will vary greatly, as demonstrated by the fact that the CFTC's regulations recognizes that the scenario analyses may be based on confidential proprietary information. Prop. Reg. § 23.431(a)(1)(iv). Second, the Department's proposed regulations do not contain any general exception for advice based on factual data. On the contrary, the existence of <u>very specific</u> exceptions for factual data provided with respect to plan menu issues and for IB 96-1 raises a strong inference that no such general exception applies.

We strongly believe that the right answer in this case is that the seller exemption should apply to the swap dealer or MSP in this case. The swap dealer or MSP is the opposing party, and the plan knows not to rely on anything provided by such an opposing party. It is critical, however, that the applicability of the seller exemption be clarified to apply to swap counterparties. Without this clarification, swap dealers or MSPs would be required to be fiduciaries and, as such, would be engaging in a prohibited transaction in the case of swaps with plans. Thus, all plan swaps would be required to cease.

<u>Review of plan's representative.</u> Under the CFTC's proposed regulations, if a swap dealer or MSP is simply entering into a swap with a plan, the swap dealer or MSP must engage in a swap-by-swap in-depth analysis of whether the plan's representative is qualified to function as an advisor to the plan. Prop. Reg. § 23.450. It is clear under the CFTC's regulations that the swap dealer may not simply accept representations to that effect, but rather must engage in its own scrutiny of any representations given.

Thus, there is a very strong argument that the swap dealer or MSP is effectively rendering advice to the plan regarding its choice of an advisor. As noted in the preamble to the Department's proposed regulations, advice to a plan regarding its choice of an investment advisor is a fiduciary act under the proposed regulations. Thus, the swap dealer or MSP may be treated as a fiduciary with respect to the plan under the proposed regulations, triggering a prohibited transaction in the case of swaps with plans. Unless the two sets of proposed regulations are modified, this analysis could result in a cessation of all plan swaps.

Recommending a swap. Under the CFTC's proposed regulations, if a swap dealer or MSP "recommends" a swap or trading strategy to a plan, the swap dealer or MSP has (1) a duty to act in the best interests of the plan, and (2) a duty to have a reasonable basis to believe that the swap is suitable for the plan.

So the question is: under what circumstances would a swap dealer or MSP be treated as "recommending" a swap or trading strategy. This is very unclear under the CFTC's proposed regulations. The preamble to the CFTC's proposed regulations states that a:

> recommendation would include any communication by which a swap dealer or major swap participant provides information to a counterparty about a particular swap or trading strategy that is tailored to the needs or characteristics of the counterparty, but would not include information that is general transaction, financial, or market information, swap terms in response to a competitive bid request from the counterparty.

In our view, if the swap dealer or MSP clearly informs the plan in writing that the swap dealer or MSP is functioning as a counterparty and not as an advisor, everything communicated to the plan by the swap dealer or MSP should be treated as "selling" not recommendations. But the CFTC's proposed regulations contain no such seller exemption. On the contrary, under the CFTC's proposed regulations, it is very possible that the CFTC's proposed regulations could be interpreted differently to turn common-place selling—e.g., "this is appropriate for you because it addresses your need to hedge your interest rate risk"—into a "recommendation", triggering a duty of the swap dealer or MSP to act in the best interests of the plan. If that is so, problems arise.

If a swap dealer or MSP must act in the best interests of the plan, that would seem to imply a duty to advise the plan regarding the swap. Unless the seller exemption applies, that would clearly make the swap dealer or MSP a fiduciary under the Department's proposed regulations, creating a prohibited transaction in the case of swaps with plans. Thus, again it is critical that the seller exemption be clarified to apply to the swap dealer or MSP.

DISTRIBUTION ADVICE.

The preamble to the proposed regulations invites comments regarding "whether and to what extent the final regulations should define the provision of investment advice to encompass recommendations related to taking a plan distribution." This issue needs to be divided into two analytically separate parts: (1) advice regarding whether to take a distribution, and (2) advice regarding how to invest any distribution that may be made. As discussed below, from a statutory and conceptual perspective, these questions need to be addressed separately.

Distribution Advice is Not Fiduciary Advice Under the Statute.

ERISA section 3(21)(A)(ii), on which the proposed regulations are based, specifically refers to "investment advice." A decision whether to invest in an S&P 500 index fund inside a plan or to take a distribution from the plan and invest in the same fund outside the plan is simply not an investment decision. Thus, advice regarding that decision is not investment advice under the statute, and the Department lacks the statutory authority to treat such advice as giving rise to fiduciary status.

Distribution Advice Cannot be Fiduciary Advice Conceptually.

The lack of a statutory basis to treat distribution advice as fiduciary advice makes conceptual sense. A fiduciary has a duty to the participants as participants. A distribution decision is a decision in which an individual must weigh his or her needs as a participant versus his or her needs as a non-participant. By definition, a fiduciary cannot help in that regard, since a fiduciary is required by law to act on behalf of a participant as a participant and not consider the participant's needs as a non-participant. So, advice regarding distributions is, by definition, made in a non-fiduciary capacity.

Advice Regarding Investment of Distributed Assets in an IRA or Another Plan Can be Investment Advice, Subject to the Seller Exemption.

We appreciate the Department's concern with respect to advice provided to participants regarding how to invest distributed assets in an IRA or another plan. Such advice could be investment advice with respect to the IRA or other plan. However, this issue is an excellent reminder of how critical the seller exemption is, and how important it is that the scope of that exemption be clarified in accordance with our recommendations so that entities are able to promote and sell investment products for IRAs, subject to the clear disclosures discussed above with respect to the seller exemption.

<u>Coordinating With Other Guidance.</u>

If the Department decides to issue guidance that goes beyond the framework discussed above, it is critical that the Department do so in a coordinated manner. Issuance of any guidance treating distributions as fiduciary advice should be coordinated with expansion of IB 96-1 to apply to distributions so that the retirement plan community understands how to stop short of fiduciary advice but still provide valuable education. For example, guidance regarding the allocation between annuity distributions and non-annuity distributions should be treated as education to the extent that no specific options (such as a particular provider's annuity) are recommended. In addition, the investment advice area contains many prohibited transaction exemptions that permit advice to be given under appropriate circumstances not contemplated expressly by the statute. We would certainly need similar prohibited transaction exemptions to make the distribution area function appropriately if distribution recommendations become fiduciary advice. So any regulatory guidance treating distribution advice as fiduciary advice should be combined with appropriate prohibited transaction exemptions. Providing the regulatory guidance without prohibited transaction exemptions would almost certainly create the same type of havoc that withdrawing all investment advice prohibited transaction exemptions would create.

However, as noted above, we strongly believe that there is no statutory basis to treat distribution recommendations as fiduciary advice.

<u>Advisory Opinion 2005-23A.</u>

Finally, we urge the Department to revisit Advisory Opinion 2005-23A. In the Advisory Opinion, recommendations regarding the investment of distributed assets made by <u>any</u> plan fiduciary are automatically fiduciary advice. This is inconsistent with the clear longstanding rule of law that an entity is only an ERISA fiduciary with respect to those functions for which it has fiduciary powers and duties. So, for example, if an affiliate of a directed trustee that has no responsibility regarding the investment of plan assets were to make recommendations regarding the investment of distributed assets, such affiliate is clearly not a plan fiduciary with respect to those recommendations and there is no reason to treat it as such. We urge the Department to revise Advisory Opinion 2005-23A accordingly.

Our position here is not inconsistent with <u>Varity Corporation v. Howe</u>, 516 U.S. 489(1996). In <u>Varity</u>, the plan administrator, acting as the plan administrator, provided misleading information regarding the plan. This case stands for the proposition that a fiduciary, when acting as a fiduciary, is subject to ERISA's fiduciary standards. It does not apply to a plan fiduciary who is acting as a wholly separate capacity, i.e., as a seller of services unrelated to its status as a plan fiduciary.

IRA AND NON-ERISA PLAN ISSUES: APPLICATION OF IB 96-1 AND THE INVESTMENT MENU EXCEPTIONS.

The proposed regulations apply to IRAs. We are concerned that the regulations were developed in the plan context and do not reflect consideration of the many unique factors affecting IRAs. This letter does not address in a substantive way the issue of whether IEAs should be covered by these regulations. This is an issue that can be more directly addressed by other organizations, but we believe that the Department should consider separating the proposed regulations into two parts, one addressing plan issues and one addressing IRA issues.

At a minimum, however, we note that the proposed regulation can be read not to apply the IB 96-1 and investment menu exceptions to IRAs and non-ERISA plans subject to the Code. This should be corrected. IRA owners and non-ERISA plan participants need investment education, just as ERISA plan participants do, so there is no reason not to make the IB 96-1 exception applicable to IRAs and non-ERISA plans subject to the Code. In addition, IRA sponsors and non-ERISA plans subject to the Code can provide a menu of investment options and can provide objective assistance with respect to choosing among such options, just as service providers in the ERISA plan area would do. The investment menu exceptions should thus apply to IRAs and non-ERISA plans subject to the Code.

* * *

In short, we believe that the proposed regulations address a wide range of critical issues. An extended and robust public policy dialogue on all of these issues is needed to avoid (1) a material reduction in the services, investment education, and guidance available to plans, plan participants, IRA owners, and plan sponsors and (2) a substantial increase in costs.

We very much appreciate the opportunity to comment on these important proposed regulations.

Sincerely,

Jan Jacobson
Senior Counsel, Retirement Policy