



February 3, 2011

Submitted Electronically – **Re: Definition of the Term “Fiduciary” (RIN 1210-AB32)**

Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave, NW
Washington, DC 20210
e-ORI@dol.gov

Ladies and Gentlemen:

On behalf of the Competitive Enterprise Institute, we are writing to submit comments regarding the proposed regulation published by the Department of Labor’s Employee Benefits Security Administration (the Department) defining the term “fiduciary” in connection with the provision of investment advice under ERISA (the Proposal).¹ The Proposal would replace the current regulation at 29 CFR §2510.3-21(c) promulgated by the Department in 1975. The Department has argued that the new rules are necessary because of changes in the market in the past 35 years. However, we believe that these changes – notably the proliferation of defined contribution plans – make such a broad definition of “fiduciary” even less appropriate now than it would have been when the majority of workers were in defined benefit plans.

We thank you for the opportunity to comment on this regulation. CEI supports the Department’s decision to review and update aging regulations. However, we are strongly concerned about the costs this proposal imposes on the investing community and the curtailment of options for individual workers planning their retirement. We also have concerns regarding the regulatory impact analysis accompanying the Proposal, and we appreciate the opportunity to share our thoughts with you.

The Competitive Enterprise Institute (CEI) is a non-profit public policy organization dedicated to advancing the principles of limited government, free enterprise, and individual liberty. Founded in 1984, our mission is to promote both freedom and opportunity. We make the uncompromising case for economic freedom because we believe it is essential for entrepreneurship, innovation, and prosperity to flourish.

¹ 75 Fed. Reg. 65263 (Oct. 22, 2010)

One of CEI's ongoing initiatives is to evaluate whether the regulations promulgated by the Federal government properly take into account the burden they place on private enterprise. We seek to eliminate unnecessary regulation, and to promote thorough and accurate cost-benefit analysis. As the federal regulatory structure imposes significant costs on our economy, it is imperative that federal agencies conduct their regulatory impact analyses in accordance with Executive Orders and Office of Management and Budget guidance designed to ensure thorough estimation of costs and benefits, as well as full consideration of the regulatory alternatives that minimize burdens and maximize regulatory efficiency.

Summary:

At the outset, we have basic concerns about the thrust of this proposal. Expanding "fiduciary duty" as the Department proposes will make it harder, not easier, for workers to exercise their rights and responsibilities in their retirement plans. Individual choice is the hallmark of defined contribution plans such as 401(k)s, and we believe this proposal will make it more difficult for workers to get the information or advice they seek to make informed decisions. Plan sponsors and workers should be free to select service providers on a non-fiduciary basis to assist them in making their own decisions—we believe the likely effect of the Proposal would be to limit the ability of plans and workers to make that choice.

We are also concerned that the regulatory impact analysis accompanying the Proposal overstates the Proposal's benefits and understates its costs, and does not comply with the intent of Executive Order 12866 and OMB Circular A-4. Accordingly, our comments will identify for the Department the areas we believe should be reviewed and revised.

First, the Department did not conduct a threshold analysis of the cost of the Proposal, as required in OMB Circular A-4 when an agency determines costs cannot be quantified. The Department did, however, conduct a threshold analysis of the benefits of the Proposal. We are concerned that the lack of a threshold cost analysis could significantly understate the Proposal's costs relative to its benefits. Given the vast size of the regulated universe, with approximately \$10 trillion held by ERISA plans and Individual Retirement Accounts (IRAs),² even a very small proportion of providers experiencing transition and other costs could result in very high costs to plans and participants. We are also concerned that the Department did not appear to consider the cost impact on the \$4.5 trillion IRA marketplace at all. Given the significant differences between ERISA plans and IRAs, including the fact that the IRA holder affirmatively selects the IRA provider he or she prefers, it is not at all clear that the same cost considerations obtain.

Second, we are concerned that the analysis may significantly overstate the Proposal's benefits because it does not appear to take into account the effect of the Department's previously

² See "The U.S. Retirement Market: Third Quarter 2010," Investment Company Institute, January 2011, pg. 6.

promulgated Interim Final ERISA §408(b)(2)³ regulation regarding undisclosed compensation. That regulation, which will take effect on July 16, 2011, already prohibits, deters and punishes the same conflicts of interest that the Proposal claims to prevent. We believe the Department appears to be, in effect, “double-counting” the benefit of the prior regulation.

Third, we are concerned that the regulatory impact analysis did not sufficiently consider the impact the Proposal would have on small businesses, including financial advisors and appraisers. We urge the Department to examine data regarding the average size of a financial advisor and of an appraiser to reassess this issue.

Fourth, the Proposal did not consider alternative regulatory options that might have significantly reduced costs by narrowing the scope of the Proposal—instead the Department considered only two alternative options that would have expanded the scope of the Proposal. This seems inconsistent with the intent of Executive Order 12866 and OMB Circular A-4.

Fifth, the Proposal does not appear to consider what impact increasing the number of fiduciary service providers may have on existing prohibited transaction exemptions that plans and service providers use to conduct ordinary plan business. A number of commonly-used prohibited transaction exemptions may not be available to service providers if their services become fiduciary in nature. The regulatory impact analysis is silent on this point.

Finally, given the reliance the Preamble and the regulatory impact analysis place on the Department’s experience with its national enforcement project on employee stock ownership plan (ESOP) issues and the Consultant/Adviser project (CAP), we believe the Department should have analyzed the impact the Proposal would have had in these cases and make that information available for public comment as part of this rulemaking. For example, the Department has provided no data showing how many CAP cases the Department successfully closed with results under the current rule. Of those that did not close with results, how many likely would have closed with results under the Proposal and why?

In our nation’s voluntary system of employee benefits, the Department has a responsibility to regulate efficiently; ensuring workers are protected without unnecessarily increasing costs and reducing the availability of plans. Given these concerns about the regulatory impact analysis, and given the potential impact of the Proposal on the cost and availability of retirement plans for America’s workers, we believe the Department should reevaluate the Proposal in light of the comments received, conduct a new regulatory impact analysis that properly accounts for expected costs and benefits, and repropose the entire rule so that the public has a meaningful opportunity to comment upon all relevant data that the Department has relied upon in preparing the Proposal.

³ 75 Fed. Reg. 41599 (July 16, 2010).

Threshold Analysis Requirement:

OMB Circular A-4 provides clear direction regarding the need to conduct a threshold analysis when the agency believes it cannot quantify the cost or benefit impacts. The guidance provides:

“If the non-quantified benefits and costs are likely to be important, you should carry out a ‘threshold’ analysis to evaluate their significance. Threshold or ‘break-even’ analysis answers the question, ‘How small could the value of the non-quantified benefits be (or how large would the value of the non-quantified costs need to be) before the rule would yield zero net benefits?’ In addition to threshold analysis you should indicate, where possible, which non-quantified effects are most important and why.”⁴

While the Department may not have all the cost information it believes it needs to quantify the specific impact of the Proposal (such as the proportion of assets managed or held pursuant to variable compensation arrangements the Proposal may prohibit), there is sufficient information available to conduct at least a threshold cost analysis that would provide a more accurate understanding of the range of potential impacts than the Department has provided in the Proposal. Private sector defined contribution and defined benefit plans subject to the Proposal hold nearly \$6 trillion; IRAs hold roughly an additional \$4.5 trillion.⁵ Given the scale of this roughly \$10 trillion marketplace, the Proposal need only result in a very small percentage of service providers being required to change their business models and compensation arrangements to make the transition costs of the Proposal extremely significant. At the very least, the Proposal likely will result in a significant impact on a substantial number of small entities.⁶

Furthermore, the Department’s analysis does not appear to make any attempt to quantify or otherwise estimate the impact of the Proposal on the \$4.5 trillion IRA marketplace. This is troubling, as the IRA marketplace is inherently different from the ERISA plan marketplace. The IRA holder acts as his or her own fiduciary in selecting the IRA provider of his or her choice, and generally does so in the retail rather than in the institutional market. It is not at all clear that the same assumptions the Department made about the impact of the Proposal on the ERISA space will apply in the IRA space—in fact, many factors, including the number and type of service providers operating in the IRA space, are likely quite different.

Overstating the Proposal’s Benefits and §408(b)(2):

We are also concerned that the economic impact analysis may be overstating the benefits of the Proposal by “double-counting” the enforcement benefits already achieved in a prior regulation. In assessing the benefits of the regulation with respect to preventing conflicts of

⁴ OMB Circular A-4, pg 2.

⁵ “The U.S. Retirement Market: Third Quarter 2010,” at 6.

⁶ See Regulatory Flexibility Act, 5 U.S.C. § 601 et seq.

interest caused by undisclosed service provider compensation, the analysis does not appear to take into account that the Department has already promulgated regulations prohibiting this conduct through the Interim Final ERISA §408(b)(2) disclosure requirements.

Beginning on July 16th, most service providers receiving indirect compensation (payments from a party other than the plan in connection with the plan's business), including pension consultants and other entities identified in the Preamble to the Proposal, will be required to disclose to plan fiduciaries direct and indirect compensation totaling \$1,000 or more. Failure to provide the disclosure will result in a prohibited transaction, as the transaction will no longer be eligible for the statutory exemption for reasonable services.

The Department's regulatory impact analysis for the §408(b)(2) Interim Final regulation concluded that:

"Harmful arrangements generally are those that are tainted by unmitigated conflicts. A plan's service providers may strike deals that profit one another at the plan's expense. Such arrangements may thrive in the shadows, but tend to wither in sunlight. These arrangements exist today in the market for plan services precisely because information asymmetries obscure them. Mandatory proactive disclosure will reduce the asymmetry, creating a sunnier climate that is less friendly to harmful arrangements."⁷

The regulatory impact analysis for the Proposal makes essentially the same claim, finding:

"Harmful arrangements generally are those that are tainted by unmitigated conflicts. These arrangements occur when a plan's service providers strike deals that profit one another at the plan's expense or subordinate the plan's interest to someone else's...According fiduciary status to certain service providers that provide investment advice...and subjecting them to the full extent of remedies under ERISA, would discourage harmful conflicts and create more beneficial arrangements in the pension plan service provider market."⁸

While the mechanism used by the two regulations is different—the §408(b)(2) regulation imposes an excise tax on the non-disclosing service provider for committing a prohibited transaction while the Proposal would impose fiduciary liability on the service provider—the effect in deterring and preventing conflicted advice is likely the same. Thus, absent a discussion in the Proposal's regulatory impact analysis about the Proposal's incremental improvement upon the Interim Final regulation's enforcement effect, it appears as though the Department is claiming the same benefit twice in two different regulations.

⁷ 75 Fed. Reg. 41599, 41622 (July 16, 2010).

⁸ 75 Fed. Reg. 65263, 65272-65273 (Oct. 22, 2010).

Impact on Small Entities:

We urge the Department to engage in discussions with trade associations representing financial advisers, insurance agents, broker-dealers, and appraisers to obtain real data about the size of these providers. It is our understanding that most financial advisers are not employees of large financial institutions, but rather are either wholly independent business people or independent contractors. Thus, these entities are likely to have a large proportion of small businesses, many of whom could be forced to make substantial changes in their business models in response to the Proposal. For example, one survey of 450 financial advisors serving qualified plans, ranging in size from advisors with only a small number of plans to advisors whose plan clients represented as much as \$2 billion in plan assets, suggested that even many larger advisors had fewer than 25 employees and revenues below the Small Business Administration guidelines.⁹

Regulatory Alternatives:

In explaining its reasons for publishing the Proposal, the Department identified a number of specific concerns with the existing regulation. These included: undisclosed conflicts of interest by service providers who did not meet the five-part test of the regulation; the accuracy of appraisals of employer stock in connection with ESOPs; and the lack of fiduciary status for one-time advice, regardless of its significance to the plan. The Department also expressed concern with the requirement of the current regulation that advice provided would be the “primary” basis for a plan’s decision-making.

However, the Proposal is much broader than is necessary to address these issues. It adds a new category of fiduciary advice regarding “management” in paragraph (c)(i)(A)(3), and would potentially make a fiduciary of any entity giving individualized advice for a fee that “may be considered” by the plan in paragraph (c)(1)(ii)(D). While the proposal also provides certain exceptions to this broad scope of fiduciary conduct and status, it is likely that many providers who have not previously been fiduciaries would become fiduciaries under the Proposal as written.

Despite this very broad scope, when considering regulatory alternatives for the purposes of the regulatory impact analysis, the Department chose to consider only two alternatives, both of which expanded rather than limited the scope of the proposal. This seems inconsistent with the intent of Executive Order 12866 and its interpretive guidance, OMB Circular A-4. For example, Circular A-4 advises agencies of a variety of different ways to evaluate potential alternatives, including the “degree of stringency,” writing:

“In general, both the benefits and costs associated with a regulation will increase with the level of stringency (although marginal costs generally increase with stringency, whereas marginal benefits may decrease). You should study alternative levels of stringency to

⁹ “Benchmarking Your Practice: Practice Profiles” pg. 29, Monarch, 2010.

understand more fully the relationship between stringency and the size and distribution of benefits and costs among different groups.¹⁰

In our opinion, the Department's two alternatives demonstrated that the marginal benefits of more stringent alternatives decreased while costs increased. However, we believe the Department also should have examined alternatives of lesser stringency to determine if these would allow the Department to achieve its primary objectives with less cost and greater efficiency within the regulated community.

Effect on Prohibited Transaction Exemptions:

By expanding the number of service providers who likely would be fiduciaries under the Proposal, the Department may indirectly impact the ability of these providers to engage in many common plan transactions that rely on certain prohibited transaction statutory and administrative exemptions. As both the Preamble and the regulatory impact analysis are silent on this point, it is not clear whether the Department considered this issue and determined there was no concern, or whether the matter was not considered. We urge the Department to review these issues, as there could be unintended consequences for individual or class exemptions, with resulting costs to plans and participants.

Enforcement Experience Data:

The Preamble suggests the Department relied on its experience in its national enforcement projects on Consultants/Advisers and ESOPs in developing and justifying the Proposal. While the Department makes some very cursory information about these programs publicly available, it is not sufficiently detailed to evaluate the interconnection between this experience and the Proposal.

The Department should provide detailed information about these cases in connection with its policy decision. Specifically, the Department should disclose how many CAP cases were closed with results and the ratio of cases closed with results to those closed without results. The Department should further disclose whether the Proposal likely would have changed the outcome in cases closed without results, and if so, why. This information is necessary for the public to evaluate the efficacy of the Department's policy decision in achieving its stated objectives.

Conclusion:

ERISA establishes a voluntary system—employers are not obligated to offer employee benefits to their workers. As a result, it is vitally important that ERISA regulations efficiently balance the need to protect workers from inappropriate conduct regarding their retirement savings with

¹⁰ OMB Circular A-4, pg 8.

the need to ensure the cost-effectiveness of offering plans. Ultimately, the Department is charged with the responsibility to ensure that its rules offer investor protection that includes the protection of investor choice. The rules also should not overly burden investment providers, because the added costs are inevitably passed on to retirees. To fulfill this important responsibility, the Department must engage in thorough and comprehensive analysis of its regulatory decisions.

Thank you for the opportunity to comment on these important issues, and we would be happy to answer any questions you may have.

Sincerely,



F. Vincent Vernuccio, JD
Labor Policy Counsel
Competitive Enterprise Institute



John Berlau
Director, Center for Investors and Entrepreneurs
Competitive Enterprise Institute



Bradford P. Campbell
Outside ERISA Counsel to CEI
Schiff Hardin, LLP