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Invested in America

February 3, 2011

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

Re: Proposed Definition of Fiduciary Regulation

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA") is pleased to provide comments regarding the Department of Labor's ("Department") proposed regulation under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") that will redefine the term "fiduciary" under section 3(21) of ERISA and section 4975(e) of the Internal Revenue Code of 1986, as amended (the "Code"). We appreciate the opportunity to comment and hope that our comments are helpful to the Department as it assesses the impact of the proposal on plans and their participants. We respectfully request an opportunity to testify at the Department's March 1-2, 2011 hearing.

SIFMA believes that the regulation, as proposed, will have unintended consequences. These include:

- *The ability of millions of Americans to save for retirement will be adversely impacted.* Financial institutions will not be able to deliver critical investment tools, information and services, or will only be willing to do so at an added cost to IRA account holders and retirement plan participants. With the number of self-directed plans and IRAs increasing, it is more critical than ever that individuals be provided with low cost tools for retirement planning.
- *Costs exceed benefits.* We believe that the reasons given by the Department for proposing the regulatory change pale when compared to the costs of the proposal.
- *More limited choices.* The proposed regulation will limit access to markets, investment products and service providers. Limited availability and decreased competition will result in higher costs and spreads and adversely impact market efficiency. Service providers and counterparties that choose to continue to provide services to, and trade with, plans and IRAs will incur a multitude of new costs, much of which will be passed on to clients.

Costly litigation resulting from an ambiguous rule and all of the costs of amending client agreements, modifying model forms, training of personnel, additional legal and compliance resources, and fiduciary insurance will further add costs to plans and IRAs.

- *Investment options will be curtailed.* Plans will be prohibited from engaging in swaps, restricted in their use of custody, lending, cash management, and futures strategies, and limited in their access to alternatives.
- *Higher costs for participant investment education.* Under the proposed regulation, the risk of failing to meet the requirements of the participant education bulletin has enormous consequences, because a small discrepancy will almost certainly cause the service provider to be treated as a fiduciary under the "may consider" test.
- *Creates significant uncertainty.* The proposed regulation replaces the clarity of the current regulation with vague and ambiguous definitions which do not permit service providers to know whether, in hindsight, they will be considered fiduciaries and who will be claiming to have "considered" their advice. The proposed regulation will make it very difficult to determine whether market-makers and futures commission merchants are fiduciaries because the proposal does not require a relationship with the plan or IRA or a mutual understanding between the parties.
- *Inconsistent with Congressional intent.* Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") requires the SEC to conduct a study on the appropriate standard of care for retail accounts and, if necessary, issue regulations implementing a uniform standard of care for investment advisers and broker-dealers, without requiring changes in the fees and commissions charged these accounts. SEC Staff recommended a "uniform fiduciary standard" which is not inconsistent with the current regulation defining the term "fiduciary", especially as the SEC uniform standard would permit commission-based arrangements, sale of proprietary products and principal trades, and no continuing duty following provision of advice. Staff conducted a detailed cost analysis in determining that these activities should be permitted and, consistent with the FINRA recommendation, determined that the standard should be business-model neutral and flexible to allow different types of compensation arrangements. Both agencies agreed that to change the business model would hurt retail accounts. Their conclusions should not be ignored.
- *Inconsistent with Dodd-Frank.* The proposed changes are inconsistent with the very recent framework set forth in Dodd-Frank and the proposed regulations thereunder with respect to business conduct standards applicable to the trading of swaps, overturning the careful balance that allows financial institutions to deal with plans in derivative transactions.
- *Disrupts capital markets.* Trading counterparties will be severely limited because dealers will not know whether their affiliates will be deemed fiduciaries. All of the exemptions for principal transactions prohibit transactions with anyone who is fiduciary with respect to the assets involved in the transaction. The proposed regulation will make it nearly impossible to determine whether market-makers are fiduciaries with respect to those assets because it requires no relationship with the plan and no mutual understanding between the parties. In addition, a futures commission merchant may not be able to provide services to plans and IRAs if it is a fiduciary with respect to the assets involved in the transaction.
- *Turns ministerial custodial valuations or pricing services into fiduciary acts.* Custodians will prohibit plans and IRAs from holding assets which cannot be valued through a third

party pricing service and such pricing services may be deemed fiduciaries even with respect to plans and IRAs with respect to which they have no relationship. Custodians may be prohibited from hiring third party appraisers to take on the fiduciary duty because of the substantial expense of doing so, or because the securities laws do not permit delegation to a third party. The regulation will significantly curtail the choices of the IRAs and plans that the Department seeks to protect.

- *Adversely affects the economy.* At a time when the economy is making at best a fragile and halting recovery, the adverse effects on the capital markets will be significant and capital currently invested by plans and IRAs in real estate and private equity will be reduced.

SIFMA also believes that the reasons cited by the Department for these changes do not warrant the limiting affect on plan choices and the very significant cost increases that the rule will cause. Finally, we believe the cost analysis which accompanies the proposal is flawed and incomplete. Many of the issues described herein were not considered by the Department in its cost analysis and where considered, were seriously underestimated. Finally, the regulation's economic analysis does not consider the costs on IRAs at all.

SIFMA urges the Department to withdraw the proposal, conduct a comprehensive cost analysis and if necessary, repropose a regulation that is more targeted to the abuses it perceives.

Respectfully submitted,

T. Timothy Ryan, Jr.
President and CEO

cc: Hilda L. Solis, Secretary of Labor
Phyllis C. Borzi, Assistant Secretary
M. Patricia Smith, Solicitor of Labor

Comments of the Securities Industry and Financial Markets Association
Proposed Changes to the Definition of Fiduciary

SIFMA[1] is pleased to provide comments regarding the Department of Labor's ("Department") proposed regulation under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") that will redefine the term "fiduciary" under section 3(21) of ERISA and section 4975(e) of the Internal Revenue Code of 1986, as amended (the "Code"). We look forward to working with the Department to avoid these results. SIFMA also appreciates the scheduling of a hearing on this important proposed regulation and respectfully requests an opportunity to testify at the hearing and to supplement our comments in light of the testimony at the hearing.

We are concerned that the Department has not fully considered the impact of this proposal on the ability of individuals to save for retirement. The Department itself has publicly stressed the importance of investment assistance in saving for retirement. Americans held $16.5 trillion in retirement assets at the end of the first quarter of 2010, accounting for 35% of all household assets in the United States. As of this date, the assets in IRAs exceeded $4.3 trillion[2]. Mutual funds only account for 45% of the assets in these accounts, which means that they hold more than half of these accounts in stocks, bonds and other property.[3] The trading costs for these assets will increase dramatically if the proposed regulation is finalized in the current form. This proposal could critically impact the ability of these individuals to reach a successful retirement, because the financial institutions most able to efficiently deliver investment assistance will no longer be willing to do so or will only do so at an added cost to the participant or IRA account holder. These institutions are currently able to help participants and IRA account holders invest for retirement by providing valuable services without such services giving rise to fiduciary status under the current ERISA fiduciary definition. Examples of these important functions are:

- providing information on available investment tools, services and products;
- narrowing the platform of thousands of investment options available to these accounts to a more manageable number; and
- providing referrals or recommendations with respect to the selection of third party or affiliated investment managers (who themselves are ERISA fiduciaries).

If these types of interactions cause service provider to become fiduciaries, certain interactions would cease altogether, meaning millions of Americans will not have sufficient information to be able to invest effectively and meet their retirement goals. This proposal will limit choice and increase costs for all plans. We think this result is inconsistent with Congress' express goals for regulation of broker-dealers

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

[2] Investment Company Institute, Retirement Snapshot, First Quarter 2010.

[3] Investment Company Institute, Research Fundamentals, The US Retirement Market, Second Quarter 2010, p.5.

in Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"). Dodd-Frank requires the SEC to conduct a study on the appropriate standard of care for broker-dealers in retail accounts; the study issued by the SEC, which recommends a uniform fiduciary standard, notes that it will preserve investor choice while minimizing cost and disruption.[4] We urge the Department to reconsider this proposal to ensure that any changes in the current regulation also preserve investor choice while minimizing cost and disruption.

At a minimum, we suggest that IRAs be carved out of the proposal at this time to determine so that the Department may fully consider the costs of the proposal on IRAs, and on this form of individual retirement savings. The Department has done no cost analysis on IRAs and the additional costs, described below, will have a disproportionate affect on IRAs. In addition, the choices that will be foreclosed to IRAs have not been fully analyzed under the regulation.

We further believe that the Department has not fully considered the costs of this proposal on plans and IRAs[5] and the manner in which their investment choices will be curtailed, or the costs on plans that may be unable to engage in swaps, prime broker their assets, invest in alternatives, obtain futures execution and otherwise have their investment choices limited by the proposal. The disruption to the capital markets has also not been explored: the additional costs of principal transactions, the restriction on use of trading platforms and other venues which improve liquidity and market efficiency, the artificial barriers on investments in private equity and real estate.

We hope that the comment period and the hearing will shed significant light on the unintended costs of the proposed regulation, enabling the Department to conduct a comprehensive analysis of the costs associated with the proposal.[6] The Department's cost analysis notes that it is incomplete and concedes that it does not consider the costs to plans; we note that it does not include the costs to IRAs at all, or the additional costs associated with the change in the proposed rule that makes any person who provides a plan with valuation information a fiduciary. These costs must be taken into account.

We also hope the Department will consult with the Securities and Exchange Commission ("SEC"), the Commodity Futures Trading Commission ("CFTC") and the Financial Industry Regulatory Authority, Inc. ("FINRA") on the coordination of standards and requirements among these statutory regimes, especially in light of recent regulatory initiatives from each of these regulators and on the effect of this proposed regulation on the capital markets.[7]

[4] Dodd-Frank Section 913 Study, available on the SEC website at http://www.sec.gov/news/studies/2011/913studyfinal.pdf.

[5] Generally throughout this comment, the term "plan" will refer to both plans and IRAs.

[6] This analysis should include the costs likely to be incurred by service providers and counterparties (which, if history is a guide, will be passed on to clients).

[7] As the SEC noted in its comments on the Department's proposed exemption and section 3(21) regulation, the prohibited transactions of ERISA "may require that broker-dealers refrain from trading as principal with employee benefit plans to which they provide services. This may have an immediate, wide-spread and detrimental impact on the operation and functioning of a significant portion of the United States capital markets, and may serve to restrict the ability of employee benefit plan managers to invest plan assets in equity and debt securities. The Commission is greatly concerned about the potential severe disruption and dislocation in the capital markets, and the probably concomitant negative impact on employee

SIFMA urges the Department to withdraw the proposal, conduct a comprehensive cost analysis and if necessary, repropose a regulation that is more targeted to the abuses it perceives. This is especially true for IRAs, where it appears there has been no cost analysis conducted at all.

Our comments will address SIFMA's concerns with the specific applications of the change on retail and institutional client accounts, the costs of the proposed changes on these clients, and the disruption to the markets that the proposed changes may cause.

1. The Department's Proposed Changes

The current regulation is straightforward and workable. It requires that advice be provided on a regular basis, where there is a mutual agreement, arrangement or understanding that the advice will form a primary basis for the investment decision. It covers investment products, and not the selection of managers or the appraisal of property. Under current law, fiduciaries know they are fiduciaries, and they know the identity of the plans and IRAs relying on them. The role of fiduciary is a serious one, encompassing duties that are the "highest known to law," Donovan v. Bierwirth, 680 F. 2d 262, 272, n.8 (2nd Cir., 1982). It would be inconsistent with these duties for a service provider to be defaulted into this role, solely based on status or on one party's understanding, not shared by the service provider.

While SIFMA agrees with the Department that if a person identifies himself to a client as a fiduciary, he should be deemed a fiduciary, we believe the proposed regulation goes far beyond that point and allows IRAs, plans and participants to decide, after the fact, whether the relationship was a fiduciary relationship with its attendant responsibilities and prohibited transactions. The new tests are vague and subjective, and conducive to later allegations of fiduciary status. As described more fully below, the proposed definition relies on status or title, and does not require a plan or IRA to actually have any relationship at all with an advisor on whom it later claims to be relying. All four tests of the proposed rule must clearly be conditioned on an agreement, arrangement or mutual understanding with the plan that the service provider is providing recommendations that are individualized to **that** plan and a primary basis for the plan's decision making. The primary basis test has been used for 35 years and is clearly understood by plans and service providers; the Department should not jettison it now, especially in light of the Department's acknowledgement in the preamble that the proposal intends to capture persons that significantly influence the decisions of plan fiduciaries and have a considerable impact on plan investment. The proposed regulation is written so broadly that virtually everyone who deals with a plan or with the investing public will be a fiduciary unless they can prove they are not.

These "status" determinations, rather than current law function and relationship distinctions, will make it more difficult for service providers to structure their businesses in a manner compliant with the

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benefit plans and their beneficiaries, which may occur, if, as a result of the present uncertainties concerning the scope and application of these provisions of ERISA to the activities of broker-dealers, a substantial portion of the business transacted between employee benefit plans and broker-dealers is suddenly terminated or substantially curtailed. . . Thus, to the extent that employee benefit plans wish to utilize for execution the largest and best capitalized broker-dealer firms, those plans may be limited severely in their ability to buy and sell securities in the substantial segment of the market where transactions primarily occur on a principal basis, since many of the same large and well capitalized broker-dealer firms are the leading factors in such market". Letter from Ray Garrett, Jr., Chairman, Securities and Exchange Commission, dated January 9, 1975 (copy attached).

securities and commodities laws and ERISA. If service providers cannot be sure they will not be deemed fiduciaries, they will either rearrange their businesses to assume they may be fiduciaries, imposing the trading restrictions (*e.g.*, prohibiting all principal trades and potentially agency trades such as futures) and costs that accompany that role, or they will limit their dealings with plans or IRAs. Turning all retirement accounts into advised accounts, with their associated advisory fee structure, is not likely to benefit plans and IRAs, and any benefits suggested by the Department would be unlikely to outweigh these additional costs. Making it very difficult for plans and IRAs to identify fiduciaries will make any principal transaction prohibited and lead to untoward consequences under other regulatory provisions, such as the special disclosure rules required of fiduciaries under the new 408(b)(2) fee disclosure provisions applicable to plans. The costs of these consequences will be significant.

For the reasons described more fully below, counterparties to swap transactions could become fiduciaries under the proposed regulation solely on account of the duties that a swap counterparty will be required to undertake under the business conduct rules of Dodd-Frank in order to deal with plans; the impact on defined benefit plans and plan asset hedge funds will be substantial. [8] Plans and funds would be deprived of an important risk-management tool. For example, defined benefit plans often use interest rate swaps to improve the match between assets and liabilities in order to reduce risk. Hedge funds execute absolute return strategies using swaps. The capital markets would be thrown into disarray for plans and plan asset vehicles, regardless of the intent of Congress and the government agencies responsible for regulation of the financial markets.

a. <u>Advisers Act and "Existing Fiduciary" Status</u>

The Department's proposed regulation imposes fiduciary status on any person who makes investment recommendations, *regardless of whether those recommendations are individualized*, and regardless of whether there is a mutual agreement, arrangement or understanding that the recommendations are intended as investment advice tailored to the plan. So long as the person (or its affiliate) is an adviser under the Investment Advisers Act of 1940 ("Advisers Act") or is already a fiduciary under either of the other two statutory tests (i.e., a person with discretion over the management of plan assets or a person with discretion over plan administration) (an "Existing Fiduciary"), regardless of the forum or the listener base, becomes fiduciary advice.[9] This test does not require that an investment adviser or Existing Fiduciary tailor his advice for a particular client, a test that was the hallmark of the Department's contemporaneous regulation defining fiduciary in 1975.[10] Nor does it require that the

[8] See 75 FR 80638, December 22, 2010.

[9] We note that the Advisers Act was enacted in 1940, well before the enactment of ERISA. Neither Congress nor the Department indicated that investment adviser status was determinative of ERISA fiduciary status. Further, it was not relied upon by the Department in issuing its regulations in 1975.

[10] "Investment adviser" means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities; but does not include
(B) any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession;

investment adviser know the identity of the entities relying or even considering the recommendations. Plan sponsors, participants and IRA owners solicit many points of view, without undertaking to hire anyone to provide the kind of advice that they want and intend to rely on. They do not consider these casual, informal and background conversations to be fiduciary conversations but they value input from many sources to help educate them on potential asset classes, markets, instruments and vehicles, and managers.[11] If these conversations create liability, Existing Fiduciaries and investment advisers will decline to give their views. We believe most plan sponsors and IRA owners will see the absence of this information as harmful to their plans and their participants, not protective of them.

The proposed regulation does not allow plans and their service providers to agree on the scope of service and the extent that the plan chooses to rely on the service provider. That agreement between the parties is a critical piece of the current rule, and provides certainty and a consistent framework for plans and service providers. Plans are accustomed to entering into arrangements, agreeing on price, scope and term. The proposed rule eliminates this central part of commercial and trust relationships. We believe plan sponsors and IRA holders should have the ability to dictate the terms of their relationships, rather than have the Department create a rule under which all of their service providers could be deemed fiduciaries.

The Advisers Act status test and the Existing Fiduciary test are flawed in additional ways. Flatly deeming any adviser under the Advisers Act a fiduciary under ERISA subjects all research departments of financial institutions to the prohibited transaction rules and to cofiduciary duties, regardless of whether the financial institution has any relationship with the plan or IRA and regardless of whether the recommendation was intended for the plan or the general public. Market research is widely and freely disseminated to the general public. It is untenable to suggest that issuers of such research become fiduciaries to any plan or IRA that may receive such research, even if such accounts receive the research on the internet, on television or radio, or from third parties. Advisers appear on radio and television stations frequently, giving their recommendations and advice about the markets. The proposed regulation would make such advisers fiduciaries to every plan listener even though the writer or speaker may have no idea who is relying on his advice, and even where it is quite plainly not tailored to the particular plan. The same is true of a plan or IRA's Existing Fiduciary. If he is speaking to the general public, at a meeting or on television, or issuing generalized recommendations to all clients, the Existing Fiduciary becomes a

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(C) any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor;
(D) the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation;
(F) any nationally recognized statistical rating organization, as that term is defined in section 3(a)(62) of the Securities Exchange Act of 1934 [15 U.S.C. 78c (a)(62)], unless such organization engages in issuing recommendations as to purchasing, selling, or holding securities or in managing assets, consisting in whole or in part of securities, on behalf of others.

[11] It is unclear how the Department would define individualized advice. If a plan client asks to see 4 and 5 star mutual funds in an asset class, and a broker identifies those 4 and 5 star funds, is that individualized advice? Is the broker a fiduciary for having done that factual legwork if he is an adviser, an existing fiduciary or if the client may consider those facts? Is Morningstar a fiduciary for having rated the funds? If a plan client asks a broker for a screen of stocks that pay dividends with a 5% or more yield, is the provision of a list of stocks that meet that criterion "individualized" advice? Where the standard for determining who may be a fiduciary is so broad, it is critical that the Department distinguish between factual information, and subjective recommendations.

fiduciary with respect to that recommendation. If an adviser is managing the assets of a plan, issuing widely disseminated research, speaking at a conference, or writing a newsletter to all clients, the fiduciary's affiliated dealer will not take the risk of trading with the plan at all, for fear that its affiliate has become a fiduciary for assets of the plan other than those over which it has discretionary authority or control.

The basic trading exemptions, PTE 75-1 and ERISA section 408(b)(17), require that the dealer or counterparty not be a fiduciary with respect to the assets involved in the transaction. Even where the plan has its own investment manager or has hired an investment adviser, the dealer who has issued such research, chatted with the plan's ERISA section 3(38) manager, or otherwise disseminated information that a plan fiduciary or participant heard, may be a fiduciary under the proposed regulation and ineligible for the prohibited transaction relief. Because these dealers will have no idea whether they are fiduciaries with respect to a transaction, they will be unwilling to take the risk of trading with a plan or IRA, even where that plan has its own fiduciary upon whom it is relying. As the SEC Staff noted in its Dodd-Frank Section 913 Study:

> "If the broker-dealer exclusion were eliminated, broker-dealers, as well as investment advisers affiliated with broker-dealers, might decide to no longer sell securities as principal to retail clients. (Footnote Omitted). If so, they might lose the customers who seek that service to advisers that are not affiliated with broker-dealers, and also might lose underwriting revenue to the extent that underwriters were selected by some issuers because they could distribute not only to institutional customers but also to retail customers. Such loss in revenue could potentially manifest itself in increased costs to customers for other services and loss of investor choice, as discussed below in sub-Section B.3."[12]
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> For example, any self-imposed restrictions on selling securities out of firm inventory, as chosen by the broker-dealer with the aim of avoiding conflicts of interests and adhering to a new standard, may increase costs to retail investors. If, as a result of such restriction, firms decide not to sell securities as principal, which can potentially lower the quality of execution of transactions. As a result of any new conflicts of interest restriction, broker-dealers may stop trading on a principal basis in certain securities, such as bonds that are not exchange traded, potentially depriving investors of the best possible execution. While that may have less of an impact for certain securities (e.g., highly liquid securities such as exchange-traded equities) the debt market is

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[12] SEC 913 Study, page 151. The SEC 913 Study quotes from a comment letter submitted by FINRA which notes at footnote 673: See FINRA Letter, supra note 471 ([B]roker-dealers provide an important liquidity function by buying and selling securities from their own account. The Advisers Act prohibits an investment adviser from acting as principal for his own account without disclosing to such client in writing the capacity in which he is acting before completion of the transaction and obtaining the consent of the client to the transaction. Thus, if the Commission imposes on broker-dealers the identical investment adviser application of a fiduciary duty to retail customers, it would force broker-dealers to either cease providing investment advice to retail customers or forego one of the defining aspects of the broker-dealers model that significantly contributes to market liquidity and efficiency. Both of those repercussions inure to the detriment of retail customers: the former would reduce competition for financial services and might deprive customers of continued association with the financial professional or firm of their choice; the latter could reduce market liquidity and increase volatility and raise trading costs to retail customers).

a dealer market and the costs associated with purchasing certain securities, particularly less liquid securities, as agent, may increase execution costs for some investors, namely those customers of broker-dealers who otherwise had maintained inventories of such securities.[13]

Since ERISA prohibits a fiduciary to a plan from entering into principal transactions with the plan, swaps would no longer be available to plans and hedge funds if the swap counterparty's affiliate has provided research to the general public. Principal transactions in securities would be severely curtailed, as the SEC feared in 1975.[14] Restricting available sources for securities is not in the interest of plans as both the SEC in its 913 Study, and FINRA have pointed out.[15]

The consequence of this uncertainty is that plans and IRAs will be required to deal with smaller financial institutions with no research departments and no asset management affiliates, and these smaller dealers may have more limited inventory or higher markups. These institutions may be more thinly capitalized than the large banks and broker dealers and have less robust legal and compliance infrastructure. Limited competition will lead to higher spreads and transaction costs and less efficiency. Once again, only plans and IRAs will be forced to pay these additional costs; all other investors will be able to utilize the most substantial and creditworthy institutions.[16] As noted above, the swaps markets may be forced to exclude plans entirely.

We respectfully submit that this test, as written, is inapposite for the purpose it is proposed – to serve as a bright line test to determine who is a fiduciary. We urge the Department to either delete this test, or make clear that the test requires (i) an agreement, arrangement or mutual understanding with a plan regarding its fiduciary status and (ii) individualized advice, as distinguished from factual information, tailored for the particular plan and not prepared for the general public or a service provider's client base.

b. Mutual Understanding

The Department's alternative test for defining "fiduciary" eliminates the regular basis test, the mutual understanding requirement, and the test that requires the advice to be a primary basis on which the client will make his or her investment decision. The elimination of these tests will result in a service provider becoming an unwitting fiduciary. No longer must the parties agree that the relationship is a

[13] SEC 913 Study, page 159. The footnote to this observation notes as follows: "According to FINRA, excluding convertible bonds and equity CUSIPs, 84% of investment grade corporate bond trades in the secondary market are principal trades, and in terms of par value traded, 98% of investment grade corporate bonds in the secondary market are traded as principal. FINRA, TRACE Fact Book 2010 Quarterly Table for the third quarter, available at http://www.finra.org/Industry/ContentLicensing/TRACE/P085342. According to the MSRB, in 2010 approximately 90.8% of municipal bond trades were effected on a principal basis (with the remainder being effected on an agency basis). Letter from Marcelo Vieira, MSRB, to Matthew Kozora, U.S. Securities and Exchange Commission, dated Jan. 11, 2011."

[14] See fn. 7, supra.

[15] See SEC 913 Study, at pages 151-163.

[16] As noted in the cost section, infra, these additional trading costs were not considered in the Department's cost analysis.

fiduciary relationship. If the client "understands," long after information is provided by a service provider, that the relationship is, in retrospect, a fiduciary relationship, even if the service provider specifically disclaims that status, the client's one sided, opportunistic "understanding" carries the day. This is true, despite the fact that the client's one-sided understanding can be manufactured after the fact when any trade turns out less successfully than he anticipated. The formulation cannot work nor can it be validated. Allowing a plan fiduciary or participant to claim, after the fact, that he "understood" that a broker was offering tailored fiduciary advice puts too great of a burden on the fiduciary, unless the Department allows brokers and others to have written agreements disclaiming fiduciary status and the Department recognizes that disclaimer.

The elimination of the term "mutual" from the current regulation is particularly troubling. Agreements, arrangements and understandings are by definition mutual, suggesting that there are two people party to the agreement or arrangement. The most inchoate and subjective of the three terms - understanding - is made even more subjective and elusive by dropping the modifier "mutual." Thus, a regulation which should be (and currently is) a bellwether to guide standards of conduct instead becomes subjective, where no service provider will have a clear understanding of the expectations of its client. The deletion of the word "mutual" will cause significant disruption in the markets, changes in trading patterns for asset classes that currently trade on a principal basis and increases in costs to plans and IRAs, just as the Department feared in its economic analysis of the regulatory alternatives it rejected. See 75 FR 65275. Brokers will not take the risk that they will be later deemed to be fiduciaries, and in violation of the prohibited transaction provisions of ERISA and the Code.

We urge the Department to retain the requirement that any agreement, arrangement or understanding be mutual to avoid permitting a much more subjective reading of the regulation. Any change in the regulation will be unworkable unless it is based on service provider and client agreement. Department staff have said in many forums that the term "mutual" is superfluous and its deletion was editorial. In light of that acknowledgement, the term should be reinstated, since most practitioners do not see it as superfluous and it can do no harm to reinstate it if indeed, the deletion was merely editorial.

c. Recommendations that "may be considered"

Similarly, the "may be considered" test is too vague and credits even the most casual conversation as fiduciary advice. Whenever someone talks, the listener "may consider" the speaker's words. The "may be considered" test is really an "I hear you" test. We urge the Department to consider a test which both parties to a conversation understand to be fiduciary advice, such as material reliance, substantial reliance, or a significant part of the plan's decision making process. The "may be considered" test is inconsistent with the level of reliance described by the Department in the preamble to the regulation.[17] We note that this test may well capture every lawyer, accountant, actuary or other consultant that works on an investment policy, reviews asset allocations for purposes of an actuarial valuation, or looks at values for purposes of an audit. The Department's preamble specifically excludes these service providers from first prong of the regulation's four prong test; it should exclude these service providers from all four prongs. See 75 FR 65266.

[17] We note that the preamble states that the regulation is intended to capture persons that significantly influence the decisions of plan fiduciaries and have a considerable impact on plan investment. 75 FR 65265. These words are a world apart from "may consider".

The concept of a fiduciary requires that the client must be relying on the advice, not just *potentially* considering it, as one might consider the advice of a television reporter or guest, or the paper's "ask an expert" editor. Under the Department's redefined standard, casual market commentary addressed to someone else with similar risk parameters, becomes fiduciary advice.

Nor is there a brokerage exception to this "may be considered" rule, which would recognize the Advisers Act provision regarding advice that is incidental to a brokerage transaction, as the current rule does. Under the proposed regulation, there is no advice that would not make a person a fiduciary. Without such a carve out, even the suitability requirements currently being revised by FINRA and any new standards of conduct required by the SEC pursuant to the Dodd-Frank Section 913 study could meet the "individualized recommendation" provision of this test. FINRA describes the new rule as follows:

> The proposed new suitability rule, designated FINRA Rule 2111, would require a broker-dealer or associated person to have ``a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer* * *. This assessment must be ``based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile, including, but not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation. 75 FR 52564.

The Department's proposal would deem a broker a fiduciary merely because it is complying with industry rules intended to set standards for brokers who are not investment advisers.[18] Without some clarification, brokers may simply refuse to effect solicited trades for plans if, by calling a client with investment ideas and market color, they back themselves into fiduciary status.

Again, FINRA's comments to the SEC for the 913 Study are instructive:

> [T]he Commission should not merely export to broker-dealers the regulatory scheme applied to advisers under the Advisers Act or eliminate the broker-dealer exception from that statute. FINRA believes those approaches fail to acknowledge the specialized role of broker-dealers as liquidity providers, could lessen competition for financial services and deprive investors of valuable information, such as research. Instead, the Commission should apply the fiduciary standards to broker-dealers in a way that respects the purpose of the enacting legislation and allows for the differences between the investment adviser and broker-dealer models.
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> FINRA believes it would be a mistake to either (1) impose the investment adviser standard of care and other requirements of the Advisers Act to broker-dealers or (2) eliminate the broker-dealer

[18] A solicited trade is a trade where the broker has contacted the client and initiated the conversation about a security. Solicited trades must be so marked on a broker's books and records. If the Department is suggesting that all solicited trades would render a broker a fiduciary, we urge it to make that reading clear, and ask for comment from the public, as well as from the SEC and FINRA.

exclusion from the definition of "investment adviser" under Section 202(a)(11)(C) of the Advisers Act. Either of these options would negatively impact the availability of investment advice and services for retail customers, reduce competition, reduce competition in the financial services market and potentially disrupt existing relationships between retail customers and their brokers.

Broker-dealers provide an important liquidity function by buying and selling securities from their own account. The Advisers Act prohibits an investment adviser from acting as principal for his own account without disclosing to such client in writing the capacity in which he is acting before completion of the transaction and obtaining the consent of the client to the transaction. [Footnote omitted.]. Thus, if the commission imposes on broker-dealers the identical investment adviser application of a fiduciary duty to retail customers, it would force broker-dealers to either cease providing investment advice to retail customers or forego one of the defining aspects of the broker-dealers model that significantly contributes to market liquidity and efficiency. Both of those repercussions inure to the detriment of retail customers: the former would reduce competition for financial services and might deprive customers of continued association with the professional or firm of their choice; the latter could reduce market liquidity and increase volatility and raise trading costs to retail customers.[19]

The Department's proposal also will adversely affect the futures markets. The proposed rule does not eliminate the safe harbor in 29 CFR 2510.3-21(d) for brokers executing securities trades. That exception does not, however, cover futures merchants. Accordingly, any suggestions, array of alternatives or recommendations from a futures merchant, such as market, or liquidity, or time of day for the trade, regardless of whether the plan is represented by its own third party investment manager, may make the futures merchant a fiduciary and its receipt of a commission a prohibited transaction.[20]

If these changes are finalized as proposed, every plan client has a "put" back to his broker by alleging he was a fiduciary after the fact, regardless of their contemporaneous understanding. That allegation carries with it violations of the prohibited transaction provisions, with their concomitant costs of reversal and excise taxes.[21] Few brokers will trade on a principal basis with a plan or IRA and take this risk. This would mean that brokers will execute all trades as agent, even where they are not acting as a fiduciary and even in the fixed income markets, and as noted above, likely with a small dealer who is confident that the plan or IRA has not obtained any information it has generated for other clients or for the general public. The effect on price should not be underestimated; small dealers with small inventories bidding on a $25,000 bond are unlikely to provide a price as advantageous to the IRA owner as he would have enjoyed in a bundled transaction from the broker's inventory or from a large dealer.[22] But it is more

[19] Letter to Elizabeth M. Murphy, SEC, dated August 25, 2010, available at http://www.finra.org/web/groups/industry/@ip/@reg/@guide/documents/industry/p121983.pdf.

[20] PTE 86-128 covers securities but not futures, commodities, currency, etc.

[21] The Department's cost analysis does not consider the costs of exemption applications or the cost of transaction reversal and excise taxes if a service provider unwittingly becomes a fiduciary. Especially in the case of principal transactions, the 15% annual excise tax on the entire principal amount involved may be significant.

[22] We note that the Department suggests that plans and IRAs will receive better service because of this proposed change. The preamble notes: "While the improvement in service value that may result from the proposed rule is difficult to

likely that brokers will decide to provide only fiduciary services, just to have certainty. And this consequence with higher fees, more limited choices, more attenuated trading strategies and more limited liquidity will not benefit plans, their participants and IRAs.

Moreover, eliminating certainty and loosening the standards in this fashion will make it nearly impossible for financial institutions to set compliance structures, program systems, provide effective training, or clarify the difference in conduct for their employees. The Department sees enforcement through the lens of the abusive cases that come to its attention; the thousands of investment professionals and financial institutions see enforcement as the compliance structures they create by setting clear rules, providing clear, objective and comprehensible training, establishing guidelines that can be tracked through systems and oversight. These latter processes are important to ensuring that the tens of millions of retirement accounts are subject to unambiguous rules. A financial institution seeking clear rules would either (i) not provide services to, or trade with, plans and IRAs or (ii) agree to be a fiduciary. The first option is not in the best interest of plans and IRAs since decreased competition results in higher spreads and increased transaction costs. Those service providers that continue to provide services to plans and IRAs will be less willing to provide the very information and assistance necessary to assist participants and account holders to save and plan for retirement. The second option is also not favorable as financial institutions that are willing to agree to be a fiduciary would likely increase costs for the added risk, reject smaller accounts and limit the products and services provided. This is precisely the consequence of the alternatives that the Department rejected simply because plans would be hurt.[23]

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quantify, the Department believes that it has the potential to be very large. If just 10 percent of plans realize a one basis point (0.01 percent of plan assets) service value improvement, it would be worth approximately $399 million over ten years using a seven percent discount rate and reporting in 2010 dollars. In addition, GAO's study linking undisclosed conflicts with 130 basis points of underperformance suggests that value can be improved via service quality as well as price.[Footnote omitted]. Viewed in this context, the Department is confident that service value improvement could be substantial as a result of the proposed rule and may be economically significant (i.e., exceed $100 million annually)." 75 FR 65273. Thus, if just 10% of plans realize a one basis point cost increase (and as noted throughout the comment, it is far likely to be a 100 basis point increase, if not more), the cost to plans will be $399 million dollars over ten years, using the same assumptions.

We respectfully submit that the opposite is true. Brokers and other service providers may choose not to deal with these small accounts and the service level will plummet. See also, Oliver Wyman, page 29.

[23] As the SEC 913 Study noted, "Eliminating the broker-dealer exclusion could generate direct costs to investors if firms changed their pricing structures or eliminated certain account features in response. For instance, to the extent that accounts were converted from commission-based accounts to fee-based accounts, investors would become susceptible to higher costs in certain circumstances, depending on how the broker-dealers elected to re-price their services. Generally, investors pay broker-dealers either an all-in fee for a bundle of account services or pay for services separately. An all-in fee may be an asset-based fee, or commissions (including sales loads that may be supplemented by Rule 12b-1 fees) and mark-ups and mark-downs, or a combination of such fees. Investors also may pay separately for services such as, advice, trade execution, and custody. To the extent that accounts were converted or transferred from brokerage accounts (e.g., to investment advisory accounts or to managed agency accounts at affiliated banks), investors could incur additional direct costs from a changed pricing structure, whether the pricing structure remains as an all-in fee or whether investors pay separately for services. If, in response to the elimination of the broker-dealer exclusion, broker-dealers elected to convert their brokerage accounts from commission-based accounts to fee-based accounts, certain retail customers might face increased costs, and consequently the profitability of their investment decisions could be eroded, especially accounts that are not actively traded, e.g., fee-based accounts that trade so infrequently that they would have incurred lower costs for the investor had the accounts been commission-based. This practice is commonly referred to as —reverse churning or underutilization. See pp. 152-153.

d. The Selling Exception

The proposed rule provides an exception for dealers and their agents, so long as they can demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that such person (a) is providing the advice or making the recommendation in its capacity as counterparty, agent, or appraiser, (b) has interests that are adverse to the interests of the plan or its participants or beneficiaries, and (c) is not undertaking to provide impartial investment advice.

We think this exception is too narrowly written. It covers recommendations regarding purchasing and selling securities and other property, but does not cover the selling of services. The exception should also cover the selling of services, regardless of whether the client is a "new" client" or whether the client is already receiving services from the service provider, fiduciary or otherwise. Plans looking to hire new service providers ask significant detailed questions about investment approach, investment options and strategies -- areas where the service provider sees itself as having an edge. They ask to see sample lineups of options, of portfolio construction, of access to investment solutions or strategies and appropriate share classes. Failure to respond or give detailed answers would eliminate a prospective service provider from consideration. Under the proposed regulation, any of these answers may be investment advice, even where the plan has its own investment consultant acting as a fiduciary and analyzing responses.

Brokers and other service providers may provide information that a plan considers when transitioning between managers, such as methods for equitizing cash, principal transactions rather than agency transactions, principal bids for the entire portfolio, and currency management issues. In addition, brokers provide information that defined contribution plans consider when transitioning between funds on the menu, such as black-out periods, plan communications, mapping and QDIAs. All of this information would be advice under the proposed regulation. Perhaps plans will be willing to pay for this information and hire a consultant; perhaps they will simply have to manage the process on their own. But no broker who may be deemed a fiduciary for having provided this kind of information to a plan sponsor and be subject to prohibited transactions for any sale or service thereafter will provide it for free.

Pricing information is another area that brokers are asked to explain – how many affiliated funds need to be on the lineup to obtain a particular level of pricing, the pricing variations with fewer affiliated funds, use of an ERISA budget and potential allocations of that budget. Brokers are often asked questions about competing funds where a stable value fund is in the line-up or how to construct a brokerage window so that it will not compete with a stable value fund. Who will answer these questions for plan sponsors? If a broker becomes a fiduciary by answering those questions, which products will not be available to the plan as a result of that change in status?

The selling exception must include the selling of services so long as the seller makes clear that the information is not being provided in a fiduciary capacity and that the seller may have a financial interest in the outcome. The plan must be required to advise the service provider if its reliance on the service provider changes so that the service provider can reconsider the services and the relationship.

We believe that the Department intended to cover all types of property, tangible and intangible, including contract rights.[24] The exception should make it clear that the exception covers counterparties (and valuation agents, who provide valuations for both parties, and not just the dealer) in swaps, which are bilateral agreements and not securities or property. It should cover lending arrangements, including short sales, options, structured products or futures. It should cover other extensions of credit like settlement accommodations and overdraft coverage. It should cover contractual rights and the exercise of those rights, including on default.[25]

We are also concerned that the exception shifts the burden of proof to the dealer. The cost of that burden will be reflected in spreads charged to plans and IRAs. Even if the plan agrees in writing that the dealer is acting solely as a counterparty, how often does that writing need to be memorialized in order for the counterparty to have reason to believe what the recipient understands? We believe that any requirement that the agreements be regularly renewed will cause delays that will harm plans, and will lead to expense and confusion which current law avoids. Any change in the regulation should make provide that clear and conspicuous disclosure in documents and marketing materials should entitle a service provider to the exception. In addition, it should clarify that the exception is available to a service provider even if it, or its affiliates, are acting as fiduciaries with respect to other assets of the plan or IRA.

The exception does not recognize that where a plan or IRA has its own investment adviser, fiduciary, or investment professional, that fact should be controlling in whether the plan was relying on (or even considering the advice of) its counterparty, as it is in the Dodd-Frank Act with respect to swap counterparties dealing with so-called "Special Entities."[26] Counterparties dealing with a plan's own section 3(38) manager should not run the risk of being a "backstop" fiduciary for the plan.

We are also concerned about the proposed regulation's use of the term "adverse." The interests between the parties will often not be adverse, for example, where a futures merchant is acting as agent for the plan, or in the transition management context, or when a broker is providing referrals for discretionary investment management in a manager referral program. A service provider is not adverse to a plan solely because it will be receiving a fee or spread in the transaction, especially where the fact of that fee or spread is fully disclosed. Moreover, if the SEC changes the standard of conduct for brokers in retail accounts to require that they act in the best interests of their clients, they will surely be unable to advise the client that their interests are adverse. We urge the Department to eliminate the use of the term

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[24] If this isn't what the DOL intended, then advice in respect of these investments wouldn't be covered at all, since the investment advice must relate to "securities or other property" under the proposed rule (the same formulation used in the selling exception).

[25] Thus, many bilateral agreements have provisions that allow a counterparty to require more collateral or exercise certain rights if a particular condition is met. Any views on these conditions by the counterparty could make it a fiduciary under the proposed rule.

[26] We think it unfortunate that where Congress so recently has focused carefully on how to carefully delineate when a party dealing with a plan should be deemed a fiduciary, and adopted bright line tests to guide parties in their dealings so as to avoid costly litigation, the Department has chosen to move in a different direction, leaving open the possibility that a plan with its own paid adviser will *still* be able to argue that it "understood" its counterparty to be acting in a fiduciary capacity. Even if the counterparty prevails in establishing that it gave the plan and its fiduciaries the appropriate warnings, the cost of defending these frivolous lawsuits will be significant.

"adverse" or replace it with the concept that the seller or service provider must make clear it has a financial interest in the outcome.

e. The Individual Account Exceptions

The individual account exceptions should be general exceptions for all plans and IRAs. They should apply to services that defined benefit plans receive. Many brokers and insurance companies have defined benefit platforms where plans select from a range of investments, receive recordkeeping and actuarial services, etc. It makes no sense to deny defined benefit plans such platforms. Nor should defined benefit plans be denied investment education, asset allocation information, or asset class trends. Defined benefit plan sponsors will be deemed to be receiving fiduciary advice when the service provider says the exact same thing that it might have said to an additional participant. Indeed, defined contribution plan sponsors and defined benefit plan sponsors, as well as plan participants and IRAs should have the benefit of both of these exceptions.[27]

We urge the Department to extend the individual account exceptions to IRAs and to all plans, including defined benefit plans, plan asset hedge funds and other plan asset investment vehicles. All plans receive pared down choices from their service providers as recommendations, or market color or factual data. So long as a plan understands that the list of managers, mutual funds, hedge funds, insurers, etc, is not intended as individualized investment advice, there is no reason to limit this kind of investor aid to participants in a 401(k) plan or to 401(k) plan sponsors. The concepts surrounding Interpretative Bulletin 96-1 should apply to conversations with all fiduciaries and participants and beneficiaries.

We think that it is particularly critical that these exceptions apply to IRAs. Because 29 CFR 2509.96-1 applies only to ERISA covered plans, and because the Department's proposal limits the investment education exception to individual account plans as defined in section 3(34) of ERISA, service providers providing investment education within the meaning of that bulletin will be deemed to be providing fiduciary advice if an IRA owner "may consider" the content of the education *at all* or if the broker is a dual registrant. The very same information that is given to a plan participant on the day before he rolls his account balance into an IRA becomes fiduciary advice on the day after the rollover.

Even more perplexing is the Department's limitation of platforms, menu and marketing to ERISA covered defined contribution plans, rather than including IRAs, especially in light of the Department's view expressed in the economic analysis that eliminating "platform" protection would hurt plans. There are 12,000 mutual funds available to investors. We see no public policy reason to deny IRAs a smaller menu that may be helpful in easing the difficulty of making fund selections. We respectfully submit that the omission of IRAs from the exception will hurt IRAs, just as the Department understood it would hurt plans.[28]

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[27] In fact, the inference in the proposed regulation is that platforms and education to anyone not specifically covered by the exception would be fiduciary advice, even though it is very difficult to see how either constitute tailored recommendations.

[28] We assume the Department did not intend this omission; we can see no policy reason to deny IRAs the benefit of the use of platforms and menus to guide and narrow their investment choices; nothing in the Department's economic analysis or preamble explains the omission.

f. Appraisers

The proposed regulation adds a new category to the definition – appraisers and companies that give fairness opinions. The preamble to the proposed regulation notes:

> In this regard, we note that recent Department enforcement initiatives indicate there are a variety of circumstances, outside those described in the current regulation, under which plan fiduciaries seek out impartial assistance and expertise of persons such as consultants, advisers and appraisers to advise them on investment-related matters. [Footnote Omitted]. These persons significantly influence the decisions of plan fiduciaries, and have a considerable impact on plan investments. However, if these advisers are not fiduciaries under ERISA, they may operate with conflicts of interest that they need not disclose to the plan fiduciaries who expect impartiality and often must rely on their expertise, and have limited liability under ERISA for the advice they provide. 75 FR 65265.

This provision will have an enormous impact on every custodian used by plans or plan asset vehicles.[29] The cost for obtaining "current" prices for hard to price assets is very high, without requiring these pricing services to become fiduciaries. Our members who use these services for non-publicly traded assets, for purposes of completing the IRS Form 5498 for IRAs and Form 1099R for all plans, currently pay between $25 per investment to $250 per investment to obtain a value for the tax reporting. At the low end, the service confirms value with the pooled fund or issuer. The cost of a more comprehensive valuation has been quoted as between $250-375 per name. Other services quote $585 to assess a reportable value for each limited partnership and $1300 to assess a reportable value for each closely held stock. These are the prices today, and a significant reason for custodians to amend their agreements to prohibit the holding of such investments. We believe that the Department's regulation will only make this situation worse.

To the extent plans will be able to find appraisers who will agree to act as fiduciaries, and thus take on the plan assignment, their fees will surely escalate and those fees will be borne by the plans.[30] All custodians, prime brokers, fund administrators, brokers with custody and clearing brokers will become fiduciaries to the extent they value assets each month for statement purposes, even if their only act is to choose the pricing service. They risk cofiduciary status if they rely on a price provided by the investment fiduciary, fund administrator, general partner, or plan sponsor. The securities laws will not permit a custodian to take a client direction (or even a third party direction) with respect to value if that value is questionable or stale. This is particularly troublesome for clearing brokers, who have no direct relationship with a plan or IRA. We believe it goes far beyond the statute to make a clearing broker, or other custodian, a fiduciary to a plan or IRA, where there is no direct relationship with that plan or IRA.

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[29] Because The Department's economic analysis does not mention the costs that plans will incur on account of this change, we are unable to fully understand the Department's assessment of the costs and benefits of this change.

[30] The following example is illustrative. Assume an IRA owns a $50,000 interest in a real estate fund, which earns 10% in a given year, or $5000. At today's vendor pricing, the cost of confirming value for the IRS Form 5498 will cost the custodian (or the IRA, if the custodian passes through the cost) between $500 and $1000, depending on the vendor. Thus, 10-20% of the earnings are currently spent on valuation for IRS annual reporting purposes. Vendors suggest that if they are required to act as fiduciaries, the costs would at least double.

One potential result of the proposed regulation is that such service providers will refuse to provide pricing for assets that are not easily priced, or will require the plan sponsor or IRA owner to indemnify them. Neither IRAs, plans nor their participants will be better informed or safer because these service providers are forced to note that there is no available price for an asset. Because of the "hard to value" nature of the assets these appraisers and valuation agents often deal with, they will be deemed to have a target on their backs, and as we know from the costs of hiring independent fiduciaries, the fee increases to cover fiduciary insurance, the costs of litigation, and the cost of bonding, are dramatic. Where custodians refuse to permit such assets to be held in plans and IRAs, and their owners cannot find an alternative, the proposed regulation may cause a participant to take a distribution of the asset, if it cannot be promptly sold, prematurely taxing the participant and removing the investment from amounts set aside for retirement. The net result is a decrease in assets available for venture capital and real estate investment and a decrease in retirement savings.

While the proposed regulation contains a limitation for valuations provided for purposes of government reporting, that limitation excludes assets for which there is not a generally recognized market and which serves as a basis on which a plan may make distributions to plan participants and beneficiaries. As a result, those who provide values to private equity funds, venture capital funds, or real estate alternatives, will, in fact, be fiduciaries if these vehicles are part of a target benefit fund, part of a defined contribution plan, or an investment in an IRA or individual account plan. The Department should make clear that a general partner of a fund providing a net asset value as an information point, or providing a quarterly statement regarding the carrying value of various investments should not be undertaking a fiduciary act under ERISA. Any cost analysis must address the effect on the capital markets if custodians refuse to allow retirement plans and IRAs to hold these assets, and the venture capital and real estate sectors are deprived of this enormous source of capital. We urge the Department to look at the effect on the capital markets if venture capital or real estate funds decline to take ERISA and IRA funds because of the valuation issues that may make them fiduciaries. The Department was provided an enormous amount of data prior to the issuance of the Plan Assets regulation, 29 CFR 2510.3-101 which should provide a starting point for the Department to estimate the costs of the proposed change on those sectors.

As discussed in more detail below, the Department has not considered the cost effect on plans that will result from the proposed regulation's provision that makes all appraisers fiduciaries, regardless of any reliance by a plan or participant on the appraisal. We suggest that appraisers will likely reprice their services, or decline the assignment, whenever a plan (or plan investor in a fund) is an investor or potential investor. Thus, either the price will erode participant retirement savings still further, or the availability of the service from established, reputable firms will shrink, leaving in their wake those who may be the least able, least experienced and least financially responsible.

There is no exception for the daily mark requirement under section 731 of Dodd-Frank. That section requires a swap dealer to provide a daily mark for the swap, at the request of the plan. The daily mark would cause a swap dealer to become a fiduciary. And of course, if the swap dealer is a fiduciary, it cannot enter into the swap at all, because of ERISA sections 406(a)(1)(A) and 406(b).

During the drafting of Dodd-Frank, Congress worked to ensure that the swap counterparty would not be deemed a fiduciary if the plan has its own investment professional. This proposed rule will eliminate swaps from a plan's investment choices and the fears of plan sponsors that they will be closed out of the swap market will be realized.

Similarly, plans will be unable to buy structured notes or other investment products where the issuer is required to provide a daily value and take action when a particular value is reached. The appraiser provision goes far beyond any reasonable approach to status of a fiduciary. We understand the Department's frustrations with ESOP valuations but it seems likely that there are other approaches to consider, such as amending the prohibited transaction exemptions for ESOPs, and tailoring any changes to that type of plan. We believe the Department must keep in mind that there are unintended consequences of this change: if no appraiser is willing to provide an ESOP appraisal, the plan will be disqualified and all participants immediately taxed on their distributed benefits. The Department needs to consider a more tailored approach with less harmful, costly, and adverse consequences for plans and their participants.

g. Other Necessary Exceptions

In addition to broadening and clarifying the selling exception and the education and platform exceptions, we urge the Department to consider other necessary exceptions.

i. Valuation

The exemption for valuations should be modified to make clear that regardless of whether the asset is "hard to value," a custodian does not become a fiduciary for the value it places on the asset. Without a clear exemption for ministerial custody valuations, reporting of values will be disrupted and tax reporting will be thrown into disarray. Custodians will disclaim a value for any asset for which there is no public pricing service, with potential adverse consequences under the Internal Revenue Code. Custodians will not permit plans and IRAs to hold these assets. Prime brokers will limit their services to plans and plan asset vehicles (or potentially even vehicles that have any plan investment). No one will be benefited by this change.

ii. Dodd-Frank and other Laws

We also urge the Department to clearly indicate that any information required to be provided to a plan or its independent fiduciary under other laws should not make a service provider a fiduciary under ERISA. For example, the proposed rule must have an exception for information required to be provided in connection with the offering and sale of swaps under SEC and CFTC rules shall not cause a counterparty to be deemed a fiduciary.[31] Dodd-Frank requires a swap dealer, when dealing with a plan, to:

- verify that any counterparty meets the eligibility standards for an eligible contract participant;
- disclose to any counterparty to the transaction (other than a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant) —

[31] See Section 731 of Dodd-Frank, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010).

(i) information about the material risks and characteristics of the swap;
(ii) any material incentives or conflicts of interest that the swap dealer or major swap participant may have in connection with the swap; and
(iii)(I) for cleared swaps, upon the request of the counterparty, receipt of the daily mark of the transaction from the appropriate derivatives clearing organization; and
(II) for uncleared swaps, receipt of the daily mark of the transaction from the swap dealer or the major swap participant; and

- communicate in a fair and balanced manner based on principles of fair dealing and good faith.

In addition, when dealing with plans, government entities and endowments ("Special Entities"), a swap dealer must:

- have a reasonable basis to believe that the counterparty that is a Special Entity has an independent representative that—

(I) has sufficient knowledge to evaluate the transaction and risks;
(II) is not subject to a statutory disqualification;
(III) is independent of the swap dealer or major swap participant;
(IV) undertakes a duty to act in the best interests of the counterparty it represents;
(V) makes appropriate disclosures;
(VI) will provide written representations to the Special Entity regarding fair pricing and the appropriateness of the transaction; and
(VII) in the case of employee benefit plans subject to the Employee Retirement Income Security act of 1974, is a fiduciary as defined in section 3 of that Act (29 U.S.C. 1002); and ''(ii) before the initiation of the transaction, disclose to the Special Entity in writing the capacity in which the swap dealer is acting.

This list is not insubstantial and several of the duties would likely be fiduciary duties under the proposed regulation. Without such a clear exception, the Department will eliminate plans from the swaps market, a consequence that Congress clearly intended to avoid in Dodd-Frank.[32]

iii. The Plan Has Engaged Its Own Fiduciary

We also urge the Department to consider an exception where the plan or IRA has given investment discretion to an ERISA 3(38) manager and has a written agreement with an adviser, bank, insurance company or other consultant with respect to the assets involved in the transaction. Where a plan or IRA owner has selected its fiduciary, and retained such fiduciary to act with discretion or provide fiduciary advice pursuant to a written agreement, the regulation should not impose such duties on others dealing with that manager or adviser. Broker-dealers speak to advisers and managers regularly; providing recommendations, market color, investment ideas or other views to such adviser or manager should not

[32] We also respectfully request the Department's confirmation that the requirement in Dodd-Frank that a counterparty make a determination that a plan's independent fiduciary is or is not experienced and qualified will not make it a fiduciary under the proposed regulation and will not constitute the power to appoint or terminate under Part I(a) of PTE 84-14.

make the broker-dealer a fiduciary to a plan that has given discretionary control to that adviser or manager.

iv. Non-plan Asset Vehicles

Finally, we think it is very important for the Department to clarify that those who report current interests in non-plan asset funds – be it the general partner of the fund or the fund administrator – will not be deemed a fiduciary for reporting such values. The 1984 plan asset regulation carefully defines who is a plan fiduciary for purposes of investments in pooled vehicles; this regulation should not overturn that careful balancing.[33]

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[33] Congress has spoken repeatedly on when a vehicle holds plan assets and when its managers are fiduciaries. With no Congressional authorization or analysis from the Department, the proposed regulation would indirectly reverse those rules. While we would like to believe that this result is unintended, the clear language of the proposed regulation would make any person who provides a "recommendation" as to the value of an asset a fiduciary, regardless of whether the fund is subject to the fiduciary requirements of ERISA, regardless of the intention of the parties and regardless of any agreement between them. The proposed regulation would have that result even if the person providing input into values for a pooled fund did not know a plan was invested in the pooled fund. Nothing in ERISA (or any other law) permits or requires this result.

We are very concerned that without proposing the amendment of the Department's long-standing plan asset rules, and without assessing the cost of changing these rules or otherwise demonstrating why the rule should be changed, this proposal would effectively reverse course and cause the managers of non-plan asset vehicles and the custodians, prime brokers, and valuation personnel that deal with them to be fiduciaries. This result is unsupported by the Department's enforcement difficulties, or indeed by any of the issues it raises in the preamble to the proposed rule and the economic analysis that accompanies the proposed rule. We urge the Department to make clear that the proposed rule does not apply in any way to nonplan asset funds.

If, on the other hand, this result was intended, we think it is inconsistent with clear Congressional intent over the last 25 years. From 1979 through 1986, the Department proposed and reproposed regulations defining the circumstances under which a pooled fund would hold plan assets. Those proposals were very controversial and were met with significant market concern. In response to that concern, in 1985, Congress prohibited the Department from issuing any regulation defining plan assets in the private equity and real estate areas that would require such a fund to fall below certain defined thresholds specified by Congress in P.L. 99-272. The 1986 plan asset regulation reflected Congress' intentions and over the following 25 years, the general partners and other service providers to these funds were not subject to the ERISA fiduciary rules on account of the internal workings of the funds.

Similarly, in the Pension Protection Act just a few years ago in 2006, Congress added section 3(42) to ERISA to reinforce the 25% test for plan asset funds, and excluded public plans from the calculation, effectively overturning the Department's attempt to broaden the application of ERISA to pooled funds, solely because of their public plan investors. In our view, that amendment signaled Congress' intention to eliminate any burden or cost on pooled funds in which ERISA assets were not significant to avoid the imposition of those restrictions on other investors. Section 3(42) reflects Congress' intention that general partners and other service providers to these "under 25%" funds were not subject to the ERISA fiduciary rules on account of the internal workings of the funds.

In addition, less than 6 months ago, Section 406 of the Dodd-Frank Act provides the Commission with broad authority to define, by rule, terms in the Advisers Act. However, it expressly limits the Commission's authority to define the term "client" by prohibiting the Commission from defining the term for purposes of Section 206(1) and (2) to include investors in a private investment fund if the fund has an advisory agreement with the adviser. Section 913 of the Dodd-Frank Act amends Section 211 of the Advisers Act to provide a similar limitation, such that, to the extent the Commission issues rules under the Advisers Act regarding an adviser's fiduciary duty to customers, the Commission may not define "customer" to include investors in a private investment fund if the fund has an advisory agreement with the adviser.[33] Thus, in Dodd-Frank, Congress took a consistent position regarding funds: where the adviser's client is the fund, the adviser has no duty to the individual

h. Clarification of the Fee Language

We also request the Department's clarification of the fee language in the proposed regulation. While it tracks judicial decisions for the most part, the last sentences of the section provide as follows: "The term fee or compensation includes, for example, brokerage, mutual fund sales, and insurance sales commissions. It includes fees and commissions based on multiple transactions involving different parties." The latter sentence is not explained in the preamble, and we would appreciate some examples of the conduct and fee arrangements that the Department is addressing.

2. Effect on Retail Accounts

We have already mentioned the concern that brokers simply will not deal with IRAs and plans for all the reasons given thus far. We have also mentioned the likelihood that hedge funds, private equity funds, real estate funds, and other alternative funds may be unwilling to take IRA assets, despite the fact that normal tax investment education would suggest that these investments are appropriate, if not most appropriate, for tax advantaged retirement accounts. Assuming a broker does choose to deal with a plan or IRA as a fiduciary, the Department would need to alter a variety of prohibited transaction exemptions to support this business.

With some changes, PTE 75-1 will permit such plans to deal with market makers who are fiduciaries, and to buy mutual funds that are not affiliated with their broker fiduciary. With some changes, PTE 86-128 will permit the broker fiduciary to execute transactions as agent, and to engage in agency cross trades but will not permit the fiduciary to execute transactions involving deposits, currency, futures, or any property other than securities. With some changes, PTE 77-4 will permit the broker fiduciary to recommend its affiliated open end mutual funds or affiliated bank deposits but there is no exemption that would allow it to receive trailers, fees or commissions from the mutual fund if the fund is purchased on an agency basis.

There is no exemption that would permit the plan to purchase currency from the broker fiduciary. Thus, small amounts of currency which previously were purchased at favorable rates from the broker will be purchased in small odd-lots from third parties at likely unfavorable rates. Similarly, there is no exemption that would permit the plan to purchase deposits on unaffiliated banks. A very popular program for cash sweep, the so-called deposit sweep program, which sweeps idle cash to bank deposits so that all

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investors in the fund. All of this authority consistently stands for the proposition that where a fund does not hold plan assets, the adviser or general partner does not have fiduciary duties to the underlying investors.

This proposed regulation is inconsistent with these three laws, as well as within the Department's own regulations. After notice and comment, the Department issued regulations in 1986, prompted by a Congressional mandate, to make sure that real estate and private equity funds that met the requirements of the regulation, were not covered by ERISA. With no suggestion that anything about the 1984 plan asset regulation was wrong, no longer relevant, an enforcement issue for the Department, or unprotective of participants and beneficiaries, the Department proposes to reverse that regulation without notice and comment by proposing that any person who values an investment, or an asset within a fund, becomes a fiduciary. The Department should not modify or reverse the plan assets regulation through this proposal, especially where that regulation was specifically mandated by Congress.

deposits are covered by FDIC insurance, would be prohibited. Under such a program, the broker receives a spread from the interest paid. As a fiduciary, it would not be able to receive that fee, so clients would be foreclosed from this alternative. Another alternative for cash sweep is the free credit balance, where the broker pays interest on idle cash in the account. Because the free credit balance program is a use of plan assets, a fiduciary may not permit a plan or IRA account to participate in the program. Therefore, plans and IRAs will be presented only with a money market fund cash sweep alternative. Given recent economic turbulence, one can understand why investors (including IRA owners and Keogh plan owners) would desire and benefit from unlimited FDIC insurance coverage. In today's market, the very low rate of interest generally available on cash will fall to almost imperceptible returns for plans and IRAs, unless the Department provides exemptions for such programs.

PTE 84-24, the class exemption that covers sales of mutual fund shares and insurance products, will need to be significantly revised because counterparties may be fiduciaries because they or their affiliates are advisers and have circulated research.[34]

Another product that brokers sell to IRA owners is annuities. In light of the Department's focus on retirement income options, we urge the Department to confirm that PTE 84-24 would remain available to fiduciaries who provide investment advice for a fee and would cover sales of affiliated and unaffiliated annuities as well as any compensation received by an affiliated insurance company, affiliated money managers of variable annuity subaccounts, and any revenue sharing, commissions or other fees paid to the broker fiduciary.

Unless changes are made to PTE 75-1, these clients will be unable to engage in short sales or trade on margin because the prohibited transaction exemptions do not permit fiduciaries to extend margin credit to plans. There is similarly no exemption that would permit a broker fiduciary to cover overdrafts or provide settlement accommodation for failed trades (and indeed, no settlement accommodations at all) because no exemption exists for broker-dealers to extend credit where it is acting as a fiduciary.[35] Thus, unless the Department grants new exemptions, plans and IRAs, unlike all other investors, will be foreclosed from markets and transactions that the Department determined in 1975 were appropriate for plans.

All of the consequences described above assume the most likely case: that brokers will assume that the risks and costs of being retroactively deemed a fiduciary are too great and this class of accounts must be treated as fiduciary accounts. But what if a broker decides it does not want to provide fiduciary services. How will it revise its practices to comply with the law? First, it is likely that these retail plan and IRA accounts will be foreclosed from purchasing securities except on an unsolicited basis. That

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[34] There is significant confusion regarding the sale of 3rd party and affiliated mutual funds under PTE 75-1, 84-24 and 86-128. If the Department finalizes the proposed rule without change, all of these exemptions will require revision. Indeed, without clarification regarding how these exemptions apply to mutual fund sales under current law, it may be impossible for brokers to determine the impact of this regulation on their business models. We believe any economic impact assessment would be incomplete without an assumption as to whether brokers would be able to rely on these exemptions for sales of affiliated and 3rd party mutual funds.

[35] Without an immediate exemption for settlement accommodations in these accounts, trading will simply cease in these accounts for the same reason raised with the Department in 1975.

means no calls from one's broker, alerting the client to a particular move in the market, a trend in an industry, a new equity or bond issue. Second, when the client asks for information and suggestions for all of its assets, including its retirement assets, the broker will simply decline to provide any asset allocation or other information with respect to these accounts and will advise the client in writing that it is treating the client's assets as if the retirement accounts did not exist. Third, brokers may well limit the products they are prepared to sell plans: perhaps only equity and debt securities on an agency basis.[36] Fourth, certain products and services may be sold at a higher cost to account for the higher compliance and regulatory costs. In addition, brokers may provide only asset-based advisory services, which may not be the optimum alternative for a buy and hold retirement account.

Still another area of concern for retail accounts is futures trading. Because the broker-dealer exception in current law and unchanged in the proposed rule does not cover futures merchants, no futures merchants will execute trades for plans without additional exemptive relief. In addition, since PTE 86-128 only covers securities trades and not futures trades, the client's broker will be unable to execute the trade itself or through an affiliate. Plans and IRAs will find it more difficult to invest in futures because the futures merchant may become a fiduciary solely by providing market information and no exemption would then exist for its commissions. While exchange-traded funds may be a reasonable substitute in some markets, they may not be available in all markets. Finally, these accounts will be unable to invest in affiliated closed end funds, hedge funds, limited partnerships, venture capital and real estate operating companies or other commingled grantor trusts, even if the valuation issues described above do not foreclose plan investment in these vehicles without additional exemptive relief. And while not free from doubt, the proposal can be read to prohibit brokers providing services to plans to help the plan pick a recordkeeper, trustee or insurer, if the broker's affiliates are in those businesses, in the absence of exemptive relief.

3. Effect on Institutional Accounts

As described earlier in our comments, without significant changes in the regulation, plans may be forced out of the swaps market, solely because the duties imposed by Dodd-Frank will make dealers fiduciaries under the Department's regulations. The trading partners and other service providers available to plans will be significantly restricted because of the fear that research or market color is deemed to be fiduciary advice. The free exchange of ideas, strategies, peer initiatives and introduction to new managers will come to a halt, as everyone considers the possibility of becoming a fiduciary. Market color from the dealer or other service provider will be significantly curtailed, if provided at all. Plans may be limited in their ability to invest in hedge funds, private equity funds and real estate funds as general partners seek to avoid fiduciary status and appraisers refuse to provide services if plans are involved.

Prime brokers may refuse to provide services for plans and plan asset funds, forcing these accounts off of efficient platforms for trading, cash management, lending and other services. Because all of these

[36] Many broker dealers provide liquidity and best execution to retail customers by acting as principal in securities transactions. This is a cornerstone of the equity securities markets and a basic equity market-maker assumption that many broker-dealers perform. Broker-dealers also provide substantial liquidity and best execution by acting as principal in the fixed income markets. See, in this connection, the Department's preamble to its principal transaction relief in PTE 75-1. If retail retirement account customers lose access to this liquidity, their execution costs will increase and markets will lose a significant source of liquidity. These costs should be considered in the Department's economic analysis.

services require that the prime broker not be a fiduciary, prime brokers will weigh carefully whether the proposed rule will cause their services to be deemed fiduciary services. This is particularly an area where the most sophisticated plan sponsors and fund managers should be able to agree that they are not, and will not be relying on the prime broker for fiduciary services. Similarly, with respect to other information and educational services provided by service providers to sophisticated plan sponsors, such as information on investment strategies like liability driven investing, plan sponsors should be able to agree that they are not, and will not be, relying on the service provider for fiduciary advice in connection with such information.

As noted above, billions of dollars of capital are invested by plans in hedge funds, private equity funds and real estate. The proposed rules relating to appraisals and valuation alone will cause funds to reconsider plan investment. The result may be significantly reduced capital in these markets, at a time when those reductions would harm the current economic recovery. This provision also appears to reverse the plan asset regulation which defines which funds are deemed to hold plan assets, as well as create an inconsistency with section 3(42) of ERISA, just recently enacted in the Pension Protection Act of 2006, and the Congressional mandate in 1982 that required the Department to provide an exception for real estate and private equity funds.

The proposed regulation will also have unintended effects on cash and electronic trading platforms where a dealer is interposed as principal, if that dealer is unsure whether he is a fiduciary to any trading plan. Plans may be foreclosed from using such platforms, which will create significant inefficiencies and reverse a trend toward more automated and liquid markets.

Plans often purchase structured notes or other products in order to obtain a market exposure more efficiently. Those notes often give the issuer calculation agent duties which could make the issuer a fiduciary and invalidate the sale and holding of the note. This is still another example of the unintended consequences of the proposed rule.

4. The Department's Stated Reasons for the Change

The Department suggests that the change in the regulation is necessitated by "significant changes in both the financial industry and the expectations of plan officials and participants." 75 FR 65265. While there have been many changes in financial products and institutions over the last 35 years, none have altered the way securities brokers and dealers provide services to their clients. The comments on the Department's proposed regulation 35 years ago describe a "one on one" relationship by these plan service providers through which plan fiduciaries and IRA owners learn about available investment alternatives, market color, asset allocation theory and lifetime income options. Concededly, there has been a shift away from defined benefit plans in the last 35 years; however, defined benefit plans rarely use investment advice fiduciaries but instead, give managers discretionary control. We respectfully submit that the same topics discussed in 1975 form the basis for conversations between brokers and their clients today, regardless of whether the conversations relate to a defined benefit plan or a defined contribution plan or an IRA, and regardless of whether the participant in the conversation is a plan fiduciary, a plan participant with respect to his or her individual account, or an IRA owner. There may be more products, and more or different institutions and different methods of communications, like email and the internet, but these nonfiduciary conversations are little changed over the last 35 years.

The comments made in connection with the current regulation in 1975 raise these same issues in a very similar factual context – small plans, dependent for their market information on brokers, without advisory relationships. The comments are remarkably similar to those we make today: in the small plan universe, people depend for their market information and investment ideas on brokers who are providing this information incidentally to the brokerage relationship. If that relationship is required to be a fiduciary relationship, either costs will increase for those plans to accommodate the relationship or access to the information will decrease.

See, for example, the comments of Hazelhurst & Associates addressing the need for as objective a standard as possible ("We feel that there may be considerable misunderstanding, possibly subject to retroactive interpretation. . ."). On the inclusion of a test that automatically made a person a fiduciary if it had discretionary control over other assets of the plan, commenters pointed out that such a test was inapposite. See, for example, the comments of Sullivan & Cromwell ("The alternative requirement of discretionary control to buy and sell plan assets contained in subsection 1(ii)(A) of the proposed regulation is not relevant to the meaning of investment advice, as that term is used in Section 3(21)(A)(ii) of the Act. Congress specifically provided in Section 3(21)(A)(i) of the Act that a person would be a fiduciary with respect to a plan if he had discretion to buy and sell plan assets; and as a separate category, provided in Section 3(21)(A)(ii) that a person would become a fiduciary if he were paid to render investment advice to the plan. Accordingly, section 2510.3-21(c)(1)(ii)(A) should be eliminated from the definition of 'investment advice' since it has no bearing on the meaning of the key terms which would define a fiduciary under Section 3(21)(A)(ii) of the Act – 'investment advice' and 'fee or other compensation, direct or indirect'.").

The Sullivan & Cromwell comment also pointed out that the Department's exemption for agency trades, Part I of PTE 75-1, implicitly recognizes that a broker might be able to furnish "advice, either directly or through publications or writings, as to the value of securities, the advisability of investing in, purchasing or selling securities or the availability of securities or of purchasers or sellers of securities or of any analyses or reports concerning securities, economic factors, or trends or the performance of accounts' without being a fiduciary to a plan, unless he renders such advice 'under circumstances which make [him] a fiduciary'." As we do today, the comment points out that the Department must preserve the concept that securities advice made available to the public at large, or a broker's entire client base or some large segment thereof, whether or not for a fee, is not fiduciary advice, unless the Department is prepared to endanger the "access to general market and economic information which brokers may otherwise be unwilling to provide for fear they would be fiduciaries to plans".

That comment goes on to point out that the regulation will be impractical to apply if the broker unilaterally has to determine his fiduciary status based on vague concepts. The comment specifically points to the agreement, arrangement or understanding language which requires both parties to reach an understanding. As we do today, commenters pointed out that service providers who may be retroactively "understood" to have fiduciary responsibility, with all of the prohibited transactions that entails, may choose not to service the market using the business construct that existed well before ERISA and has consistently existed, under the Department's regulations, since that time.

On the subject of valuation, Sullivan & Cromwell's comment suggested that the Department should adopt the language from the interim PTE 75-1 exemption that fiduciary investment advice does not include the performance of valuation, custodial or other functions incidental to the conduct of a broker's securities business (which the Department did adopt in 1975). The same point can be made today.

See also the comments of Dean Witter:

> Routine executions of securities transactions and providing general research information to customers should not be equated with "investment advice". The inclusion of advice as to "the availability of securities or other property" in the definition of "investment advice" reaches activities vital to market executions. The possession of this kind of information is one of the intangible elements that provide a customer with the best execution. This is particularly true in larger transactions where speed in execution often determines the ability to get a desired price as either a buyer or seller. Such information, when provided by the broker or dealer in the conduct of his business as such and without special compensation, should not be included in any definition of "investment advice".
>
> Research generally made available to customers as an investment tool and for which no special fee is charged should likewise not be included in the definition of "investment advice". This information might not otherwise be available to persons trying to do business in the securities markets. Inequality of access to full information is a prime concern of the various securities laws and the extensive securities regulatory system we have in this country. Employee benefit funds should have as full access to investment information as any other investor.

Even Philip A. Loomis, an SEC Commissioner at the time, in approving the 1975 formulation of the regulation, noted the regulation properly permits brokers to provide advisory services without becoming fiduciaries. The comments of Merrill Lynch were consistent with this point of view. ("Keogh plans and other small plans normally do not employ a professional investment manager, but rather, look to one or more broker-dealers to generate research and investment ideas for the plans' assets. Broker-dealers, in recommending securities transactions to plans (as well as to all other customers) are generally obliged to tailor their advice to the particular needs of the plan. Of course, the advice may or may not be acted upon. Yet under the proposed language of the regulation, the frequent rendering by a broker of advice might raise doubts as to whether such advice serves as a primary basis for investment decisions with respect to plan assets. The broker might have been one of several sources consulted by the plan in formulating the investment advice; however the broker may have no knowledge of the plan's other brokerage relationships or utilization of additional advisory sources. Also, if the plan executes transactions through others, the broker may have no idea of the extent to which its recommendations are being followed."). The 1975 comment serves to underscore the need for a mutual arrangement, understanding or agreement between the parties, consistent on both sides, and subject to termination at any time by either.

All of these comments suggest a marketplace remarkably similar to that which exists today, with the exception of individual participants in self-directed 401(k) accounts. But 401(k) participants in plans generally have little contact with brokers, and to the extent that they do, the contact is quite similar to that of an IRA owner. Thus, we do not agree with the Department's view that the market has shifted in a dramatic enough way to necessitate the wholesale revision which it has proposed here.

The Department suggests that its proposed changes are required to make its enforcement program more effective. The preamble to the proposed regulation states:

> Amending the Department's current regulation by broadening the scope of service providers that would be considered fiduciaries would enhance the Department's ability to redress service provider abuses that currently exist in the market, such as undisclosed fees, misrepresentation of compensation arrangements, and biased appraisals of the value of employer securities and other plan investments. (Footnote omitted).

The Department has just released the last of its three initiatives (*i.e.*, the Form 5500 Schedule C, the interim final regulation under section 408(b)(2) and the participant disclosure regulation) which were designed to eliminate undisclosed fees, undisclosed conflicts, and misrepresentation of fee arrangements. It is difficult to understand why this regulation is necessary to address the same issues. This regulation is far broader than the aims it seeks to address. It imposes fiduciary status without a relationship to a plan and creates prohibited transactions and cofiduciary liability on entities who have *no* understanding with a plan or IRA that any services at all will be provided. The Department also states that participants and beneficiaries would directly benefit from the Department's more efficient allocation of enforcement resources by providing greater protections than are available under the current regulation. However, no example or explanation of this benefit is provided that would justify these sweeping changes. We respectfully submit that there is no evidence that the proposed regulation will be more protective but a great deal of evidence that these "protected" accounts will suffer greater costs and fewer choices – new asset-based advisory fees to replace a commission/spread based structure, additional transaction costs, and elimination of investment options and alternative vehicles, constriction of the dealer market, limits on permissible assets in IRAs, elimination of pricing of anything other than publicly traded assets.

The Department suggests that the proposed regulation will benefit its enforcement program by "expediting the resolution of difficult factual questions and enforcement challenges by removing the requirements in the current regulation's five-part test that investment advice must be provided on a regular basis based on the parties' mutual understanding and that the advice will serve as a primary basis for plan investment decisions". 75 FR 65273. Reversing 35 years of case law, enforcement policy and the understanding of plans and plan service providers, without any legislative direction to depart from the Department's contemporaneous understanding of the statute, to make it easier for the Department to sue service providers seems to us an inadequate basis for proposing this radical change. And of course, this enforcement rationale cannot apply to IRAs, over which the Department has no enforcement authority.

Just six months ago, in section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress asked the Securities and Exchange Commission to conduct a study on investment advisers and broker dealers and the distinctions between them. In addition, FINRA has proposed changes to its "Know Your Customer" (Rule 2090) and "Suitability" rules (Rule 2111), 75 FR

51310, August 19, 2010.[37] The preamble to the DOL's proposed regulation notes that the Department does not have cost data regarding how that conclusion alone would implicate the prohibited transaction rules of ERISA and the Code. One would hope that the agencies will coordinate rule-making so that the change in the standard of conduct would be effective at the same time that this regulation and the changes in the necessary prohibited transaction trading exemptions were effective. The SEC 913 study does NOT suggest or recommend ERISA-like fiduciary duties with its attendant prohibited transactions, but rather a uniform standard of care that is business model/fee neutral and permits (i) principal trading, (ii) commission based arrangements and (iii) sale of proprietary products, all activities that ERISA's prohibited transaction rules would prohibit for fiduciaries. The SEC 913 Study changes the standard of care without requiring all trading practices and products to be reconsidered; the SEC approach is carefully tailored to help retail accounts without increasing their costs, eliminating their choices, and making their trading less efficient.

If all brokers who provide market color or investment information are deemed to be fiduciaries, regardless of the intentions of the parties, the vast majority of commission based accounts may move toward fee based arrangements. Securities and currency transactions that were formerly executed with a dealer as principal will be executed on an agency basis against a third party dealer, subjecting the account to an asset-based fee, plus commissions and markups. The effect of these changes on the capital markets should be studied by the agencies with jurisdiction over the securities markets.

5. Costs of the Change

The Department's cost estimates focus on the cost to service providers, and not the cost to plans. We think this emphasis is misplaced. The real question is the cost to plans and their participants. And even the list of uncertainties does not once mention IRAs. [38]

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[37] The FINRA rule describes the initiative as follows: "The 'know your customer' and suitability obligations are critical to ensuring investor protection and fair dealing with customers. Under the proposal, the core features of these obligations set forth in NYSE Rule 405(1) and NASD Rule 2310 remain intact. FINRA, however, proposes modifications to both rules to strengthen and clarify them. In Regulatory Notice 09-25 (May 2009), FINRA sought comment on the proposal. The current filing includes additional proposed changes that respond to comments." 75 FR 51310.

[38] The Department's list of uncertainties is as follows: The Department's estimates of the effects of this proposed rule are subject to uncertainty. The Department is confident that adopting a new definition of the term ``fiduciary'' should discourage harmful conflicts of interest, improve service value, and enhance the Department's ability to redress abuses and more effectively and efficiently allocate its enforcement resources. However, it is uncertain about the magnitude of these benefits and potential costs. It is possible this rule could have a large market impact.

For example, the Department is uncertain regarding whether, and to what extent, service provider costs would increase due to the proposed rule, and if so, whether the increased cost would be passed on to plans. The Department expects that more service providers would be determined to be fiduciaries under the proposed rule than under the current regulation. These service providers could experience higher costs of doing business due to the increased liability exposure that is associated with ERISA fiduciary status, such as fiduciary liability insurance costs, which could result in higher fees for their plan clients. The Department also is uncertain whether the service provider market will shrink because some service providers would view the increased costs and liability exposure associated with ERISA fiduciary status as outweighing the benefit of continuing to service the ERISA plan market. The Department does not have enough information to provide a specific number. However, it is possible that many plans currently employ service providers who would be considered fiduciaries for the first time under the proposal.

The SIFMA study conducted by Oliver Wyman & Associates in connection with the Dodd-Frank section 913 study estimates that the realized cost for individual account plans will be an increase of 23-27 basis points each year on these small plans and IRAs. If you multiply that increase by the $4.3 trillion in IRA plans today, the additional cost to IRA owners is $9.6 million to $11.3 million in investment costs annually.

Data provided to the SEC for the SIFMA study suggests that over 30 million households hold assets solely in commission based accounts; 27 million of these accounts are from the small investor segment (less than $250,000 in assets).[39] These accounts hold $58 billion of fixed income securities purchased through commission based accounts.[40] If these self-directed, nonfiduciary accounts were to be deemed fiduciary accounts, all fixed income securities would be required to be purchased from broker-dealers unaffiliated with the account's primary broker. While PTE 86-128 permits fiduciaries to select themselves or an affiliate to effect agency trades for a commission, there is no exemption that permits a fiduciary to sell a fixed income security (or any other asset) on a principal basis to a fiduciary account. The result of that prohibition is that the broker would trade away from his own firm, charging a commission for the trade on top of the mark-up charged by the selling dealer. That commission would result in an added cost for these self-directed accounts, and would disproportionately fall on smaller investors, such as small plans and IRAs. In addition, the mark-up on these small trades would likely be higher than the broker's own firm would have charged an existing client because the trades are so small. These additional costs, when added to the advisory fees that a fiduciary will likely charge its clients, will significantly erode the investment return of these smaller accounts.

As noted elsewhere in this comment, IRAs hold more than $4.3 trillion as of March 2010. The vast majority of these assets are in self-directed accounts.[41] The effect on plans should be analyzed using two different assumptions: (i) that the accounts will enter into asset based fee arrangements with their brokers, with the brokers complying with the prohibited transaction rules that govern fiduciaries under ERISA and the Code and (ii) that brokers will decide that the continuous monitoring and other duties required of fiduciaries is simply not feasible or economically efficient for these small accounts, regardless of whether asset-based fees can be charged.

Also, if more service providers are fiduciaries, more transactions would violate the self-dealing prohibitions contained in ERISA section 406(b). In order to avoid committing prohibited transactions, affected service providers would have to identify transactions that would be prohibited because they involve self-dealing, restructure these transactions, and modify their business practices in the absence of an applicable statutory, class, or individual prohibited transaction exemption. The Department is uncertain regarding the number of transactions that would have to be restructured, whether an applicable prohibited transaction exemption would be available for such transactions, and if not, the number of prohibited transactions exemption applications the Department could expect to receive regarding the transactions. The Department welcomes public comments regarding this issue.

[39] Oliver Wyman study, page 12; 2007 Federal Reserve Survey of Consumer Finances

[40] Oliver Wyman study, page 16.

[41] Investment Company Institute, Research Fundamentals, The US Retirement Market, Second Quarter 2010

It is critical to measure the effect on these small accounts in the event that brokers reach this latter conclusion. If these IRAs have no ongoing relationship with a broker or other market professional, their primary resource will be the internet or other generic data sources like the financial press for information; they will be forced to make the effort to obtain their own market information, recommendations, and array of alternatives. We suggest that this proposed regulation, like the Department's investment advice initiatives, will leave this pool of assets with no advice, or very expensive advice. Higher fees or no service: a Hobson's choice for millions of IRA owners.

The Employee Benefit Research Institute (EBRI) estimates that less than half of all families have a retirement plan through a current employer, 30% of all families have an IRA or Keogh plan, and two thirds of families have an IRA, Keogh or retirement plan though a past or current employer.[42] These savings vehicles account for 60% of the assets of all families with income of $100,000 or less.[43] Among families with both an individual account plan and an IRA, 45% of the overall asset average was attributable to IRA/Keogh balances. For families with an income under $100,000, the percentage of assets in IRAs alone exceeded 60% in 2007.[44] Assuming just a 0.23% increase in cost, modest when one considers both the advisory fee likely to be imposed and the additional commissions charged on fixed income instruments, the incremental cost on these small accounts may lower returns by 1.17%.[45] The effect on these accounts, virtually all of which are nonfiduciary commission-based accounts, will be substantial and detrimental at every income level, solely from the advisory fees and additional commissions.

The Department suggests that the cost of complying with the new regulation will be $10 million in 2011 (for existing service providers to analyze their plan relationships, and almost $1 million each year thereafter, for new service providers to do a compliance review.[46] The analysis does not include banks, trust companies, fund administrators, private funds, FX dealers, all of whom sell products to plans and may be fiduciaries under the proposed regulation. The analysis also does not include advisers, which we think is mistaken, since the rule imposes additional fiduciary requirements on advisers simply because of the "status" tests for 3(21)(i) and (iii) fiduciaries and advisers. The Department's estimates are based on the Form 5500 data and thus ignore the entire IRA universe.[47] See 75 FR 65274, fn. 33. The estimates

[42] EBRI Issue Brief No. 333, August 2009

[43] Id, p. 14.

[44] EBRI Issue Brief No. 333, Figure 9a.

[45] Oliver Wyman, Page 24.

[46] We think the Department's assumptions with respect to compliance costs for service providers are wrong. Every brokerage and custody agreement will need to be revised, and re-signed. It seems very unlikely that any broker would take the risk of deemed consent, in light of the Department's proposals. All documents and agreements will need to be revised to add the Department's new disclosures required by the exceptions. A more reasonable estimate would be 50 hours of outside counsel time, at an average cost of $400/hr., and 1000 hours of internal legal and compliance costs at $150/hr., plus printing, mailing and follow-up costs for the millions of small plan and IRA accounts. Similarly, all swap documentation, dealer agreements, clearing agreements and advisory agreements will need to be revised.

[47] We think it is at least possible that if the IRA universe had been captured, there would be many more service providers who service only this market, who are not reflected in the analysis at all.

ignore the costs of retooling all of the systems which create a compliance structure for the 4500 broker dealers in this country alone, ignoring the insurance agents, banks and trust companies, consultants, appraisers, recordkeepers, each of whom will have similar costs. The estimates also ignore the costs of retraining hundreds of thousands of professionals, of revising every plan service provider contract, of changing how transactions are effected in the principal markets, such as fixed income and currency, and the cost of the scores of exemptions that will be required.

More importantly, the estimates do not reflect the likely advisory fees that will be imposed on small plans and IRAs. If one looks only at IRAs and assumes an advisory fee of 100 basis points or 1%, the likely added costs are $43 billion a year, many times the Department's estimates of the costs. Based on the facts in advisory opinions issued by the Department, this estimate may be significantly low. See DOL Adv. Opin. 2005-10, which provides as follows: "For the provision of asset allocation, custody and related services, the Bank charges each IRA participating in the CoMPAS Program an annual investment fee (i.e., the Management Fee) equal to 1.75% on the first $50,000, 1.5% on the next $250,000, and 1.25% on all assets over $300,000."

The estimates also ignore the additional fees and commissions that plans and IRAs will incur to do all transactions away from the broker dealer, resulting in both markups and commissions.[48] The estimates ignore the constraints that the regulation will put on dealers who disseminate research or opinions, publicly or privately, to the plan sponsor or its fiduciaries. The trading costs to plans of dealing only with smaller dealers who are "institutional only" are critical components of any cost study. Finally, the estimates ignore the cost of the litigation that will ensue because of the lack of certainty or the lack of mutual understanding between the parties.

The Department concedes that there could be a large market impact:

> For example, the Department is uncertain regarding whether, and to what extent, service provider costs would increase due to the proposed rule, and if so, whether the increased cost would be passed on to plans. The Department expects that more service providers would be determined to be fiduciaries under the proposed rule than under the current regulation. These service providers could experience higher costs of doing business due to the increased liability exposure that is associated with ERISA fiduciary status, such as fiduciary liability insurance costs, which could result in higher fees for their plan clients. The Department also is uncertain whether the service provider market will shrink because some service providers would view the increased costs and liability exposure associated with ERISA fiduciary status as outweighing the benefit of continuing to service the ERISA plan market. The Department does not have enough information to provide a specific number. However, it is possible that many plans currently employ service providers who would be considered fiduciaries for the first time under the proposal.

[48] The Department notes that it rejected a regulatory alternative that would have simply tracked the statutory language because it would create uncertainty, causing most service providers "in order to mitigate or avoid any potential risks, might simply presume fiduciary status and charge higher fees to any plan client or limit or discontinue the availability of their services or products to ERISA plans." We note again the fact that the Department has ignored the effects on IRAs. For all the reasons cited in this comment, the alternative selected by the Department has precisely the flaws, and will have precisely the effect of the alternative it rejected.

Also, if more service providers are fiduciaries, more transactions would violate the self-dealing prohibitions contained in ERISA section 406(b). In order to avoid committing prohibited transactions, affected service providers would have to identify transactions that would be prohibited because they involve self-dealing, restructure these transactions, and modify their business practices in the absence of an applicable statutory, class, or individual prohibited transaction exemption. The Department is uncertain regarding the number of transactions that would have to be restructured, whether an applicable prohibited transaction exemption would be available for such transactions, and if not, the number of prohibited transactions exemption applications the Department could expect to receive regarding the transactions. The Department welcomes public comments regarding this issue.

The Department believes its assumptions are reasonable based on the available information and tentatively concludes that the proposed regulation's benefits would justify its costs. The Department invites comments that will help it assess the impact of areas where it is uncertain.

Yet, in light of this uncertainty, the Department has not commissioned a study, issued a notice of intent to propose a rulemaking as it did with retirement income options, or sought out the significant amount of data that exists on the costs of commissions and fee based programs on small investor investment costs and returns. The Department's cost analysis refers to a 2005 SEC study, without reference to the data currently before the SEC in connection with the Dodd-Frank investment adviser study. It is unclear, how, in light of the Department's stated uncertainties, it has determined that its assumptions are reasonable.

In addition to the costs on IRAs and plans, which are described above, the economic analysis for the proposed regulation suggests that service providers will spend only $10 million in the aggregate to come into compliance with this proposal, if adopted. If one assumes, as we do, that the costs of redocumenting every retirement account, retraining all personnel, revising data systems and trade order entry systems to block principal transactions, obtaining fiduciary insurance, and other retooling costs by the more than 4500 broker-dealers *alone* will cost many multiples of that amount.[49] It is not an unreasonable assumption that at least some of these additional costs will be shifted to customers. If one assumes that each broker will spend an average of $500,000 to comply with the new rules, the costs for broker-dealers alone is $300 million, without considering other service providers that will be similarly affected. If even half that cost is shifted to small plans and IRAs, the cost increase per plan, over and above the costs discussed above, would likely approach hundreds of dollars per account.

6. Effective Date and Transition Rules

The preamble to the proposed regulation states that the regulation will apply 180 days after its adoption. We believe that the effective date of the regulation raises very significant issues, especially

[49] The Department's estimates are unrealistic. There are 4500 securities firms that would be affected by the proposed change, as well as insurance companies, consultants, appraisers, valuation agents, custodians, etc. Even if one assumed that the entire $10 million estimate in the Department's analysis applied only to the securities industry, that number suggests that each broker-dealer would need to spend under $2,200 to come into compliance with the rule. That amount would not begin to cover the costs of fiduciary liability insurance, retraining, and revising systems and compliance programs.

when the change in interpretation applies to statutory language which has not changed. We think it is critical that the regulation have a significantly delayed effective date (at least two years) to give service providers adequate time to change their systems, their agreements, their training and their compliance programs. We also believe that the Department needs to provide some protection for conduct premised on the existing regulation. The Department provided almost a year delay for the section 408(b)(2) regulation which has been published in interim final form, and about 14 months for the participant disclosure regulation that interprets the requirements under section 404. We urge the Department to consider a transition period and a safe harbor rule for past conduct in reliance on the current regulation. In addition, we strongly urge the Department to make the regulation effective after the effective date of the Dodd-Frank regulations on standard of conduct and swap dealer business conduct standards.

7. Plan Distributions

The Department requested comment on whether and to what extent any final regulation should define the provision of investment advice to include recommendations regarding whether and when to take a plan distribution. Where a service provider is already acting as a fiduciary with respect to assets of a plan, these recommendations may be fiduciary recommendations; where there is no agreement, there is no reason to suggest that where assets are held (rather than how they are invested) should be deemed fiduciary conduct. In our view, this is not an investment decision. It is not related to decisions on how to invest assets of a plan or how to allocate assets of a plan. It is a personal, tax and financial decision, often based on a person's desire to have all of his or her assets consolidated in one place for more efficient reporting. At older ages, this becomes more and more important and is often a decision on which children and spouses weigh in. The Department issued its opinion in this area just a few years ago; we do not believe it should be changed. Nothing has changed in the last 5 years.

Conclusion

On behalf of its members, SIFMA respectfully urges the Department to reconsider its proposed changes to the definition of fiduciary regulation, to reassess its economic analysis, to confer with FINRA, the SEC and the CFTC on the interaction of these changes with the requirements of Dodd-Frank, the new suitability rules and the Investment Adviser/Broker-Dealer regulations that will be proposed by the SEC.

We look forward to the hearing on March 1, 2011 and a continuation of this very important dialogue with the Department.

Attachment A: Oliver Wyman Study
Attachment B: Text of Section 913 of Dodd-Frank

"(B) disclosing the action, if any, the Commission intends to take with respect to the finding or recommendation.

"(h) COMMITTEE FINDINGS.—Nothing in this section shall require the Commission to agree to or act upon any finding or recommendation of the Committee.

"(i) FEDERAL ADVISORY COMMITTEE ACT.—The Federal Advisory Committee Act (5 U.S.C. App.) shall not apply with respect to the Committee and its activities.

"(j) AUTHORIZATION OF APPROPRIATIONS.—There is authorized to be appropriated to the Commission such sums as are necessary to carry out this section.".

SEC. 912. CLARIFICATION OF AUTHORITY OF THE COMMISSION TO ENGAGE IN INVESTOR TESTING.

Section 19 of the Securities Act of 1933 (15 U.S.C. 77s) is amended by adding at the end the following:

"(e) EVALUATION OF RULES OR PROGRAMS.—For the purpose of evaluating any rule or program of the Commission issued or carried out under any provision of the securities laws, as defined in section 3 of the Securities Exchange Act of 1934 (15 U.S.C. 78c), and the purposes of considering, proposing, adopting, or engaging in any such rule or program or developing new rules or programs, the Commission may—

"(1) gather information from and communicate with investors or other members of the public;

"(2) engage in such temporary investor testing programs as the Commission determines are in the public interest or would protect investors; and

"(3) consult with academics and consultants, as necessary to carry out this subsection.

"(f) RULE OF CONSTRUCTION.—For purposes of the Paperwork Reduction Act (44 U.S.C. 3501 et seq.), any action taken under subsection (e) shall not be construed to be a collection of information.".

SEC. 913. STUDY AND RULEMAKING REGARDING OBLIGATIONS OF BROKERS, DEALERS, AND INVESTMENT ADVISERS.

(a) DEFINITION.—For purposes of this section, the term "retail customer" means a natural person, or the legal representative of such natural person, who—

(1) receives personalized investment advice about securities from a broker or dealer or investment adviser; and

(2) uses such advice primarily for personal, family, or household purposes.

(b) STUDY.—The Commission shall conduct a study to evaluate—

(1) the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers imposed by the Commission and a national securities association, and other Federal and State legal or regulatory standards; and

(2) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care

for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.

(c) CONSIDERATIONS.—In conducting the study required under subsection (b), the Commission shall consider—

(1) the effectiveness of existing legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice and recommendations about securities to retail customers imposed by the Commission and a national securities association, and other Federal and State legal or regulatory standards;

(2) whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute;

(3) whether retail customers understand that there are different standards of care applicable to brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers in the provision of personalized investment advice about securities to retail customers;

(4) whether the existence of different standards of care applicable to brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers is a source of confusion for retail customers regarding the quality of personalized investment advice that retail customers receive;

(5) the regulatory, examination, and enforcement resources devoted to, and activities of, the Commission, the States, and a national securities association to enforce the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers when providing personalized investment advice and recommendations about securities to retail customers, including—

(A) the effectiveness of the examinations of brokers, dealers, and investment advisers in determining compliance with regulations;

(B) the frequency of the examinations; and

(C) the length of time of the examinations;

(6) the substantive differences in the regulation of brokers, dealers, and investment advisers, when providing personalized investment advice and recommendations about securities to retail customers;

(7) the specific instances related to the provision of personalized investment advice about securities in which—

(A) the regulation and oversight of investment advisers provide greater protection to retail customers than the regulation and oversight of brokers and dealers; and

(B) the regulation and oversight of brokers and dealers provide greater protection to retail customers than the regulation and oversight of investment advisers;

(8) the existing legal or regulatory standards of State securities regulators and other regulators intended to protect retail customers;

(9) the potential impact on retail customers, including the potential impact on access of retail customers to the range of products and services offered by brokers and dealers, of imposing upon brokers, dealers, and persons associated with brokers or dealers—

(A) the standard of care applied under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.) for providing personalized investment advice about securities to retail customers of investment advisers, as interpreted by the Commission and the courts; and

(B) other requirements of the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.);

(10) the potential impact of eliminating the broker and dealer exclusion from the definition of "investment adviser" under section 202(a)(11)(C) of the Investment Advisers Act of 1940 (15 U.S.C. 80b–2(a)(11)(C)), in terms of—

(A) the impact and potential benefits and harm to retail customers that could result from such a change, including any potential impact on access to personalized investment advice and recommendations about securities to retail customers or the availability of such advice and recommendations;

(B) the number of additional entities and individuals that would be required to register under, or become subject to, the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.), and the additional requirements to which brokers, dealers, and persons associated with brokers and dealers would become subject, including—

(i) any potential additional associated person licensing, registration, and examination requirements; and

(ii) the additional costs, if any, to the additional entities and individuals; and

(C) the impact on Commission and State resources to—

(i) conduct examinations of registered investment advisers and the representatives of registered investment advisers, including the impact on the examination cycle; and

(ii) enforce the standard of care and other applicable requirements imposed under the Investment Advisers Act of 1940 (15 U.S.C. 80b–1 et seq.);

(11) the varying level of services provided by brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers to retail customers and the varying scope and terms of retail customer relationships of brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers with such retail customers;

(12) the potential impact upon retail customers that could result from potential changes in the regulatory requirements

or legal standards of care affecting brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers relating to their obligations to retail customers regarding the provision of investment advice, including any potential impact on—

(A) protection from fraud;

(B) access to personalized investment advice, and recommendations about securities to retail customers; or

(C) the availability of such advice and recommendations;

(13) the potential additional costs and expenses to—

(A) retail customers regarding and the potential impact on the profitability of their investment decisions; and

(B) brokers, dealers, and investment advisers resulting from potential changes in the regulatory requirements or legal standards affecting brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers relating to their obligations, including duty of care, to retail customers; and

(14) any other consideration that the Commission considers necessary and appropriate in determining whether to conduct a rulemaking under subsection (f).

(d) REPORT.—

(1) IN GENERAL.—Not later than 6 months after the date of enactment of this Act, the Commission shall submit a report on the study required under subsection (b) to—

(A) the Committee on Banking, Housing, and Urban Affairs of the Senate; and

(B) the Committee on Financial Services of the House of Representatives.

(2) CONTENT REQUIREMENTS.—The report required under paragraph (1) shall describe the findings, conclusions, and recommendations of the Commission from the study required under subsection (b), including—

(A) a description of the considerations, analysis, and public and industry input that the Commission considered, as required under subsection (b), to make such findings, conclusions, and policy recommendations; and

(B) an analysis of whether any identified legal or regulatory gaps, shortcomings, or overlap in legal or regulatory standards in the protection of retail customers relating to the standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to retail customers.

(e) PUBLIC COMMENT.—The Commission shall seek and consider public input, comments, and data in order to prepare the report required under subsection (d).

(f) RULEMAKING.—The Commission may commence a rulemaking, as necessary or appropriate in the public interest and for the protection of retail customers (and such other customers as the Commission may by rule provide), to address the legal or regulatory standards of care for brokers, dealers, investment advisers, persons associated with brokers or dealers, and persons associated with investment advisers for providing personalized investment advice about securities to such retail customers. The Commission shall consider the findings conclusions, and recommendations of the study required under subsection (b).

(g) AUTHORITY TO ESTABLISH A FIDUCIARY DUTY FOR BROKERS AND DEALERS.—

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o) is amended by adding at the end the following:

"(k) STANDARD OF CONDUCT.—

"(1) IN GENERAL.—Notwithstanding any other provision of this Act or the Investment Advisers Act of 1940, the Commission may promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice about securities to a retail customer (and such other customers as the Commission may by rule provide), the standard of conduct for such broker or dealer with respect to such customer shall be the same as the standard of conduct applicable to an investment adviser under section 211 of the Investment Advisers Act of 1940. 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. Nothing in this section shall require a broker or dealer or registered representative to have a continuing duty of care or loyalty to the customer after providing personalized investment advice about securities.

"(2) DISCLOSURE OF RANGE OF PRODUCTS OFFERED.—Where a broker or dealer sells only proprietary or other limited range of products, as determined by the Commission, the Commission may by rule require that such broker or dealer provide notice to each retail customer and obtain the consent or acknowledgment of the customer. The sale of only proprietary or other limited range of products by a broker or dealer shall not, in and of itself, be considered a violation of the standard set forth in paragraph (1).

"(l) OTHER MATTERS.—The Commission shall—

"(1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest; and

"(2) examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.".

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 211 of the Investment Advisers Act of 1940, is further amended by adding at the end the following new subsections:

"(g) STANDARD OF CONDUCT.—

"(1) IN GENERAL.—The Commission may promulgate rules to provide that the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the Commission may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice. In accordance with such rules, any material conflicts of interest shall be disclosed and may be consented to by the customer. Such rules shall provide that such standard of conduct shall be no less stringent than the standard applicable to investment advisers under section 206(1) and (2) of this Act when providing personalized investment advice about securities, except the Commission shall not ascribe a meaning to the term 'customer' that would include an investor in a private fund managed by an investment adviser, where such private fund has entered into an advisory contract with such adviser. The receipt of compensation based on commission or fees shall not, in and of itself, be considered a violation of such standard applied to a broker, dealer, or investment adviser.

"(2) RETAIL CUSTOMER DEFINED.—For purposes of this subsection, the term 'retail customer' means a natural person, or the legal representative of such natural person, who—

"(A) receives personalized investment advice about securities from a broker, dealer, or investment adviser; and

"(B) uses such advice primarily for personal, family, or household purposes.

"(h) OTHER MATTERS.—The Commission shall—

"(1) facilitate the provision of simple and clear disclosures to investors regarding the terms of their relationships with brokers, dealers, and investment advisers, including any material conflicts of interest; and

"(2) examine and, where appropriate, promulgate rules prohibiting or restricting certain sales practices, conflicts of interest, and compensation schemes for brokers, dealers, and investment advisers that the Commission deems contrary to the public interest and the protection of investors.".

(h) HARMONIZATION OF ENFORCEMENT.—

(1) SECURITIES EXCHANGE ACT OF 1934.—Section 15 of the Securities Exchange Act of 1934, as amended by subsection (g)(1), is further amended by adding at the end the following new subsection:

"(m) HARMONIZATION OF ENFORCEMENT.—The enforcement authority of the Commission with respect to violations of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer shall include—

"(1) the enforcement authority of the Commission with respect to such violations provided under this Act; and

"(2) the enforcement authority of the Commission with respect to violations of the standard of conduct applicable to an investment adviser under the Investment Advisers Act of 1940, including the authority to impose sanctions for such violations, and

the Commission shall seek to prosecute and sanction violators of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under this Act to same extent as the Commission prosecutes and sanctions violators of the standard of conduct applicable to an investment advisor under the Investment Advisers Act of 1940.".

(2) INVESTMENT ADVISERS ACT OF 1940.—Section 211 of the Investment Advisers Act of 1940, as amended by subsection

(g)(2), is further amended by adding at the end the following new subsection:

"(i) HARMONIZATION OF ENFORCEMENT.—The enforcement authority of the Commission with respect to violations of the standard of conduct applicable to an investment adviser shall include—

"(1) the enforcement authority of the Commission with respect to such violations provided under this Act; and

"(2) the enforcement authority of the Commission with respect to violations of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under the Securities Exchange Act of 1934, including the authority to impose sanctions for such violations, and

the Commission shall seek to prosecute and sanction violators of the standard of conduct applicable to an investment adviser under this Act to same extent as the Commission prosecutes and sanctions violators of the standard of conduct applicable to a broker or dealer providing personalized investment advice about securities to a retail customer under the Securities Exchange Act of 1934.".

SEC. 914. STUDY ON ENHANCING INVESTMENT ADVISER EXAMINATIONS.

(a) STUDY REQUIRED.—

(1) IN GENERAL.—The Commission shall review and analyze the need for enhanced examination and enforcement resources for investment advisers.

(2) AREAS OF CONSIDERATION.—The study required by this subsection shall examine—

(A) the number and frequency of examinations of investment advisers by the Commission over the 5 years preceding the date of the enactment of this subtitle;

(B) the extent to which having Congress authorize the Commission to designate one or more self-regulatory organizations to augment the Commission's efforts in overseeing investment advisers would improve the frequency of examinations of investment advisers; and

(C) current and potential approaches to examining the investment advisory activities of dually registered broker-dealers and investment advisers or affiliated broker-dealers and investment advisers.

(b) REPORT REQUIRED.—The Commission shall report its findings to the Committee on Financial Services of the House of Representatives and the Committee on Banking, Housing, and Urban Affairs of the Senate, not later than 180 days after the date of enactment of this subtitle, and shall use such findings to revise its rules and regulations, as necessary. The report shall include a discussion of regulatory or legislative steps that are recommended or that may be necessary to address concerns identified in the study.

SEC. 915. OFFICE OF THE INVESTOR ADVOCATE.

Section 4 of the Securities Exchange Act of 1934 (15 U.S.C. 78d) is amended by adding at the end the following:

"(g) OFFICE OF THE INVESTOR ADVOCATE.—

"(1) OFFICE ESTABLISHED.—There is established within the Commission the Office of the Investor Advocate (in this subsection referred to as the 'Office').

OLIVER WYMAN

sifma

Invested in America

Financial Services

October 2010

Standard of Care Harmonization
Impact Assessment for SEC

NYC-FMJ001-001

Contents

Section 1

Executive summary

Summary findings (1)

- Oliver Wyman collected data from a broad selection of retail brokerage firms to assess the impact of significant changes to the existing standard of care for broker-dealers and investment advisors
  - A total of 17 firms provided data
  - These institutions serve 38.2MM households and manage $6.8TN in client assets
  - The survey captures approximately 33% of households and 25% of retail financial assets in the US
- The primary issue at stake in the SEC 'standard of care' study is how to better protect the investor while preserving choice of relationship, product access, and affordability of advisory services
- The key insight from the survey is that broker-dealers play a critical role in the financial services industry that cannot be easily replicated with alternative services models
- Wholesale adoption of the Investment Advisers Act of 1940 for all brokerage activity is likely to have a negative impact on consumers (particularly smaller investors) across each of the following dimensions
  - Choice
  - Product access
  - Affordability of advisory services

Continued…

Summary findings (2)

Potential impact of rulemaking on retail investors

Choice	▪ Reduced access to the preferred ‘investment and advisory model’ for retail investors – 95% of households hold commission-based brokerage accounts today – The fee-based advisory platform is far less popular (only 5% of households) – The ‘preference’ for brokerage accounts is evident across all wealth segments but strongest for smaller investors with less than $250K in assets
Product Access	▪ Reduced access to products distributed primarily through broker-dealers – Municipal and corporate bonds represent ~15% of assets held by retail investors – These products (among others) are generally offered on a ‘principal basis’ – Restricting principal or proprietary offerings will limit investor access to these products and possibly limit financing options for municipalities or corporates at current pricing
Affordability of Advisory Service	▪ Reduced access to the most affordable investment options – Fee-based services are 23-37 bps more expensive than brokerage[1] – For an investor with $200K in assets, this translates to $460 in additional fees – The cost of shifting to fee-based pricing alone would reduce expected returns by more than $20K over a 20 year horizon (assuming 5% annual returns) ▪ And the indirect costs of additional compliance, disclosure, and surveillance may have an even greater impact on consumers → we estimate that 12-17MM small investors ‘at the margin’ could lose access to current levels of advisory service if even 2 additional hours of coverage and support is required per client

1. Cost expressed as a percentage of assets under management in basis points (1bp = 0.01%)

Section 2

Methodology and source data

Oliver Wyman collected data from 17 SIFMA member firms to support the impact assessment

Purpose of study

- The impact assessment that follows was designed in response to the SEC request for comment on the upcoming study of the standard of care obligations for broker-dealers and investment advisers
- Oliver Wyman gathered data from 17 SIFMA member firms to provide relevant market data for the SEC study
- The study is intended to help
  - Identify the investor segments most likely to be affected by changes to the standard of care
  - Understand the cost to the consumer (choice, product access, transaction costs) of potential changes
  - Understand the one-time and ongoing costs of compliance for advisory and brokerage firms
  - Estimate the broader market / economic impact of any changes, particularly for capital formation

Note on survey methodology

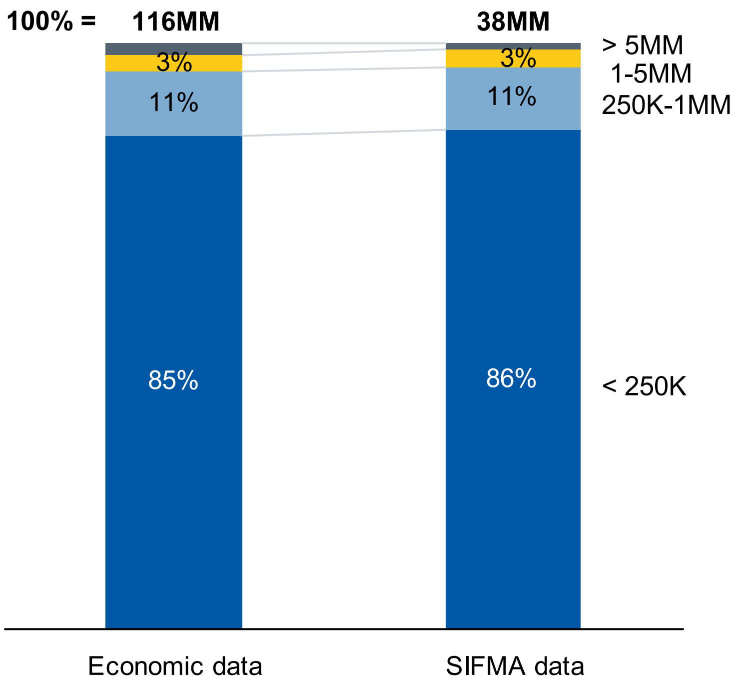
- 17 member firms participated, representing $6.8TN in assets (approximately 27% of total U.S. household financial assets) across 38.2MM households
- To obtain a fairly representative sample of the industry, data on asset management accounts, investor profiles, and cost structure was gathered from a diverse set of brokerage firms

Note on confidentiality

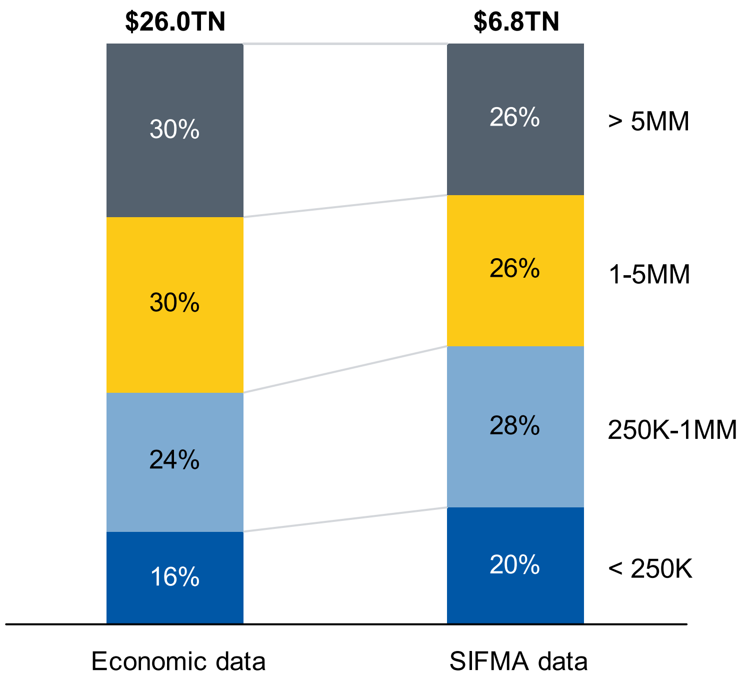
- Due to the highly sensitive nature of firm-specific information, all data is presented in aggregated form

The survey proved to be highly representative of the investor population as a whole, capturing 33% of households and 27% of financial assets

Investors by wealth segment[1]
Number of U.S. households, 2009



Assets by wealth segment
Investable assets, 2009



Note: Economic data includes all investable assets whereas SIFMA data refers to managed assets, SIFMA data skews toward investors with <$1MM in assets

1. Wealth segments based on client assets under management

Source: SIFMA member data, 2007 Federal Reserve Survey of Consumer Finances, Oliver Wyman analysis

Section 3

Background and context

Regulators have wide discretion in establishing a uniform ‘standard of care’ for the IABD industry

- Regulators have a range of options in establishing a uniform ‘standard of care’ for broker-dealers and investment advisers in the United States
  - Limited changes to current model
  - A ‘standard of care’ with disclosure / consent to conflicts that preserves commission-based brokerage
  - Wholesale adoption of the Advisers Act of 1940 for all broker-dealers and investment advisers
- A major shift in the ‘standard of care’ will impact individual investors in several ways
  - Choice of advisory model
  - Access to investment products
  - Cost of investment and advisory services
- Beyond these direct costs to the consumer, we also anticipate broader economic costs to the industry as a whole
  - Broker-dealers and investment advisory firms will all face one-time and ongoing costs to comply with new fiduciary, disclosure, and surveillance requirements → these may be passed on to investors
  - Potential limitations on product accessibility for retail investors will place constraints on capital formation and issuers’ ability to finance at attractive rates

Our analysis will focus on the relative impact of two possible scenarios for harmonization of the standard of care

Activity	Rule making scenarios		
	STATUS QUO WITH GREATER DISCLOSURE *Harmonized standards that preserve existing practices but require greater disclosure*	**FIDUCIARY DUTY WITH CONSENT TO CONFLICTS** *Fiduciary standard for advisory activity that preserves commission-based brokerage model*	**ADOPTION OF ADVISERS ACT OF 1940** *Fiduciary standard for advisory activity with fees based on assets under management*
Investment planning	▪ Suitability for resultant securities transactions	▪ Best interest of the client with disclosure / consent to conflicts	▪ Best interest of the client
Asset allocation advice	▪ Suitability for resultant securities transactions	▪ Best interest of the client with disclosure / consent to conflicts	▪ Best interest of the client
Advice on client holdings	▪ Best interest of the client (advisory services) or suitability (brokerage services)	▪ Best interest of the client, at point of sale or ongoing depending on relationship	▪ Best interest of the client
Proprietary product sales	▪ Best interest of the client (advisory services) or suitability (brokerage services)	▪ Best interest of the client with disclosure / consent to conflicts	▪ Not available
Principal transactions	▪ Best interest of the client (advisory services) or suitability (brokerage services)	▪ Best interest of the client with disclosure / consent to conflicts	▪ Trade-by-trade prior consent required
IRA / retirement accounts	▪ Best interest of the client (advisory services) or suitability (brokerage services)	▪ Best interest of the client or solely in the interest of the client, depending on relationship	▪ Solely in the interest of the client

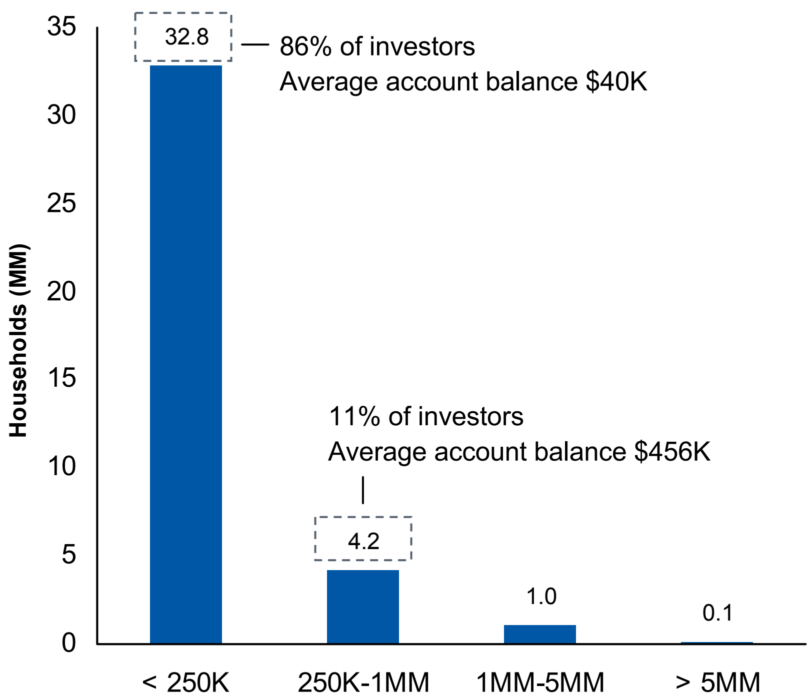
Baseline for impact analysis

Section 4

Impact on choice

The vast majority (97%) of the US investor population holds less than $1MM in assets with a broker-dealer or investment adviser

Investor landscape (survey population)
Number of investors by wealth segment[1], 2009



Client assets under management			
$1.3TN	$1.9TN	$1.8TN	$1.8TN

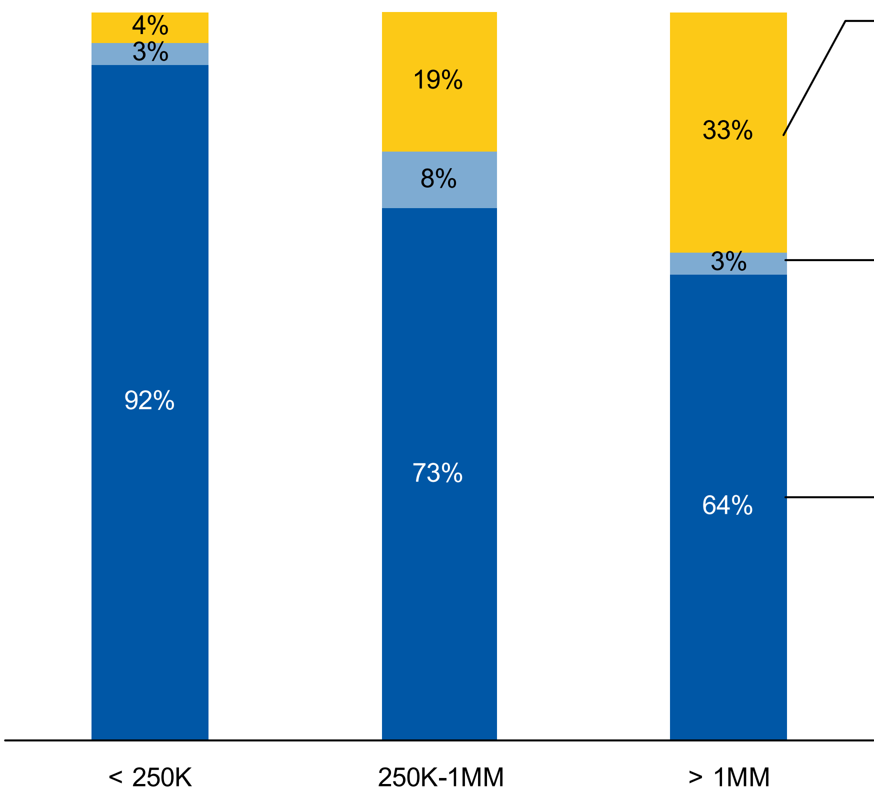
Key observations

- 97% of investors in the survey (37.0MM) hold less than $1MM in assets with broker-dealers or investment advisers
- Despite the heavy skew toward small clients, total assets are evenly distributed across the wealth spectrum ($1.3-1.9TN in all groups)
- Average account balance for investors in the lowest wealth segment is $40K → this is the segment most likely to be affected by a significant increase in costs

1. Wealth segments based on client assets under management
Source: SIFMA member data, 2007 Federal Reserve Survey of Consumer Finances, Oliver Wyman analysis

Across wealth segments, less than 5% of investors use fee-based accounts alone to serve their investment needs

Channel preference (survey population)
Number of households by relationship model, 2009



1 Mix of commission- and fee-based accounts

- As wealth increases, more investors use a hybrid model of fees and commissions-based management

2 Fee-based accounts

- Only 1.3MM investors (4% of total) hold AUM solely under fee-based management
- Fees-only management is the least common channel across all wealth segments

3 Commission-based accounts

- Over 30MM households hold assets solely in commission-based accounts; 27MM of these are from the lowest wealth segment
- Investors in the lowest wealth segment have a much stronger skew towards commissions-only management than any other wealth segment

Source: SIFMA member data, 2007 Federal Reserve Survey of Consumer Finances, Oliver Wyman analysis

The current model offers investors a wide range of advisory service, product access, and pricing options

Key Attributes	Account Types			
	Fee-Based	**Fees and Commissions**	**Commission-Based** *Advised*	**Commission-Based**[1] *Non-Advised*
Share of population	4%	7%	← 88% →	
Advisory needs	▪ Broad, portfolio-based financial planning and investment advice	▪ Broad, portfolio-based financial planning and investment advice plus product-specific advice	▪ Product-specific advice, access to principal products	▪ Uncertain
Investment activity	▪ Combination of active and passive, depending on client needs	▪ Active investment	▪ Combination of active and passive, depending on client choice	▪ Combination of active and passive, depending on client choice
Level of service	▪ Highest → ongoing advice and account surveillance	▪ Highest → ongoing advice and account surveillance	▪ Balanced → point in time advice on specific products	▪ Limited service
Typical holdings	▪ Investable assets only	▪ Investable assets ▪ Cash and equivalents ▪ Concentrated positions with special requirements	▪ Investable assets ▪ Cash and equivalents ▪ Concentrated positions with special requirements	▪ All investable assets ▪ Cash and equivalents
Cost	▪ Highest cost ▪ Range = 67-117 bps[2]	▪ Balanced cost ▪ Range = 43-99 bps[2]	▪ Balanced cost ▪ Range = 38-94 bps[2]	▪ Lowest cost, depending on trading activity
Common investors	▪ Affluent and HNW	▪ Affluent and HNW	▪ All investors	▪ Predominantly lower net worth investors

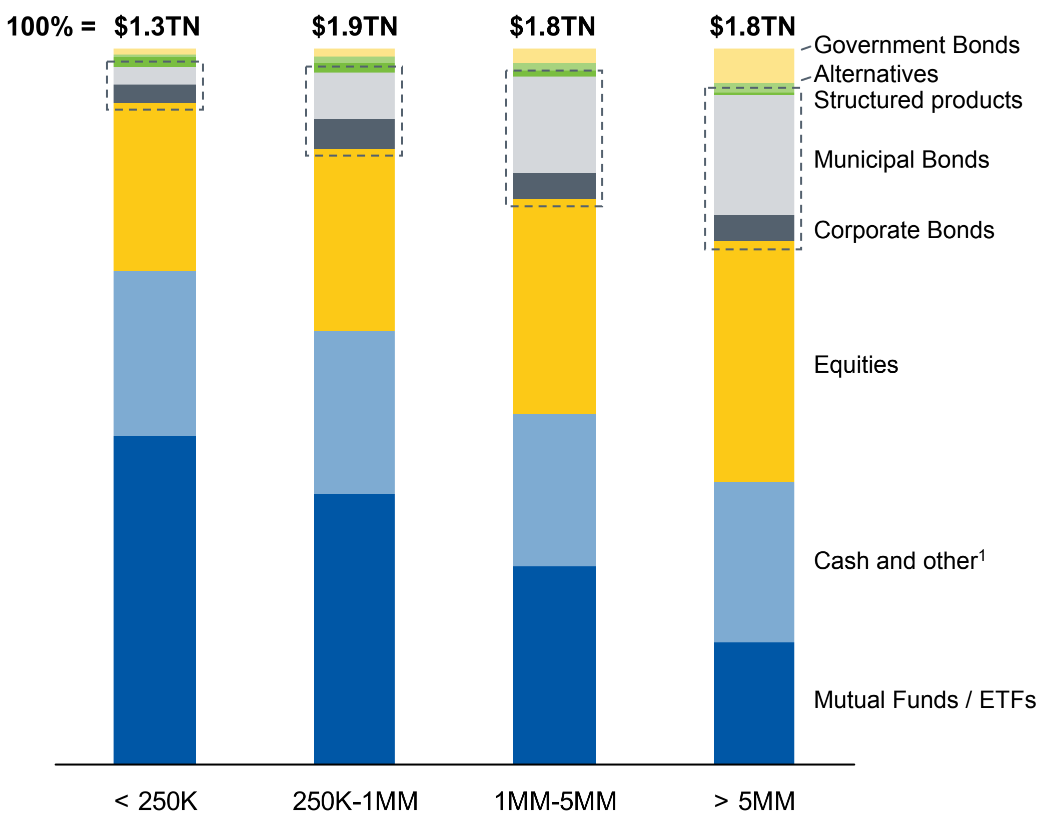
1. Non-advised accounts (e.g. self-directed online) were not targeted in this study but represent a significant subset of commission-based accounts
2. Range dependent on wealth segment (high end of the range reflects pricing for lowest wealth segment)

Section 5

Impact on product access

Direct holdings of individual securities (such as municipal bonds) represent an important element of investment strategy across all wealth segments

Asset allocation (survey population)
Allocation of assets (%) by wealth segment, 2009



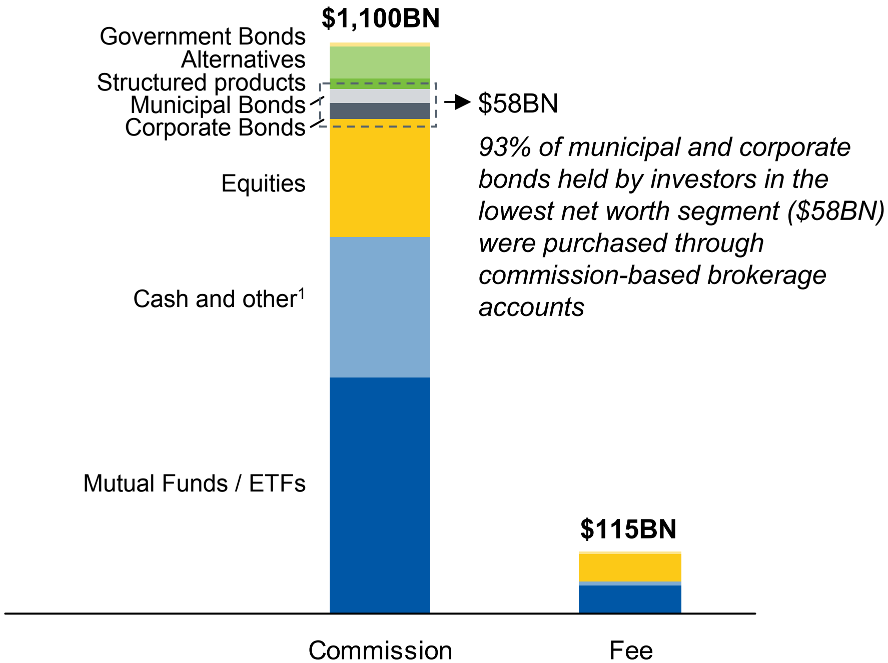
1. Includes cash, currencies, money market funds, etc
Source: SIFMA member data, Oliver Wyman analysis

Key observations

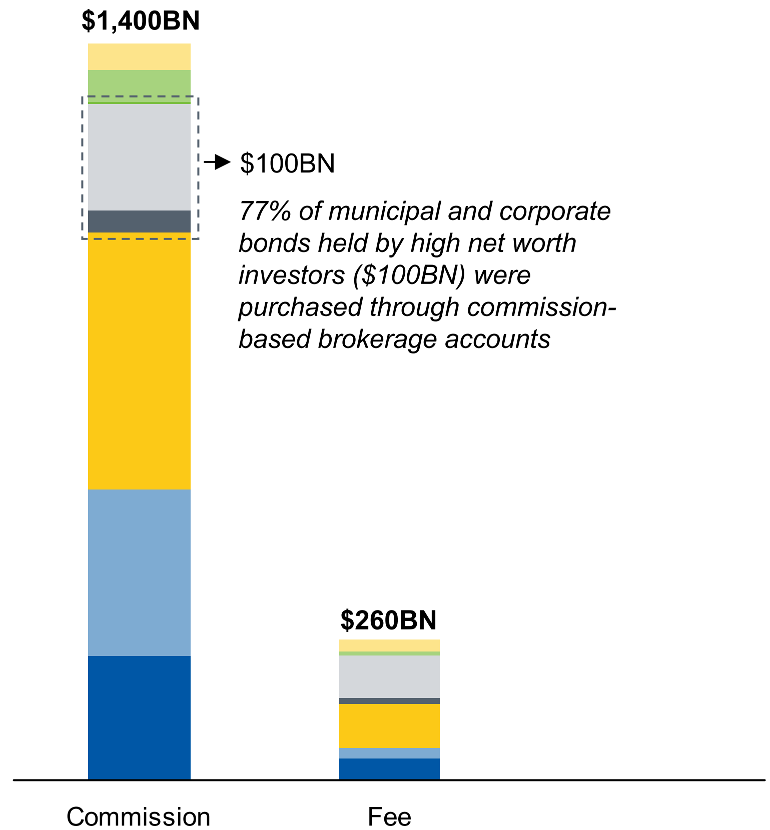
- Investors across all wealth segments have at least 30% of their portfolio in direct holdings of individual securities
- Municipal and corporate bonds offer tax and diversification benefits that investors may be unable to access via funds
- Across all investors, municipal and corporate bonds represent 13% of total wealth and 18% of invested assets (excluding cash)
- Allocations to municipal and corporate bonds range from 7% of investable assets for low net worth accounts to as high as 26% for high net worth accounts

Commission-based brokerage is the primary channel for accessing these products today, especially for investors in the lowest wealth segment

Low Net worth investors (<250K AUM)
Product access by account type[2]



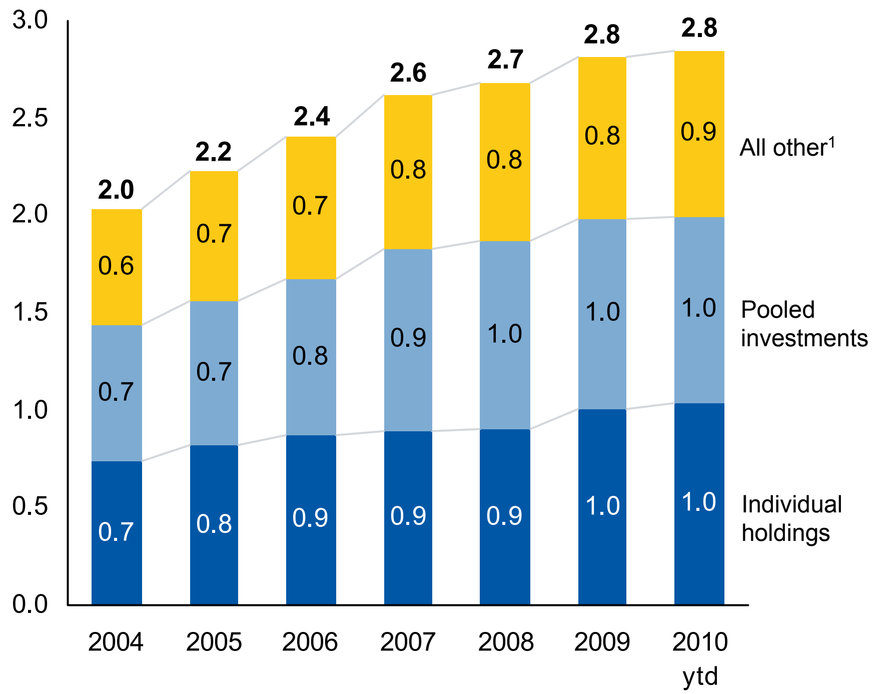
High Net Worth Investors (>5MM AUM)
Product access by account type



1. Cash and other includes cash, currencies, money market funds, etc.
2. Non-discretionary, commission accounts and discretionary, fee accounts
Source: SIFMA member data, Oliver Wyman analysis

Individual investors hold 70% of municipal debt in the US today, both through direct and pooled investments

Investor demand for Municipal Securities
Holdings of Municipal Securities by segment, $TN



Individual holdings (% of total outstanding)							
Direct	37%	37%	36%	34%	34%	36%	36%
Indirect	34%	33%	34%	36%	36%	35%	34%

1. Other sectors include corporates, financial institutions, broker-dealers, and foreign entities
Source: Federal Reserve

Key observations

- The municipal securities market has grown steadily over the past several years and now provides nearly $3TN in financing for state and local governments
- Municipalities in the U.S. have issued ~$400BN debt annually over the past five years through these instruments
- The market is dominated by individual investors who hold ~ 70% of outstanding debt, split across direct exposures and pooled investments
- Financial institutions are relatively minor players in the space, collectively holding less than 30% of total assets (including broker-dealer inventories)
- A significant shift in the 'standard of care' required for origination and distribution of investments sold on a principal basis (as Munis are) could have a significant market impact along 2 dimensions
  – Access and cost for retail investors
  – Low cost financing for municipalities

Broker-dealers play a key role in the Munis market, providing individual investors with direct and cost effective access to new issuances of these securities

Channels

Retail Investors

Primary market

- Transaction costs are built into the 'discount' or underwriting fees paid by the issuer
- Investors have access to securities with no explicit mark-up during limited retail order periods

Secondary market

- Securities trade on the secondary market and prices fluctuate to reflect supply and demand
- Investors have access to securities through broker-dealers who act as principals and build inventory (mark-up paid by investors)

Pooled investment funds

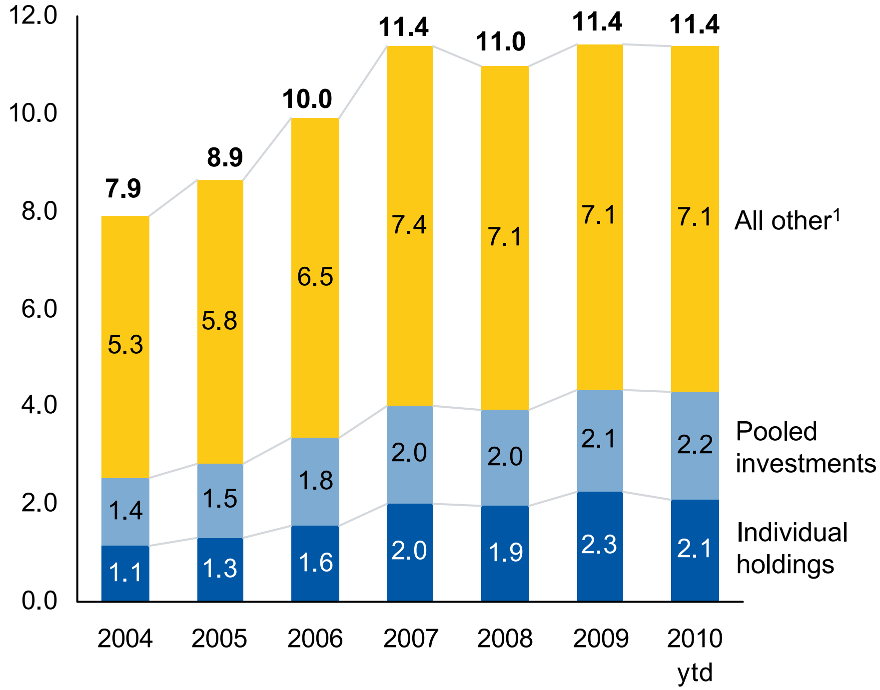
- Securities are bought and sold by broker-dealers on behalf of pooled investment funds
- Investors pay the funds' asset management / advisory fees in addition to transaction costs / sales loads passed on by the fund

Role of the broker-dealer

- Direct, affordable access to municipal bonds for retail investors via primary and secondary principal trading desks → mutual funds are an alternative channel to Munis but at higher cost as management fees erode returns (~1% management fees vs. 4-5% average yield)

Individual investors are also important participants in the corporate bond market

Investor demand for Corporate and Foreign Bonds
Holdings of Corporate and Foreign Securities by segment, $TN



Individual holdings (% of total outstanding)							
Direct	14%	15%	16%	18%	18%	20%	18%
Indirect	18%	17%	18%	18%	18%	18%	19%

1. Other sectors include corporates, financial institutions, broker-dealers, and foreign entities
Source: Federal Reserve

Key observations

- Corporations and foreign entities rapidly increased issuance of new debt between 2004-2007 and have maintained annual new bond issuance of ~ $11TN since the financial crisis
- Individual investors (via direct holdings or pooled investments) are the largest single class of investor in the corporate and foreign bond market
- Individual investors hold $4.3TN or nearly 40% of outstanding debt today
- In absolute terms, individual investors' share of the corporate securities market is larger than municipal securities
- Capital formation for US corporates is driven in large part by individual investment

Broker-dealers anticipate retail demand for corporate bonds and hold inventory to quickly, efficiently, and cost effectively meet client needs in the secondary market

Channels

Channel	Retail Investors
Primary market	▪ Predominantly institutional market ▪ Retail investors have little to no access to primary issuance
Secondary market	▪ Primarily over-the-counter market → broker-dealers provide main point of access for retail investors to these securities ▪ Investors pay upfront mark-ups but no ongoing management fees that are likely to erode returns
Pooled investment funds	▪ Securities are bought and sold by broker-dealers on behalf of pooled investment funds ▪ Investors pay the funds' asset management / advisory fees in addition to transaction costs / sales loads passed on by the fund

Role of the broker-dealer

- Direct, affordable access to corporate bonds for retail investors via secondary principal trading desks → principal traders anticipate retail demand and build inventory that meets specific investment needs of clients

Section 6

Impact on cost

We have profiled three typical investors within each wealth segment to evaluate the potential costs of broad application of the Advisers Act of 1940[1]

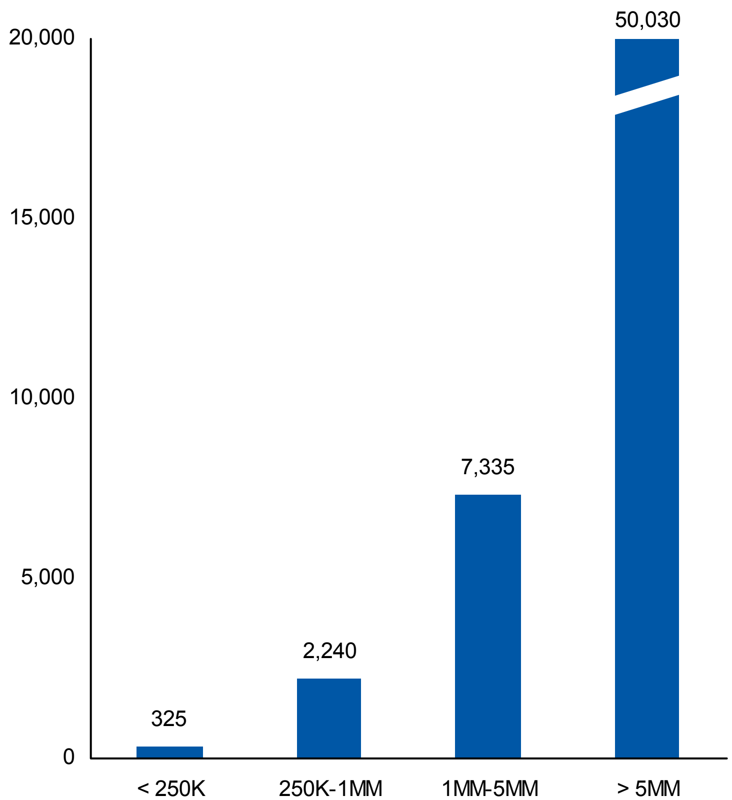
A	**'Small Investor' with commission-based accounts** *77% of all investors*	▪ $200K in assets held exclusively in commission-based accounts ▪ Passive investor with less than 10 trades per year (~50% of investors in <$250K segment) ▪ Pays 94 bps or $1,890 in commissions per year ▪ Holds $132K (68% of assets) in mutual funds and cash / cash equivalents ▪ Significant direct holdings (31% of assets), mainly in equities ▪ Limited investments in alternatives, fixed income, and structured products
B	**'Affluent Investor' with commission-based accounts** *7% of all investors*	▪ $500K in assets held in commission-based accounts ▪ Active investor with more than 10 trades per year (~75% of investors in $250K-1MM segment) ▪ Pays 53 bps or $2,650 in commissions per year ▪ Holds $292K (59% of assets) in mutual funds and cash / cash equivalents ▪ Holds $117.5K (23% of assets) in equities ▪ Hold $90.5K (18% of assets) in fixed income, structured products and alternatives
C	**'High Net Worth Investor' with commission-based accounts** *2% of all investors*	▪ $10MM in assets held in commission-based accounts ▪ Active investor with more than 10 trades per year (~75% of investors in >$1MM segment) ▪ Pays 38 bps or $38,000 in commissions per year ▪ Mutual funds and cash / cash equivalents together are $4.1MM (41% of assets) ▪ Equities are largest part of portfolio, with $3.3MM invested (33% of assets) ▪ Fixed income, structured products and alternatives represent $2.6MM (26% of assets)

1. Asset allocation based on observed average asset allocation for each wealth segment
Source: SIFMA member data, Oliver Wyman analysis

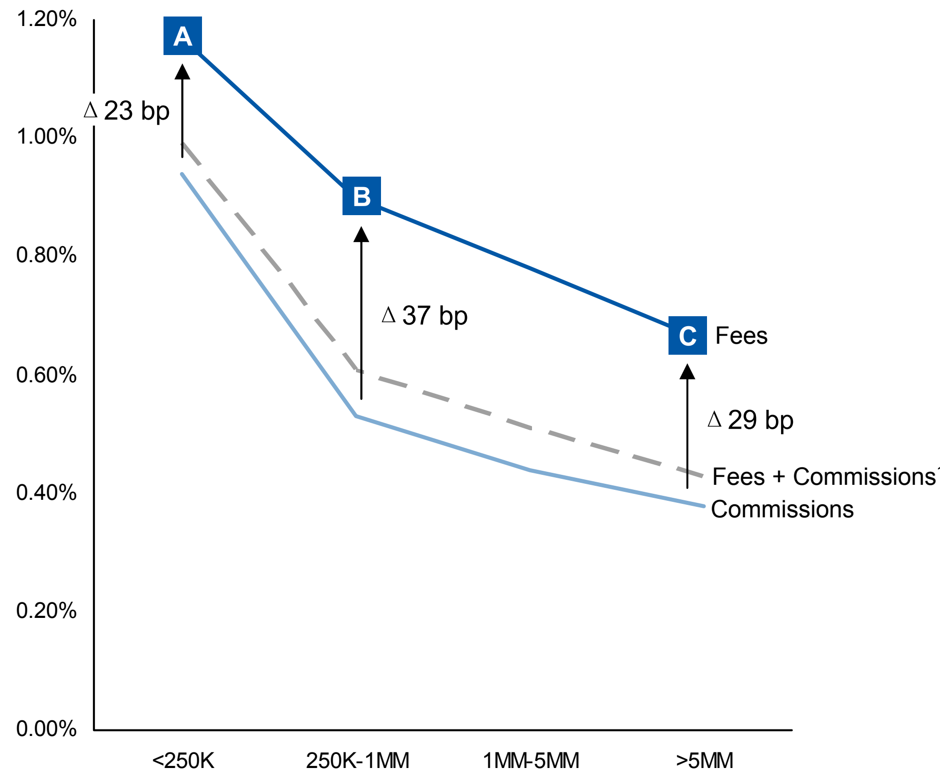
Commission-based accounts provide the most cost effective option for investors across the wealth spectrum today

Financial cost to consumer

Average annual fees and commissions, 2009



Average annual fees and commissions as % of AUM, 2009



1. Based on existing balance of assets between fee-based and commission-based accounts

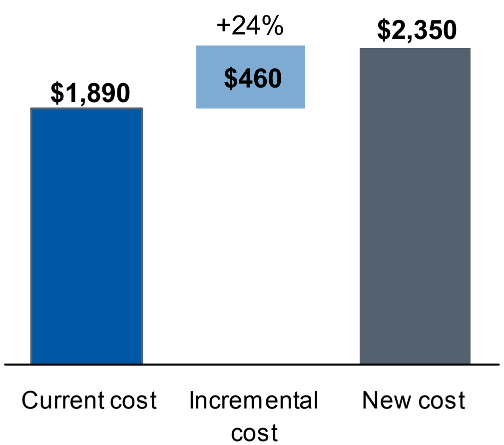
Source: SIFMA member data, Oliver Wyman analysis

A broad shift to fee-based advisory would substantially increase costs across all wealth segments

Potential impact on advisory fees and expected returns

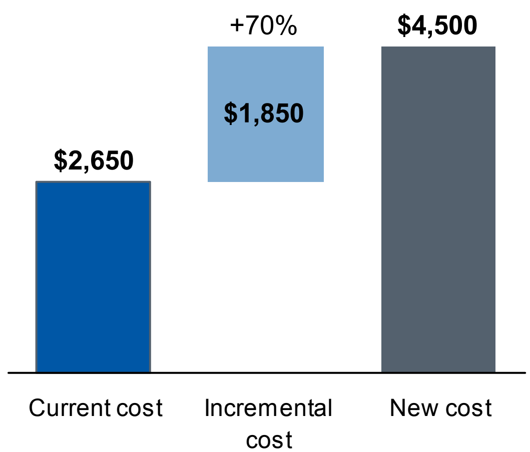
Pro forma impact of transition to fee-based accounts at current pricing, annual advisory costs[1]

A Small Investor



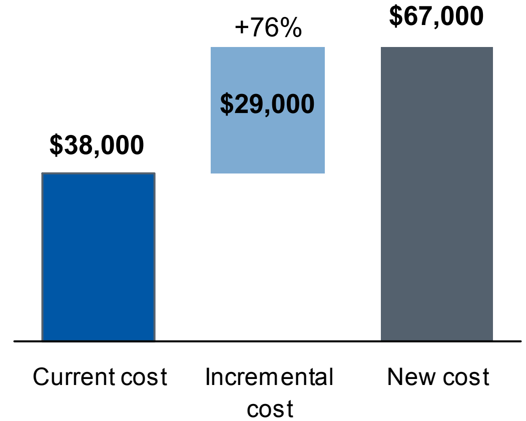
Gross Expected Return[1]	5.00%
- Current Cost	0.94%
Current Expected Return	4.06%
- Incremental Cost	0.23%
New Expected Return	**3.83%**

B Affluent Investor



Gross Expected Return[1]	5.00%
- Current Cost	0.53%
Current Expected Return	4.47%
- Incremental Cost	0.37%
New Expected Return	**4.10%**

C High net worth Investor



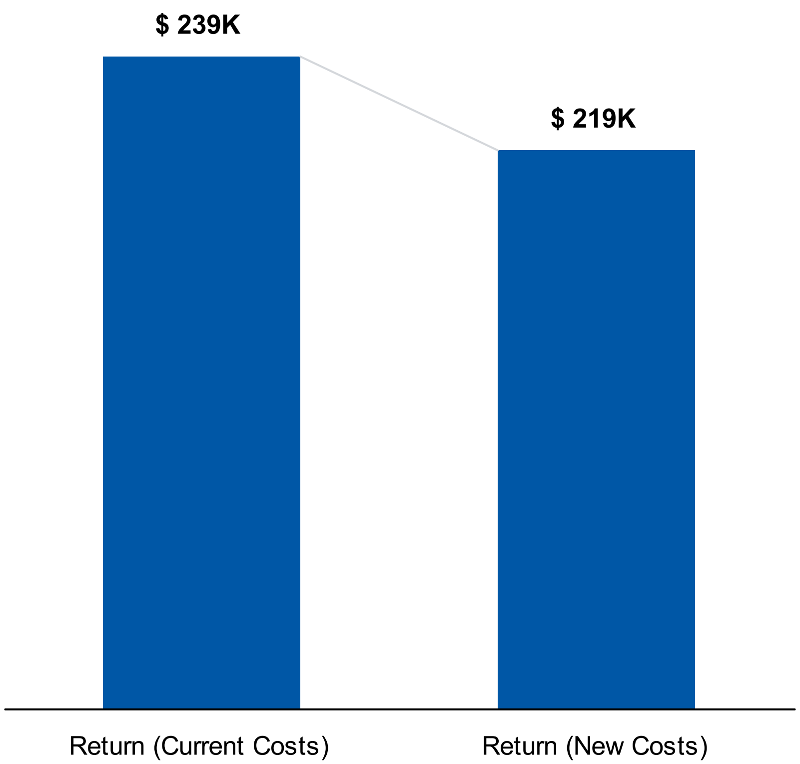
Gross Expected Return[1]	5.00%
- Current Cost	0.38%
Current Expected Return	4.62%
- Incremental Cost	0.29%
New Expected Return	**4.33%**

1. Assumes current pricing for commission- and fee-based accounts hold for all investors
2. Illustrative, not based on observed annual returns

Sources: SIFMA data, Oliver Wyman analysis

The shift to a fee-based model would reduce cumulative returns to 'small investor' (with $200K in assets) by $20K over the next 20 years

Impact of cost on investor returns
Expected investment gains on $200K portfolio, 2010-2030[1]



Key observations

- The average investor in the lowest wealth segment trades relatively infrequently over the course of the year
- As a result, a fee-based cost structure is generally more costly for these 'passive investors' and the incremental costs (+23 bps) erode returns
- For 'small investor,' a fee-based model results in a cumulative reduction in investment gains of $20K over 10 years, roughly 10% of the initial investment
  - 'Small investor' would pay ~ $59K in commissions over the course of 20 years through commission-based brokerage accounts
  - Under a fee-based advisory model, 'small investor' would pay an additional $13K in fees and lose $7K in investment gains as a result of lower principal balances each year

1. Assumes initial investment of $200K in a balanced portfolio reflecting typical, balanced asset allocation for lower net worth investors with <$250K AUM; based on constant annual returns of 5%, not adjusted for inflation; commissions deducted from principal balance starting at year end

However, the costs of complying with and / or demonstrating compliance with the new standard of care will place additional pressure on pricing

Increased activities required by shift in 'standard of care'

- Adviser training
- Increased legal and compliance
- Increased risk management and oversight
- Production and mailing of additional disclosures
- Initial client consultation
  - Review relationship
  - Obtain formal consent for existing strategy
- Investment strategy and plan
  - Evaluate portfolio
  - Assess investment objectives
  - Agree on new investment plan for client
- Documentation of client discussions
- Ongoing account surveillance

Incremental cost of compliance
Annual costs expressed as bps over assets

Additional hours	1	2	3	4	5
Estimated cost	**$200**	**$400**	**$600**	**$800**	**$1,000**
A Small investor ($200K)	10bps	20bps	30bps	40bps	50bps
B Affluent investor ($500K)	4bps	8bps	12bps	16bps	20bps
C HNW investor ($10MM)	2bps	4bps	6bps	8bps	10bps

Focus of analysis on following slides (conservative estimate)

Methodology for calculating hourly rate

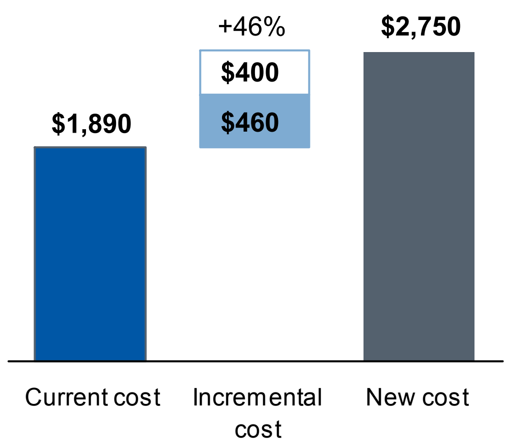
- Median income for investment advisers estimated at $173K[1]
- Adviser compensation represents 42% of fully loaded costs based on SIFMA member data
- Given 2,000 working hours per year, average hourly rate of service is $200 / hour

1. Based on 2010 annual compensation survey by Registered Rep
Source: SIFMA member data, Oliver Wyman analysis

These incremental costs will disproportionately impact investors with smaller investment portfolios

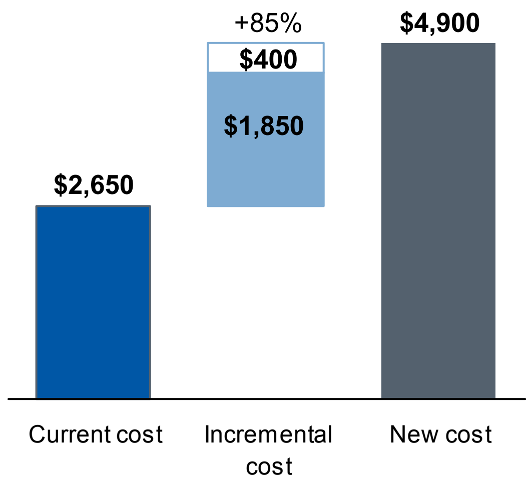
Potential impact on advisory fees and expected returns
Pro forma impact of transition to fee-based accounts at new pricing, annual advisory costs

A Small Investor



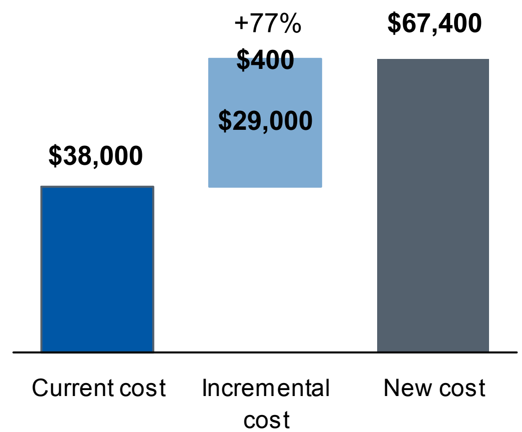
Gross Expected Return[1]	5.00%
- Current Cost	0.94%
Current Expected Return	4.06%
- Incremental Cost	0.43%
New Expected Return	**3.63%**

B Affluent Investor



Gross Expected Return[1]	5.00%
- Current Cost	0.53%
Current Expected Return	4.47%
- Incremental Cost	0.45%
New Expected Return	**4.02%**

C High net worth Investor



Gross Expected Return[1]	5.00%
- Current Cost	0.38%
Current Expected Return	4.62%
- Incremental Cost	0.29%
New Expected Return	**4.33%**

1. Assumes pricing for commission- and fee-based accounts rises to account for additional activity
2. Illustrative, not based on observed annual returns
Sources: SIFMA data, Oliver Wyman analysis

Consumers may also face significant adviser capacity constraints that will limit the availability of service under the new standard of care

Capacity analysis

Current state

Investors with <$250K in commission accounts	28.4MM
Average commissions/investor	$268
Hourly rate for asset management services	$200
Time spent per investor	1.3 hours
Time spent on all investors with <$250K AUM	38.1MM hours
Minimum number of required advisers	19K

Impact of additional service requirements

\+ 2 hours per investor

Current utilization levels	70%	80%	90%	100%
Implied capacity (MM hours)	54.4	47.6	42.3	38.1
Implied capacity (total investors, MM)	16.3	14.3	12.7	11.4
Coverage gap (total investors, MM)	12.1	14.2	15.8	17.0
Additional advisers needed	20K	24K	26K	28K

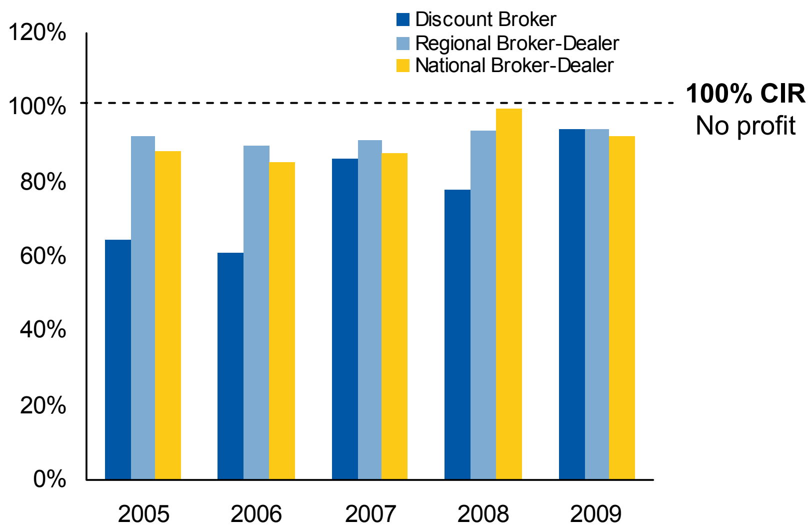
Implications

- Given current resources, we estimate that 40-57% of investors in the lowest wealth segment can be covered if advisers are required to spend 2 additional hours with each investor
- We estimate that 20-28K additional advisers will be needed to serve the 'uncovered' investors in our sample population → our sample population is 33% of US investors, which suggests that 60-84K new advisers may be needed
- Faced with this, the brokerage and investment advisory industry can respond in one of three ways
  - Increase workforce and raise prices
  - Increase workforce and absorb new costs
  - Reduce coverage for lower net worth investors whose 'personalized investment' advisory needs will exceed capacity
- While the autonomy provided by self-directed accounts is desirable for certain investors, market data suggests that investors with advised accounts
  - Make more sophisticated investment decisions
  - Achieve higher average investment returns

Source: SIFMA member data, Oliver Wyman analysis

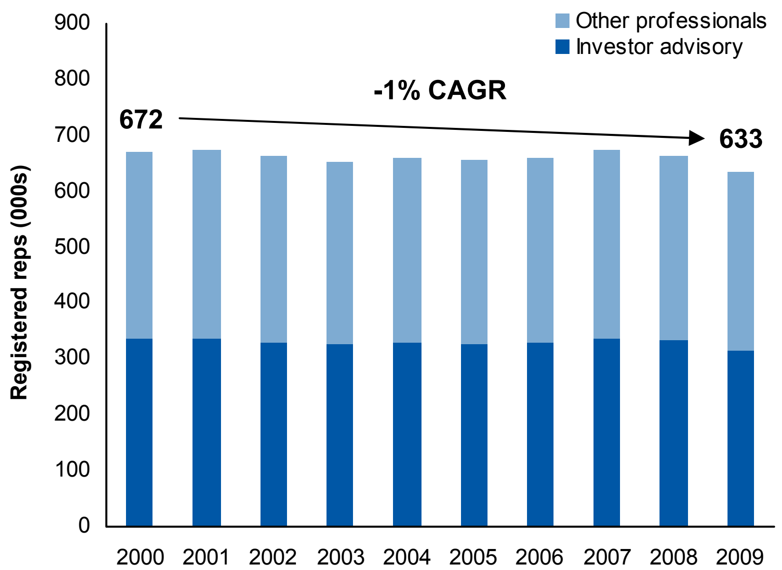
Current economics of the IA/BD industry suggest that investors will need to accept higher costs or turn to alternative service models for investment

Industry profitability
Total costs before tax over total revenues[1]



Operating margins across the industry are thin and have deteriorated since 2005, leaving little room to absorb additional cost

Industry capacity
FINRA registered representatives (000s)[2]

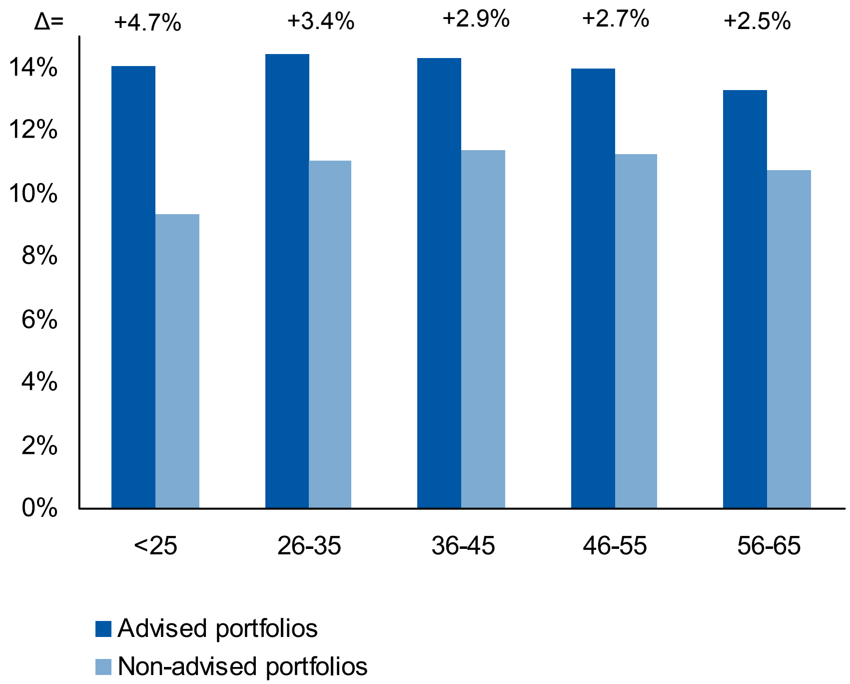


Industry headcount has been flat to negative over the past ten years; the additional capacity required to cover small clients would be difficult to provide (at least in the near term)

1. Public data for companies within the SNL National Broker-Dealer, Regional Broker-Dealer, and Discount Broker indices
2. Figures overstate actual industry capacity (approximately 50-60% of individuals who hold Series 7 licenses do not advise investors, but serve in other capacities e.g. legal, compliance, etc.)
Sources: SNL Financial, FINRA

And several recent studies suggest that investors without access to advisory services may be disadvantaged and fail to realize investment goals

Impact of professional financial advice[1] on portfolio returns
401k returns by age segment, 2006 data



Key observations

- Participants in 401k plans administered by Schwab achieved returns that were 3.3% higher on average if some level of financial advice was provided
- In addition to higher portfolio returns, professional financial advice had an impact on several dimensions
  - Savings rate → 70% of participants who received financial advice doubled their saving rates from an average of 5% to 10% of pre-tax income
  - Portfolio diversification → Participants who received financial advice held positions across 8 asset classes on average vs. self-directed investors who held positions in 3.7
  - Investor confidence → Of participants who received advice, 29% were confident of having adequate funds to retire vs. 16% of investors who did not

1. Use of advisory services for >1 year, 'advisory services' include personalized investment advice online, via phone, or in person
Source: Charles Schwab studies on 401(k) portfolio returns (2007) and impact of professional advisory relationships in 401(k) plans (2010)

Appendix

MiFID Investor Protection

In 2007, the Markets in Financial Instruments Directive (MiFID) made significant provisions for 'investor protection'

MiFID provisions

- Regulation of alternative trading systems
  - Regulation of multi-lateral trading facilities
  - Treatment of systemic internalisers, or principal traders, as mini-exchanges
- Increased pre and post trade transparency for all trading facilities
- Passporting or development of a single market for transactions in financial instruments across a number of European Union member states
- Requirement to enhance corporate governance structures to accommodate an independent compliance function
- Investor protection
  - Appropriate client categorization and client order handling
  - Best execution requirement for all trades on behalf of clients
  - Robust record keeping systems for periodic statements, transaction reporting, and client contracts and agreements

MiFID relative to Advisers Act of 1940

- MiFID provisions covered a narrower range of activities and imposed a less onerous standard of care than the 'best interest' standards that would be required if the Advisers Act were adopted

	MiFID	
	Suitability	**Best interest**
Investment planning	✓	×
Asset allocation advice	✓	×
Advice on client holdings	✓	×
Proprietary product sales	✓	×
Underwriting	Not covered	
Principal trading	✓	×
IRA / retirement accounts	✓	×

Although less onerous than the 'standard of care' currently under consideration in the US, MiFID studies nonetheless show the impact of similar compliance costs on asset management firms

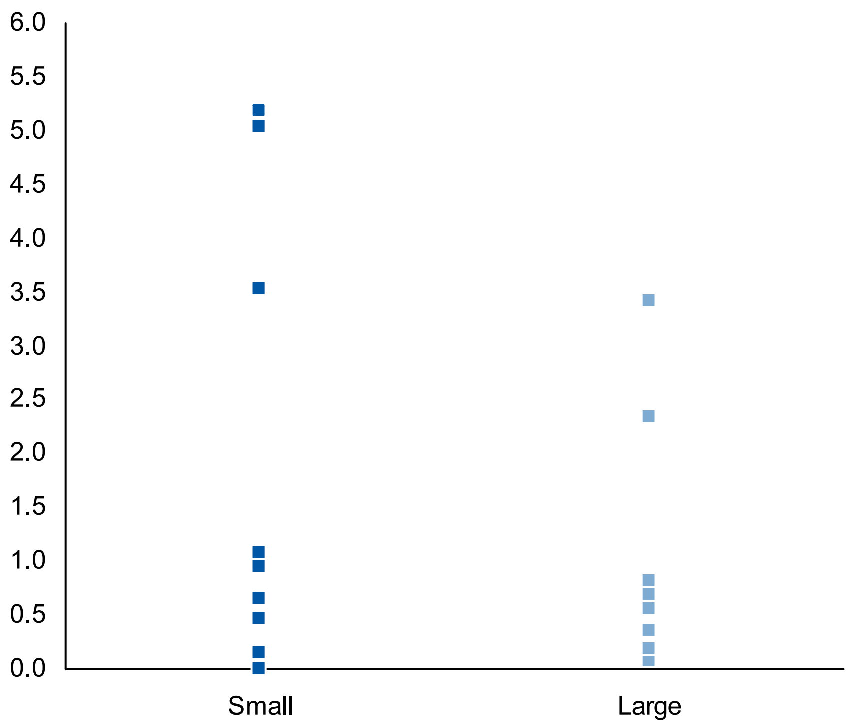
The FSA's impact studies on MiFID identified investor protection provisions as the greatest contributors to compliance costs

	Activity	Objective	Cost Factors	Cost Drivers
Client Acquisition	**Classifying client base**	Categorizing clients according to size of portfolio, # trades, etc.	System/process to capture client data Client data collection	Fixed cost # clients, length of client discussions
Client Acquisition	**Suitability/ Appropriateness**	Understanding needs, objectives, risk profiles, experience and expertise of clients	System/process to capture client data Client data collection Updated risk information on products	Fixed cost # clients, level of existing data # products offered
Client Management	**Consent/ Disclosure**	Disclosing information on suitability, best execution policy, conflicts of interest policy, principal trading, etc.	One time client agreements/contracts Routine disclosure	Response rate, # of clients # clients, frequency of disclosure
Client Management	**Maintenance of client portfolios**	Upholding suitability requirement to maintain AUM in appropriate investments	Monitoring client accounts	# clients, # products offered
Order Execution	**Best execution**	Achieving optimal mix of price, speed and likelihood of execution	Regular reviews of execution venues Disclosure to prove best execution policy	# monitored execution venues # clients, frequency of disclosure
Order Execution	**Conflict of Interest**	Identifying/addressing conflicts, actively managing potential issues before they become conflicts	Maintaining Chinese Walls Documentation/database	# departments, level of principal trading # products offered
Order Execution	**Documentation of trades**	Demonstrating compliance with suitability and best execution requirements	Electronic/voice storage Paper document storage	# trades, # clients, required level of detail # trades, # clients, required level of detail

Source: Implementing MiFID for Firms and Markets, FSA Consultation Paper 2006

Smaller firms with a large retail client base incurred higher one-off costs of compliance as a percentage of operating costs

One-off compliance costs of MiFID by firm size[1]
One-off costs as a percentage of operating costs, 2007



Determinants of one-off costs

- The study found that client profile is the most important determinant of costs, with retail clients incurring significantly more costs than institutional clients
- The biggest one-off costs arose from investment in IT and revisions of CRM systems to reflect new data points, especially for certain retail segments
- A significant portion of one-off costs were fixed, irrespective of firm size and number of clients
- Impact studies indicated that small firms would be unable to sustain large fixed costs of compliance and exit the industry
- In absolute terms, average one-off costs were ~€1 MM for a small firm and ~€4 MM for a large firm
- There is high variability in the level of one-off costs amongst smaller firms depending upon
  – Extent to which firms serve retail clients
  – Ability of firms to make large upfront investments

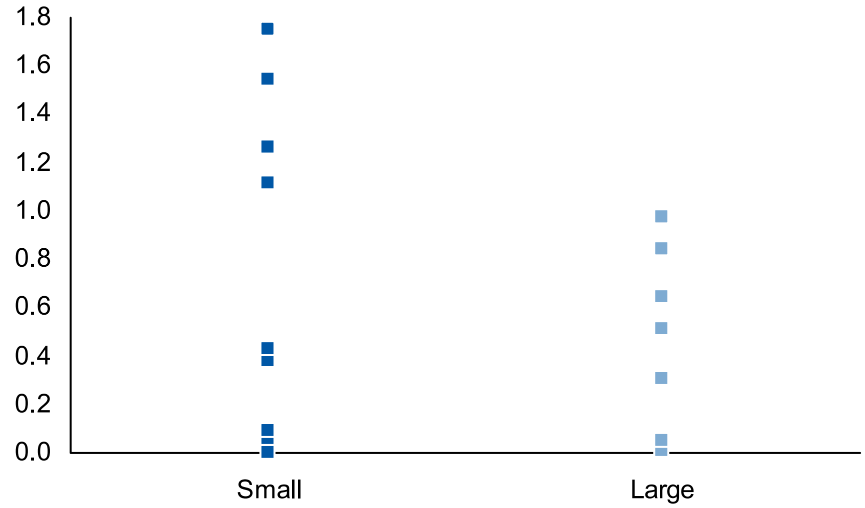
1. Firms with fewer than 100 employees were classified as “Small”
Source: Europe Economics Study, 2007

Due to their inability to make sizeable upfront investments, smaller firms typically also sustained higher ongoing costs of compliance as a percent of operating costs

On-going compliance costs of MiFID
European asset managers by firm size[1], 2007

	Small	Large
Additional staff	70%	18%
Internal reporting	9%	12%
IT	4%	30%
External reporting	12%	17%
Training	2%	7%
Audit	2%	16%

Ongoing compliance costs of MiFID by firm size
Ongoing costs as a percentage of operating costs, 2007



- Whereas larger asset managers complied with MiFID by investing in automated systems, smaller firms increased headcount
- There is a trade-off between one-off and on-going costs, e.g. for smaller firms the option of updating IT systems might have been too expensive, thus on-going costs of sustaining a larger workforce are much higher
- The smallest firms in the study had no specialist compliance functions prior to MiFID, and required significant resources to cover compliance activities

1. Firms with fewer than 100 employees were classified as "Small"
Source: Europe Economics Study, 2007