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Office of Regulations and Interpretations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

April 4, 2011

Re: Definitions of "Fiduciary" and Fiduciary Investment Advice (FIA)

Ladies and Gentlemen:

Today, there is not only a lack of clarity in the understanding of what constitutes fiduciary investment advice (FIA); but existing regulations are commonly used as support for ERISA interpretations that contradict the common sense and plain language meaning of ERISA. The proposed regulations admirably address this situation, one that exists, in part, because the existing regulations were developed years before the emergence of the 401(k) as a corporate benefit plan.[1]

Existing regulations (29 CFR § 2510-3.21(c)) define the "render[ing] of investment advice for a fee" – an important plain language identifier of fiduciary status -- as follows:

> (c) Investment advice. (1) A person shall be deemed to be rendering "investment advice" … within the meaning of [ERISA § 3(21)] only if:
>
> (i) Such person renders advice … as to the value of securities or other property, or makes recommendation as to the advisability of investing in, purchasing, or selling securities or other property; and
>
> (ii) Such person either directly or indirectly. . . .
>
> (B) Renders any advice . . . on a regular basis … pursuant to a mutual agreement, arrangement or understanding, written or otherwise, . . . that such services will serve as a primary basis for investment decisions with respect to plan assets, and that such person will render individualized investment advice … based on … particular needs … regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.

[1] http://www.ebri.org/pdf/notespdf/1203notes.pdf

The omitted language above was omitted to reflect that the proposed regulations clarify that the same understanding that applies to the providing of advice to a plan's named fiduciary also applies to advice provided to individual participants.

As a long time practitioner, around at the beginnings of 401(k) and before, my opinion is that the proposed regulations provide a greater correspondence with ERISA than the current regulations. Perhaps the best assistance that I can provide is to offer a few practical examples to illustrate the key principles that need to be preserved or addressed in the proposed regulations.

Errors in the Governance of Defined Contribution Plans Resulting from Existing DOL Guidance on Fiduciary Investment Advice (FIA)

Example One: Advice Relating to the Picking of Investment Managers is not FIA
Some practitioners torture out an argument from existing guidance to the effect that an advisor who restricts its advisory engagement to the evaluation, selection, monitoring, and de-selection of investment managers is not providing FIA. The rationale is that only the activity of an investment manager, and not the advice relating to the managers themselves, relates either to i) valuing securities or other property or ii) to the advisability of investing in, purchasing, or selling securities or other property.

This is an argument based from 29 CFR § 2510-3.21(c)(i) above. Of course, this use of existing DOL guidance to trump ERISA proves, *reductio ad absurdum*, the need for regulatory revision.

Example Two: Advice Relating to the Picking of Mutual Funds is not FIA
Some practitioners also suggest that even assisting a named fiduciary in the selection, evaluation, and the ongoing monitoring of the mutual funds to be offered as investment alternatives under a defined contribution plan is not FIA. The rationale is that such advice does not rise to the level of FIA when it does not also deal with asset allocation and efficient portfolio construction. Individualized investment needs are necessarily related to portfolio construction; and therefore, no advisor can be engaged in FIA without advising as to the diversification characteristics and risk/return efficiency of a portfolio.

This is an argument from 29 CFR § 2510-3.21(c)(ii)(B) above. Of course, this use of existing guidance to trump ERISA also proves, *reductio ad absurdum*, the need for regulatory revision.

The major gap in the proposed regulations illustrated by these two examples is that FIA must include investment advice that is not "individualized to the particular needs of the plan or the participant receiving the advice". In the course of providing fiduciary audits I have seen named fiduciaries shocked to learn that their record keepers have secured small print contractual disclaimers that they are not providing investment advice. The record keeper (who also offers proprietary investment funds) will typically send an investment

professional to every quarterly fiduciary meeting; it will provide the named fiduciary with 100% of the professional information and analysis on all investment options; and it will, in practice, recommend the investment line up that will be made available to participants. Of course, it will be paid, directly and indirectly, because of these services.

Many small and mid-size plans use the ongoing investment monitoring and "wink/wink" investment consulting services of bundled record keepers in lieu of hiring an independent investment consultant. It is true that there are a large number of investment consulting firms that also do not provide anything more than ad hoc advice on portfolio construction in any defined contribution consulting engagement. These services miss the mark on being directed at individualized needs, because every defined contribution plan needs investment options that work together to produce efficient portfolios. But the services of independent investment consultants and the "free" or bundled investment consulting are not different in this respect.

It is important for the DOL to understand the *weltanshaaung* that drives the active mutual fund picking approach to investment consulting that is so common in 401 (k) plans. The philosophical worldview behind the providing of "portfolio free" investment advice in the 401(k) world is often spelled out quite clearly in the investment policy statement (IPS) proposed by the consultant and/or the investment representative of the bundled service provider. The IPS generally reads like this:

a) The named fiduciary is responsible for selecting and monitoring funds intended to represent a range of asset classes from which the participant can create a portfolio reflecting his or her individualized risk tolerance and investment objectives.

b) The plan administrator (sometimes the named fiduciary committee, but usually the plan sponsor) is responsible for providing participants with the information needed to select the funds which will, in combination, provide unique risk/reward portfolios reflecting each participant's individualized investment objectives.

c) The participant is responsible for educating himself or herself with the information provided by the plan administrator so that he or she will be able to create a portfolio reflecting his or her individualized risk investment objectives.

Even rudimentary level portfolio construction requires – if it is to have any relationship to investments that can be evaluated in terms of the risk/return objectives of the participant -- information on the expected return (arithmetic) of the constituent funds, estimates for the forward looking volatility of these funds, and the expected correlation among every fund. When I give speeches on this subject, I ask the plan sponsor representatives in the room whether they provide any correlation information to participants, or even any education on the basics of portfolio construction. The answer is always no. I ask whether the funds being offered to participants were evaluated and selected according to how the expected return, standard deviation, correlation, and any other factors related to the characteristics of the actual funds offered to participants. The answer is always no.

Then I ask the audience whether any significant portion of the participants in their plans could use portfolio construction input information data and portfolio construction education if it was provided to them. The answer is always no. I conclude my dialog with the audience by pointing out that, based on their responses that these policies and practices are dishonest.

The point of all this is that FIA can not be exempt from being FIA because it is dishonest, inadequate, or because it fails to "render individualized investment advice … based on … particular needs … regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments." *C.f.,* 29 CFR § 2510-3.21(c)(ii)(B).

The proposed regulations correctly reject the idea that FIA can be conditioned on the existence of an agreement or understanding that the advice will be "a" primary basis for the investment decisions of a participant or a named fiduciary. But even the existence of an agreement to the contrary – an agreement that the advice will not be a primary basis for investment decisions – should not be allowed to affect the reality of the situation when that agreement is a fiction, a subterfuge, or a contract of adhesion with participants.

If the advice is intended to be, or likely to be, a primary basis for investment decisions by the recipient of the advice, the poor quality of the advice, its lack of sophistication with respect to portfolio construction, or even a written agreement indicating that the advice will not be a primary basis for any investment decision, should not be an escape hatch for any advice provider, even a conflicted bundled record keeper.

All of this is especially true for investment advice provided to individual participants, including advice on the selling and distribution of plan investments. Investment advice to participants can not possibly be authorized in any context other than one contemplating the reality that many, if not most, participants will follow that advice as "a", if not "the", primary basis for their individual investment decisions. The test for "individualized investment advice" is only appropriate for evaluating how the information is used. Insufficient advice becomes individualized for the purpose of FIA when it is provided as investment advice to an individual plan or to an individual participant.

Of course, sometimes information is provided to a named fiduciary without that information being intended to be FIA, and without any expectation that the information will be considered as or used as advice.

Proxy voting information, relating to the management of investments, has been put forward as one example of this. The providers of generalized proxy "recommendations" argue that these recommendations are to be understood as tentative. The advice may relate to the long term or short term value of a particular security or group of securities. But, or so the argument goes, it is understood that the plan fiduciary will individualize the general recommendation to reflect whether the plan is going to reallocate into or out of that security in the near term. Similarly, a yes vote on an environmental proxy issue that is bad for the particular short and/or long term value of the security may be good for a

substantially larger set of plan holdings that will be positively affected by stepping up the environmental sensitivity of the company with the proxy.

Still, even when a proxy advice provider is clear that its advice should be considered in the light of this type of additional plan specific information, and even where the named fiduciary obtains advice from two or three proxy advice providers, it seems that that a proxy vote recommendation is FIA and not simply information. This is especially the case when the recommendation is based on all the information that a named fiduciary may actually consider. Moreover, there is a strong context basis for viewing proxy recommendations as investment advice. If an RIA investment consultant for a 401(k) plan agrees to become a 3(38) investment manager with responsibility for evaluation, selection, monitoring, and de-selection of mutual fund investment options, there is no doubt but that this advisor has undertaken proxy voting responsibilities for each mutual fund. When that same advisor does not accept 3(38) delegation, but instead gives investment advice for a fee, the advice that it gives on the voting of proxies is RIA.

This does not mean that a generalized proxy information provider can not provide information without giving recommendations. A proxy information provider may have criteria for evaluating proxy issues such as: i) proposal is consistent with good governance practices; ii) proposal is good for the environment; or even iii) proposal will affect the stock price positively or negatively in the short run and/or in the long run.

Consider a proxy information provider that does not make a recommendation, but only says: “This information is being provided to many managers serving many plans with a variety of voting considerations that will not be reflected in the information provided. However, if the proxy voting policy of a manager, trustee, or other named fiduciary accountable for proxy voting calls for evaluating the proxy against one of these criteria, the information may be useful.” It seems that such generalized proxy information is not RIA if it does not come with a recommendation, and the information is organized in a way that requires each plan fiduciary to connect the information to individualized plan policies, needs, and objectives.

Bottom line, there should be no regulation that forces real information providers into fiduciary boxes contrary to the actual facts. A similar situation exists with respect to the valuation information to be provided to an independent named fiduciary, In fact, the information may be provided by two or three appraisers, each hired as the best at one of several valuation techniques. The independent named fiduciary may contemplate a cross referencing of these valuations consistent with the practices of the best chancery courts in the country. Is this information FIA?

There is no basis for considering all valuations and fairness opinions as investment advice. Just like a lawyer who can cross the line into providing investment advice, valuation and fairness opinion providers can also cross the line. But not all lawyers provide investment advice. For example, when a fiduciary asks for, and is provided with advice on whether to sell a security, there can be no reasonable FIA exception just because a central part of that advice is information about whether the sale price is fair.

But when valuation information is not driving, possibly can not drive, an investment decision, that information is not investment advice. If a valuation merely determines the price or other consequences of plan actions that take place regardless of the content of the valuation information provided, that information is not investment advice.

Now the DOL has received many comments to the effect that a fiduciary can not provide an independent and objective appraisal. This comment deserves some brief attention. The comment hinges on an interpretation of IRC § 401(a)(28)(c), and its reference to requirements for independence that are "similar to" those found in regulations for charitable deductions. Simply put, there is nothing in this "similar to" reference to make FIA by an independent appraiser a violation of the IRC. Independent appraisers who are contractually obligated to provide objective appraisals to a plan's independent named fiduciary are not transformed into non-independent appraisers when they valuations that they provide constitute FIA.

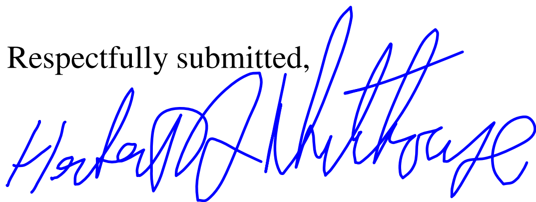
Conclusion

Effective and sustainable guidance for distinguishing information from RIA requires recognizing that not all information that relates to investments is investment advice. Accordingly, the DOL should provide a facts and circumstances oriented regulatory structure that considers whether, given the objective nature of the engagement and the recipient's relationship with the information provider, the information is:

i) specific to a particular plan or participant;
ii) provided as a recommendation; or
iii) likely to be used as a "primary" basis for an investment decision given the sophistication of the fiduciary or the participant.

These considerations and will easily inform practitioners whether FIA exists, regardless of whether the portfolio considerations that every investor must weigh in making individualized investment decisions have been ignored in the providing of investment advice for a fee.

Respectfully submitted,



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