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By Electronic Delivery

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

Re: Public Hearing on Definition of Fiduciary

Dear Sir or Madam:

Thank you for the opportunity to testify at the March 1, 2011 hearing related to the proposed regulation defining who is an investment advice fiduciary under ERISA. At the hearing, we were asked by the Department to provide more information on why we believe that the proposed regulations would be the end of commission-based sales in the IRA account and retail retirement plan marketplace. In particular, we were asked to supplement our testimony by specifically addressing the following items:

I. Why we believe we could not rely on the seller's limitation set forth in the proposed regulations in order to continue to sell products on a commission basis; or alternatively, why we could not rely upon several current class prohibited transaction exemptions for commission-based sales if brokers, insurance agents, and other financial professionals become ERISA fiduciaries under the regulations;
II. Why we do not believe that further exemptions issued by the Department would alleviate our prohibited transaction concerns; and
III. How we would suggest revising the proposed regulations to alleviate our concerns related to commission-based sales; as well as harmonize the Department's regulations with the regulations we are expecting the SEC to issue based on the 913 Study recommending a uniform fiduciary standard for brokers and registered investment advisors who provide personalized advice to clients.

The last item is vitally important given the Department's current proposed regulations are oftentimes in direct conflict with the securities laws with respect to IRAs and other retail retirement accounts.

We have added a fourth section that describes in detail the types of accounts (IRAs, Keoghs, open brokerage windows, etc.) that we believe warrant special consideration along with our rationale.

I. The Proposed Regulations Would be the End of Commission-Based Sales in the IRA and Retail Retirement Plan Marketplace

The Department's effort to expand the definition of investment advice fiduciary under ERISA will cause brokers and insurance agents to divide their products and services into the following four (4) categories:

A. Those that fit within a current prohibited transaction exemption where the conditions can clearly be met based on current guidance;
B. Those products and services that can be made fee neutral under the Frost opinion;
C. Those products that can be sold on a non-fiduciary basis; or
D. Those products that will no longer be sold.

A. Those that fit within an exemption where the conditions can clearly be met.

As you are aware, once a broker or agent is deemed to be an ERISA fiduciary, the receipt of compensation derived from the sale of investments and/or services must be analyzed to determine whether such transactions result in a prohibited transaction under ERISA or the Internal Revenue Code.

For IRAs, if a prohibited transaction does result, the broker or agent must return all of its fees to the owner plus pay significant excise taxes. In addition, if the transaction results in a loss to the plan, the broker or agent will have to reimburse the plan for such losses. Unless an exemption is clear and unequivocal, brokers will not rely on it. We would welcome timely interpretive guidance from the Department confirming availability of existing exemptions. However, at this time, our members will not be comfortable relying on current exemptions for the following reasons:

i. With respect to CPTE 86-128:

a. May be limited to "fees charged at the time of sale." In this respect, it is not clear whether it would cover revenue sharing, order flow, investment management, transfer agency and other fees of affiliated entities, etc. Moreover, with limited exceptions, the exemption is available only for fees for effecting transactions as agent for the plan.
b. Does not cover true[1] principal trades which is a common way to sell bonds.
c. Does not cover "riskless principal" trades.[2] These sales are functionally no different than commission-based agency trades yet the Department has not been willing to extend CPTE 86-128 to cover these transactions.
d. May not cover sales of mutual funds if they are determined to be sold on a riskless principal basis as opposed to an agency basis.

[1] By "true principal trades," we are referring to trades made from a broker's inventory between the broker as seller and the client as purchaser.
[2] "Riskless principal trades" are trades where the broker goes out to the market and purchases a security at the request of the client and resells it to the client with a disclosed mark-up.

e. Limited to “securities transactions” and therefore would be unavailable for futures transactions, fixed annuities, certificates of deposits and other investments that are not considered to be “securities” under current law.

f. May only apply where the broker or an affiliate has discretionary authority over the account as it only covers a plan fiduciary’s use of its “authority” to cause a plan to pay a fee. An investment advice fiduciary generally has no authority to cause a plan to enter into a transaction. Instead, the investment advice fiduciary provides recommendations which another plan fiduciary or IRA owner is free to implement or ignore.

g. For ERISA plans, the conditions are very onerous and introduce additional requirements that add new administrative costs into the broker-client relationship. For instance, the broker must send a “fire-me” letter to the client each year along with numerous other disclosures including a “portfolio turnover ratio” that have not been coordinated with the Department’s Form 5500 Schedule C disclosure regime.

ii. With respect to CPTE 84-24 (as applied to annuity sales):

a. For the sale of annuities issued by an unaffiliated insurance company, it is not clear whether the exemption is broad enough to cover fully disclosed revenue sharing payments made to the broker by the unaffiliated insurance company.

b. For the sale of variable annuities, it is not clear if the exemption would cover recommendations made by the broker regarding the selection of variable subaccounts, especially if one or more of the variable subaccounts are managed by, and pay an advisory or other fee to, an affiliate of the broker.

c. For sales of variable annuities issued by an affiliated insurance company, it is not clear if the exemption would cover the potential conflict arising out of the initial and subsequent recommendations made by the broker regarding how to allocate the contract’s account value between variable and fixed subaccounts, which of course would pay varying amounts of compensation to the affiliated investment manager depending on the investment strategy (e.g., international stock funds generally have a higher management fee than government bond funds).

d. May be limited to a situation where the adviser is inadvertently a fiduciary. The exemption should clearly apply to situations where the adviser states that he is a fiduciary and is being paid for his advice, regardless of whether the compensation is paid in the form of a commission or other fee, such as an advisory fee.

iii. With respect to CPTE 75-1 (as applied to mutual fund sales):

a. Applies solely to non-affiliated mutual fund sales which makes it of little to no value if the broker is also selling affiliated mutual funds and cannot fit sales of affiliated funds within another exemption.

b. Applies solely to open-end mutual funds.

c. May be construed to apply solely to sales of mutual funds made on a principal basis. Note that since open end mutual funds issue new shares rather than sell existing shares, whether the sale is an agency trade or principal trade is irrelevant and meaningless for all practical purposes. Whether these sales are considered to be made on a principal basis probably depends largely on how the broker accounts for the sale in its books and records.[3]

[3] For example, certain brokers record the transaction as a purchase with a debit to their general account and an offsetting debit, while for other brokers, the transaction may bypass their general account ledgers.

d. Not clear if it covers fully disclosed revenue sharing, 12b-1 fees and other compensation received from the mutual fund company or its service providers.

iv. With respect to CPTE 84-24 (as applied to mutual fund sales):

a. Does not apply to unaffiliated funds so it is of little to no value if the broker cannot fit within another exemption for unaffiliated mutual funds.
b. May not apply to affiliated funds because the exemption may not cover the receipt of investment management fees by an affiliated investment manager – see footnote 4 of Advisory Opinion 2000-15a. Note that if the exemption is not broad enough to cover the receipt of investment management fees by an affiliated investment manager, then the exemption would only be of use where the principal underwriter to the mutual fund is unaffiliated with the investment manager of the mutual fund. Although this situation is technically possible, we know of no mutual funds structured this way today or in 1984 when the exemption was issued prior to the Department narrowing its usefulness. Therefore, financial service providers are no longer confident in relying on the exemption.
c. May be limited to situations where the broker or insurance agent is an "inadvertent fiduciary."

B. Those that can be made fee neutral under the Frost opinion.

As you know, the Department issued an advisory letter to Frost Bank that permitted Frost Bank to provide fiduciary advice for an asset-based advisory fee provided that Frost Bank provided a dollar for dollar offset for all revenue received by Frost Bank and its affiliates related to the investment of those plan assets. Although issued to a bank, the rationale behind the Frost Bank advisory opinion is used by a broad range of financial service providers including dually registered brokers. For instance, dually registered brokers[4] may offer brokerage accounts on an advisory-wrap fee basis and waive any loads or commissions related to investments in the account. In addition, the broker would either rebate to the account or reduce its advisory fee to reflect any revenue received by the broker or an affiliated entity. We believe that this will be the only solution left to brokers under the rules to sell the types of products IRA owners need and desire. As noted in our March 1 testimony, advisory fee based accounts will often be more expensive for those IRA owners who purchase investments with long holding periods.

Additionally, the fee offset methodology approved by the Department under the advisory opinion issued to Frost Bank unfairly penalizes affiliated mutual funds; and therefore, favors one business model over another. In a wrap account type of arrangement, a broker is paid an advisory fee to select mutual funds for a client at her request. The client does not pay an up-front sales commission and 12b-1 fees can be rebated[5] or offset from the advisory fee. In addition to the advisory fee, the client also pays indirectly the operating expenses of the mutual funds including the investment management fee paid to the fund's investment adviser. Often the fund's adviser pays the broker a small part of the investment management fee under a revenue sharing program, and according to Frost, that payment must be offset from the advisory fee paid to the broker. The rest of the investment management fee is not offset and is therefore retained by the investment manager for the additional investment management services provided to the funds under this arrangement. However, if the mutual fund investment manager is affiliated with the broker, then guidance under Frost would require the entire

[4] Assume that the broker is dually registered as both a broker and an investment adviser.
[5] The rebating of 12b-1 fees raises potential issues under federal securities laws. To the extent that Department guidance compels brokers to rebate 12b-1 fees, it would be helpful to have the SEC issue guidance indicating that such rebating is consistent with securities laws that require all mutual fund shareholders to be treated equally.

management fee to be offset even though the investment manager is providing additional services to the client that are not offset when the services are provided by an unaffiliated investment manager. Because the investment management fee is charged as part of the mutual fund's operating expense, it cannot be waived for the client but instead must be offset or rebated.[6] This creates an unlevel playing field creating an incentive for brokers and agents to not recommend an affiliated mutual fund.[7]

For example, assume that a broker charges 100 basis points (bps)[8]to provide investment advice to a client in an advisory wrap account. The broker recommends that the client invest half his assets in Fund A (an unaffiliated mutual fund investing in equities) and half of his assets in Fund B (an unaffiliated mutual fund investing in bonds). Fund A has an internal operating expense of 100 bps and Fund B has an internal operating expense of 80 bps. Both pay the broker a 25 basis point 12 b-1 fee and a 10 basis point revenue sharing payment. The broker offsets its 100 bps fee by 35 bps to reflect these payments. The client pays a 65 basis point advisory wrap account fee plus an additional 90 bps[9] indirectly to the fund's service providers.

By contrast, assume that the broker instead recommends 50% in Fund A and 50% in Fund C. Fund C is an affiliated mutual fund that has a better track record than Fund B and a lower expense ratio – 70 bps versus 80 bps. Fund C also pays a 25 basis point 12b-1 fee and a 10 basis point revenue sharing payment. However, since the manager of Fund C is affiliated with the broker, instead of offsetting the 10 basis point revenue sharing payment, the broker is required to offset the entire 70 basis point operating expense. The result is that for the assets invested in Fund C, the broker is paid an advisory fee of 5 bps; which is 100 bps less the 25 basis point 12b-1 fee and the 70 basis point operating expense. In this respect, there is less incentive to recommend an affiliated mutual fund within a wrap account even if it's the best choice for the client.

C. Those that can be sold on a non-fiduciary basis

At this time, it appears that brokers will either have to refrain from providing any specific investment recommendations or attempt to fit within the seller's limitation under the proposed regulations. We do not believe it would be feasible for a broker to structure its services without triggering the investment advice rules unless it is permitted to avail itself of a broad seller's limitation. Unfortunately, the proposed seller's limitation does not reflect, nor serve well, the needs of the IRA market.

The proposed regulations will leave brokers with a Hobson's choice of providing no recommendations at all or trying to fit within the proposed seller's limitation. Because the compensation structure paid to a broker is established when the retail retirement account is established, the broker must know in advance whether he or she will ever provide any "investment advice" to the client. If the broker is dually registered, then he or she will be providing investment advice if she "makes any recommendations as to the advisability of investing in, purchasing, holding, or selling securities or other property." If the broker is not dually registered or otherwise affiliated with a registered investment adviser or other plan fiduciary, then in addition to making such a

[6] The requirement to offset in, and of itself, creates considerable operational challenges that can add significantly to the cost of maintaining an advisory-fee based wrap account.

[7] The ability to offer affiliated products and services permits clients to realize synergies (in the form of product design and operating scale efficiencies for example) from an affiliated broker and investment manager relationship.

[8] A basis point is a hundredth of one percent. A hundred basis points is a one percent fee.

[9] The average expense ratio of Fund A and Fund B.

recommendation, there would need to be an understanding that the recommendation may be considered in connection with the client making an investment decision and that the recommendation be individualized to the needs of the client. Given that brokers have a duty under the securities laws to both know their client and evaluate products for client suitability, any recommendation made by a broker would generally be deemed to be individualized. It seems unlikely to us that a broker would not expect her recommendations to at least be considered by her clients regardless of a client's ultimate decision. In this respect, it appears that the only way to establish a commission-based account is if the broker can be certain that the client will never ask, and the broker's registered representative will never provide, his or her opinion regarding the advisability of purchasing, selling or holding a security.

At the Department's hearing on March 1, 2011, Mark Machiz of the National Employment Lawyer's Association stated that he expected that his broker could provide him with objective information under the proposed regulations - such as that one of his stock holdings dropped in value by fifty percent. This commentator stated that so long as the broker does not advise him to buy, sell or hold the stock, then that the broker would not be an investment advice fiduciary under ERISA. We can agree with this presumption. Query, however, what he would expect his broker to say when asked whether he should hold or sell the stock? Perhaps Mr. Machiz would never ask this question but we believe many clients would do so. What if Mr. Machiz instructs the broker to sell the stock and the broker feels strongly that this is a mistake? Should the broker sit by and watch the client sell at the bottom of the market in a panic without discussing the pros and cons of doing so? Or what if Mr. Machiz tells his broker that he is thinking of purchasing a municipal bond in his IRA? Would he expect his broker to explain that he should purchase the municipal bond in his non-qualified brokerage account to avoid turning a tax-exempt investment into a taxable one? Or would he expect his broker to remain silent so as not to provide a recommendation with respect to the IRA? Clients want and expect their brokers to provide guidance in these situations and we believe the regulations should accommodate these expectations. None of our members would put in place, nor expect their registered representatives to follow, a policy that requires the registered representative to sit back and watch their clients make uninformed decisions. Nor would any of our members be comfortable hiring a registered representative that would follow such a policy. Therefore, we must assume that when clients ask for a broker's opinion, the broker will provide it. And furthermore, where a broker feels a client may be making a mistake, the broker will so inform the client. And if the broker meets the "know your client" requirement under federal securities laws, the recommendation will be individualized because the broker knows the specific client's situation quite well and the broker certainly hopes that the client will consider the recommendation as part of the client's investment decision.[10]

For the reasons discussed above, without a broad seller's limitation, it is unlikely that most brokers will be able to sell **any** products in a non-fiduciary capacity. However, there are a number of issues we see with the proposed seller's limitation:

a. First, by its terms, the limitation only applies if the broker is a counterparty or the agent of a counterparty to the IRA owner or plan participant. Except for principal transactions, brokers typically act as an agent for the IRA owner or plan participant rather than for the counterparty. Therefore, for agency trades, the seller's limitation appears to be unavailable.

[10] We would note that clients who seek limited interaction with their broker would generally seek out alternative "no-frills" brokerage business models (i.e., those that rely on client-driven transaction websites and call centers).

b. Second, the seller's limitation as currently drafted only applies to the sale of securities and other property. It does not cover the sale of advisory services. This limitation would be a problem if a broker offers both an advisory-based service and a commission-based service.
c. Third, the limitation shifts the burden of proof to the broker to prove what the client knew or reasonably should have known, an impossible standard for brokers to meet.
d. Fourth, the limitation is not available if the broker represents or acknowledges that it is acting as an ERISA investment advice fiduciary. Because the representation or acknowledgment need not be in writing, brokers will not be able to structure their programs to rely on the limitation as a client may later claim that the broker's representative acknowledged fiduciary status in a conversation at some point. Furthermore, the SEC will likely require the broker to be acting as a fiduciary for purposes of federal securities laws so a client may legitimately believe that the broker acknowledged ERISA fiduciary status when the broker acknowledged fiduciary status under federal or state securities laws.
e. Fifth, it is unclear when or how often a broker would need to provide a disclosure to clients to ensure they reasonably understand that the broker is acting in a selling capacity.
f. Finally, in order for the seller's limitation to apply, the broker must characterize his or her interests as adverse to the clients, a concept which does not work for a fiduciary under the securities laws.

D. Those products that can no longer be sold at all.

Due to our concerns noted above regarding the availability of class prohibited transaction exemptions, the problems with fee leveling under the Frost advisory opinion, and what we believe is an unworkable and too narrow seller's limitation, many essential products and services will no longer be available to IRA owners and retail retirement plan participants. Leading candidates of products or services that could no longer be sold include fixed and variable annuities, securities sold on a principal basis, commission-based mutual fund sales, affiliated mutual funds and any other product or service that does not work well in an advisory fee-based account.

As we mentioned in our testimony, annuity sales require substantial up-front work by the financial advisor and therefore have been structured to provide a larger up-front commission than many other products. Forcing annuities into an advisory wrap account where the broker is paid an ongoing asset-based fee may not be the preferred solution. First, since clients tend to hold annuity investments for a longer period of time, including them in wrap products would likely result in higher fees and less retirement income. Instead of an IRA owner paying a 5% fee once up-front, she might pay 1% per year for 20 years. Second, charging an ongoing advisory fee for assets held in an annuity would not be appropriate in all circumstances since there may not be a need for ongoing advice with respect to this type of investment.

Similarly, clients who intend to purchase and hold stocks, bonds or mutual funds for longer periods of time often pay lower fees when they pay an up-front commission rather than an ongoing advisory fee. We would encourage the Department to confer on this issue with the SEC. The SEC has considerable experience with how mutual funds are sold to retail investors, such as IRA owners, and has imposed significant fines against brokers who have sold mutual fund B shares that charge higher ongoing fees (often 100 bps or more) when, in fact, a loaded A share would have been less costly to the client. The SEC generally prohibits a broker from selling retail customers a mutual fund share class that is expected to charge higher fees to the client over the client's expected holding period. In fact, due in part to the enforcement actions of the SEC, many mutual funds have eliminated B shares entirely. Yet we fear that the Department's proposal will have the exact opposite impact on mutual fund sales by forcing brokers to sell these shares in an advisory-fee based account where an ongoing advisory wrap fee of 100 bps or more will be charged instead of a time of sale commission.

We also point out that the SEC generally prohibits brokers from placing clients into an advisory-wrap fee account unless there is an expectation of sufficient trading to justify the advisory-wrap fee. Again, the SEC recognizes that charging clients ongoing advisory fees may not be suitable for investors who plan to hold investments for a long period of time.

II. Why We Are Concerned With the Department's Suggestion to Expand or Clarify Existing and/or Add New Exemptions

We appreciate the Department's willingness to consider modifying or adding new exemptions, and we believe that any such additional guidance must be timely and clear with any subsequent interpretation or modification being applied prospectively only, given the industry's good faith reliance upon such guidance. Indeed, for the sake of clarity for IRA owners, plan participants and the industry in general, a new exemption tailored to the retail marketplace that takes into account both commission based sales and advisory services models would be preferable than a modification to a patchwork of existing exemptions which may not address all the pertinent issues.

In order for a new exemption to be effective, it would have to be issued well in advance of the effective date of any final regulations stipulating who is an investment advice fiduciary. Furthermore, any future exemptions would have to cover 406(b) self-dealing transactions.

The importance of brokers being able to rely, in good faith, upon modified or new exemptions cannot be emphasized enough. If brokers rely on an exemption and it is later determined that the exemption does not cover the activity, the broker must return **all** compensation plus pay a 15% excise tax per year on the amount involved plus a 20% recovery penalty in an ERISA enforcement action brought by the Department. Assume that a broker relies on CPTE 86-128 for commission-based sales starting on January 1, 2013 when the definition of fiduciary under ERISA is broadened. Assume further that in 2016, the Department issues an opinion letter that states that CPTE 86-128 only applies if the broker has discretionary authority over the account in question. The broker would have to submit a Form 5330 along with a check in the amount of all of its commissions and other compensation received with respect to its IRA accounts (typically about 60% of its accounts) plus 15% per year. Service providers cannot take the risk that the Department could retroactively eliminate an exemption through subsequent guidance. That is why we believe that one exemption specifically tailored for those who sell products and receive commissions and other compensation is a better solution than trying to broaden existing exemptions that were issued with different circumstances in mind. [11]

[11] We were troubled by a statement made by Mr. Monhart, a senior member of the Department's Office of Enforcement at the hearing where he suggests that the "inadvertent fiduciary" problem is overblown because, in order for a plaintiff to make a case, there must be a breach which causes a loss. This statement is untrue. If a broker is found to be a fiduciary and receives unlevel compensation, then even if the advice is great for the client and results in a significant profit for the plan, the broker would still have committed a prohibited transaction and be subject to disgorgement of all fees and excise taxes. So there is no need for a breach or a loss for an inadvertent fiduciary to face severe consequences under the prohibited transaction rules. And although the plaintiff cannot collect excise taxes, the plaintiffs' bar can and will use the potential prohibited transaction liability as leverage to extract a settlement offer.

III. Our Recommendations to Preserve Commission-Based Sales, Harmonize the Department's Fiduciary Standard with the SEC's Standard, and Still Provide Important Protections to Retail Clients

At the hearings, there was a great deal of discussion as to whether the Department had sufficiently coordinated with the SEC in issuing these proposed regulations. Assistant Secretary Borzi made the point that the ERISA fiduciary duty is the highest fiduciary duty under the law and made it clear that the Department would not abdicate its role in protecting participants as it relates to the SEC fiduciary standard. Yet, Assistant Secretary Borzi also stated that a non-discretionary fiduciary seems like an oxymoron to her. Indeed under ERISA, the only time the role of a non-discretionary fiduciary exists is when the person is an "investment advice fiduciary." Such investment advice fiduciaries are subject to the exact same fiduciary standard as those who have discretion. We believe that is why the Department deliberately constructed its investment advice regulation back in 1975 to ensure that it only applied to those persons who are providing advice on a regular basis where there is a mutual understanding that the advice will form the primary basis of the plan fiduciary's investment decision. Under the Department's new approach, anyone who ever makes an investment recommendation will be held to the same ERISA fiduciary standard as discretionary money managers. This approach is no more workable now than it was back in 1975 when the regulation was first issued in final form by the Department.

A. Carve Out For Retail Accounts

At the hearings, we did not hear any proponents for applying the Department's regulations to the IRA marketplace. In fact, some proponents of the regulations like ASPAA, specifically called for a carve-out for IRAs. Other proponents of the regulations like Mr. Certner speaking on behalf of the AARP, testified that additional regulation was needed to protect 401(k) participants because these participants do not operate in the open marketplace but rather are constrained to pick amongst a few funds selected by their employer. This rationale does not extend to the retail IRA marketplace. Mr. Certner also testified that additional regulation was needed because the Supreme Court has taken away the ability of 401(k) plan participants to sue non-fiduciary service providers – a doctrine sometimes referred to as "betrayal without a remedy." We would point out that this rationale does not extend to IRAs. Furthermore, we would note that ERISA does not preempt federal securities laws; and therefore, any duties imposed by the SEC on brokers would apply not only to IRAs but also to ERISA plans.

We also heard testimony from Ms. Tuttle of Financial Engines, a firm dedicated to providing investment advice to 401(k) plan participants through a computer model, one of the methods permissible under the PPA as well as the Department's SunAmerica opinion letter. While Financial Engines testified in support of the regulations as they apply to 401(k) plans, Ms. Tuttle admitted that Financial Engines is not in the IRA advice marketplace. This no doubt reflects the reality that creating a computer model to take into account a dozen or so mutual funds for a 401(k) plan is feasible whereas creating a computer model that can take into account the virtually infinite universe of investment choices available in the IRA marketplace is not.

We find it noteworthy that, as we reviewed the hundreds of pages of testimony from the hearings, we did not find a single proponent of these regulations who focused any part of their testimony on why the regulations should apply to IRAs. And despite the Department's request for examples of harm done to IRA owners, the record remains empty on this point. While we do not doubt that an IRA owner has ever been harmed by a commission-based broker or insurance agent, we are not aware of any situation where the IRA owner was without a remedy that would be solved by the proposed regulations.

Given the lack of support for these regulations as they apply to the IRA marketplace, we would, again, respectfully request the Department carve out IRAs and similar plans from these regulations.

B. Broad Exclusion for Those Who Disclose Conflicts

In lieu of the seller's limitation, we would suggest that the Department consider adding a broad, disclosure-based exclusion from the definition of fiduciary under ERISA for purposes of providing investment advice. Such exclusion would require the service provider to provide a written disclosure at the outset of the relationship that (i) states that the service provider is not a fiduciary under ERISA or the Internal Revenue Code and (ii) that the service provider receives compensation that varies based on the products and services purchased by the client. We would object to characterizing the service provider's advice as "adverse" or even "not intended to be impartial." We believe that the vast majority of service providers do provide objective advice to their clients, act in the client's best interests, and do not steer clients to products that pay them the most.[12] In fact, we believe that brokers will have an obligation to act in the client's best interests under the regulations that the SEC is expected to issue pursuant to the 913 study. We would therefore ask the Department to harmonize their regulation with the SEC by allowing the disclosure to state, to the extent applicable, that the service provider is a fiduciary under federal securities laws and has a duty to act in the best interests of the client under federal securities laws.

We would ask that the fiduciary exclusion be structured as a safe harbor so that the delivery of the disclosure would definitively establish that the service provider is not an ERISA fiduciary or subject to the prohibited transaction rules as to varying compensation under the Internal Revenue Code. The exception would be where the service provider represents or acknowledges in writing that it is acting as a fiduciary under ERISA or the Code. The "in writing" requirement is especially important because the broker may be required to provide information in writing and orally that it is acting as a fiduciary under federal securities laws if the SEC extends its fiduciary standard to brokers who provide personalized advice.

Note that we do not propose to limit the exclusion to those who are categorized as "sellers" or "counterparties." We believe that anyone who provides services to a plan or IRA owner should be able to avail themselves of the exemption so long as the proper disclosure is provided. From a practical standpoint, anyone who makes recommendations with respect to securities must register as an investment adviser under the Investment Advisers Act of 1940 unless they fit within an exemption. In this respect, we do not believe there is a need to limit the exemption to those who are "sellers" and are concerned that such a limitation would inevitably create doubt as to whether the exclusion were available to brokers and others who seek to use it.

C. Broad Exemption for Those Who Disclose Conflicts

While we prefer an exclusion from the definition of investment advice fiduciary, another option would be to provide as part of the regulatory process a class prohibited transaction exemption for service providers who disclose their conflicts of interest. The exemption would work exactly like the

[12] In fact, many of our members support the SEC's effort to expand the fiduciary standard found under the Investment Advisers Act to brokers.

exclusion described above, except that the service provider would acknowledge ERISA and/or Code fiduciary status rather than disclaim it. For non-ERISA plans such as IRAs, the end result would be identical since there is no fiduciary duty or obligations under the Internal Revenue Code for a Code fiduciary. For plans subject to ERISA, the service provider would still be an ERISA fiduciary and therefore, subject to ERISA's fiduciary standards, including the duty to act in the best interests of the plan and its participants. For these service providers, the Department could still bring a claim that the service provider breached its fiduciary duty by failing to act in the best interests of the plan. However, the Department would have to show more than the fact that the service provider received differing compensation for products and services but rather that the receipt of unequal compensation was the motivation behind the service provider's advice. Although we admit that this may not be an easy feat, it seems like a better use of the Department's and the IRS' enforcement budgets than trying to establish that the service provider is a fiduciary under the existing five part test. The litigation would focus on the advice provided by the service provider and the motivation for it which seems much more germane to whether the service provider breached its fiduciary duty. We would also note that although an exemption would take excise taxes off the table,[13] it would not prevent the Department from recapturing excessive compensation or investment losses that result from such a breach nor would it prevent the Department from assessing the 20% penalty under ERISA section 502(l) nor would it take away the private cause of action of a plan or plan participant under ERISA section 502(a).

An advantage of the exemption approach is that it better harmonizes the SEC's regulatory effort because the service provider that provides advice is a fiduciary under both the securities laws and ERISA. A drawback to this approach is that it would likely raise costs as brokers and other financial service providers would need to consider the purchase of ERISA fiduciary insurance or heightened supervision should their representatives and agent be deemed to be ERISA fiduciaries.

D. Rollovers

With respect to rollovers, we would encourage the Department to develop a standard disclosure document that could be provided either in writing or over the phone that would explain the pros and cons of rolling plan assets from a plan to an IRA. Such a disclosure should note that one important factor to consider is the relative cost of the investments available within the IRA versus the costs of investments held inside the retirement plan. The disclosure should not state that investments in the IRA are more expensive than those found in the plan as that is often not a true statement.[14] We note that it is already a common practice in the broker-dealer community to provide such information to plan participants. The Department could require such an educational document or conversation be provided as part of the safe harbor exclusion or exemption described above. Providing such guidance as part of these regulations would also have the effect of removing a barrier for service providers to act in a fiduciary capacity with respect to plans. Many service providers are unwilling to act as an

[13] Comment limited to the situation where the service provider actually provided the disclosures and put the plan or plan participant on notice that it received unequal compensation. Those who fail to provide disclosure would still be subject to the substantial excise taxes prescribed under the Code.

[14] Although we understand that the GAO recommends such a disclosure, we would note that in some cases the client may actually have lower fees in his or her IRA if, for instance, he or she is moving from equity-based mutual funds that may charge 100 bps or more in operating expenses to a portfolio of individual stocks. Regardless, our experience is that the primary reason clients roll their money away from their employer's 401(k) plan to an IRA is that they want the maximum amount of control over their retirement savings and do not desire either the government or their former employer to control or influence any aspect of their retirement account.

ERISA fiduciary due to concerns that doing so may prevent them from accepting IRA rollovers from the plan participants.

E. Updating Existing Exemptions

We would appreciate any helpful guidance the Department can provide with respect to the myriad of class prohibited transactions that have already been issued. While such clarification would be welcomed and we specifically support all of the modifications requested by SIFMA, we caution whether it could be done in a manner that is sufficient to fully meet our concerns. Many of the exemptions discussed in Part I of this letter were issued shortly after ERISA was passed (or were derived from such exemptions) and were intended to cover situations where brokers sold products to employers rather than plan participants or IRA owners. Over time, the Department has clarified that the exemptions would also apply to products sold to IRA owners or 401(k) participants. Even so, most of these exemptions were not designed specifically for situations where brokers are acting as investment advice fiduciaries and selling products and services to IRA owners. Some of the exemptions, such as CPTE 86-128 have no conditions as applied to IRAs while other exemptions contain stringent requirements that apply to both ERISA plans and IRA owners. It is also very confusing for brokers to have to meet the conditions of several different exemptions depending on what products and services are purchased by the client.

IV. Background on IRA and Retail Retirement Plan Marketplace

A. Types of Retail Retirement Accounts

We would ask the Department to extend the solutions we described in Part III of this letter to traditional and Roth IRAs, SEPs, SIMPLE IRAs, Keogh plans and also to participant directed accounts to the extent that the participant is able to make investments beyond a list of designated investment alternatives. IRAs are different than employer-sponsored plans because the IRA owner is free to choose the investment arrangement with no input from an employer fiduciary. In fact, IRA owners are free to select a service provider that will act in a fiduciary capacity or one that acts in a non-fiduciary capacity. The same can be said for Keogh plans and SEPs and SIMPLE IRAs too. We would also point out that many 401(k) plans permit participants to open a brokerage account with the financial institution of their choice. We believe it is important to preserve these types of accounts too.

B. Issues Unique to Retail Retirement Accounts

Many concepts that make sense in the large 401(k) market quickly fall apart in the retail retirement marketplace. For instance, the Department's long standing position is that if a fiduciary uses its discretionary authority or control to cause a plan to pay it additional fees (even if additional services are provided), the fiduciary has engaged in a self-dealing transaction. With respect to non-discretionary fiduciaries (i.e., investment advice fiduciaries), the Department's position is that if the investment advice provider recommends products or services that pay the investment advice provider more compensation, such transactions are considered self-dealing. It is important that the Department consider how this concept would be applied in the retail marketplace. If a broker can recommend the client purchase stocks through an advisory fee based account paying the broker 100 bps as opposed to a commission-based brokerage account at $25 per trade, query as to whether making such a recommendation might be considered a self-dealing transaction.

If the broker recommends the client purchase an annuity, the client will likely pay a larger up-front commission and receive some form of guaranteed income opportunity. This type of product will certainly pay more compensation to the broker than, for instance, a money market fund. In fact, the only product or service that a fiduciary broker could sell (without an exemption) would be the one that pays it the lowest possible compensation regardless of whether that product or service is suitable to meet the client's needs. Most likely in today's world, that product or service would be a sweep account option or a money market mutual fund; neither of which would be suitable long-term investments for the average retirement saver. Therefore, without a method to either (i) permit brokers to provide recommendations without becoming a fiduciary or (ii) a prohibited transaction exemption that permits brokers to sell products and services that pay it various forms and levels of compensation, brokers will be required to do away with commission-based sales entirely and place clients into a "super wrap" fee-based advisory account.[15]

Another problem we see with applying the proposed regulations to the retail marketplace is the difficulty to determine what compensation should be deemed to apply to recommendations made by the broker. Typically, brokers and investment advisers deliver a financial plan for a fixed fee and the client chooses to implement the financial plan by purchasing products and services from the investment adviser. The advice in such a scenario would appear not to trigger a prohibited transaction because it was paid for through a flat fee. However, if the investment adviser's experience is that 95% of the time clients choose to implement such a financial plan through products and services offered by the investment adviser's affiliated broker, query as to whether the Department would consider this implementation to be a self-dealing transaction. What if the broker or investment adviser provides the financial plan for free in the hopes that the client will implement the plan with the broker? What if the broker provides free advice related to the client's 401(k) plan held at another institution but receives compensation related to other products or services provided to the client? It is imperative that brokers continue to be able to provide clients with a holistic financial plan on all of their assets including those held in retirement plans.

One issue that came up at the hearings was a concern that where a 401(k) participant is receiving assistance from a financial professional endorsed (either expressly or implied) by their employer to help them select amongst funds chosen by their employer, there is a heightened concern that the 401(k) participant would assume that the financial professional is acting in a fiduciary capacity. On the other hand, where a retail client seeks out help from a broker that is unrelated to his or her 401(k) plan and/or selecting among a whole universe of options that have not been constrained by their employer, then the retail client is no different than any other consumer in the financial marketplace. While all consumers deserve protection, there is no policy reason why IRA owners should be subject to greater restrictions on what products and services they may purchase and which financial professionals they may consult than consumers with non-qualified accounts when seeking out financial assistance and guidance.

In any of the above examples, the broker or agent who has established a relationship with the IRA or Keogh owner may advise the client to roll over any assets held in their former employer's 401(k) to

[15] For instance, even if the Department clarified that CPTE 86-128 applied to agency sales made by an investment advice fiduciary broker, the broker could not make this solution available if it sold other products through an advisory-wrap fee program modeled after the Frost advisory opinion. In that situation, the broker would recommend the advisory-fee wrap program for clients who planned to trade frequently or who needed more advice. Although recommendations made once the advisory relationship has been established would be fee neutral, the recommendation to place the client into the advisory wrap program would not be fee neutral and in fact may very well lead to the broker earning more compensation.

an IRA maintained by that broker's firm. If the broker or agent has no relationship with the 401(k) plan then he or she probably receives no compensation with respect to the assets in the 401(k) plan. In that case, if the broker is deemed to be a fiduciary, a recommendation to rollover to an IRA will always result in the broker receiving more compensation and thus would constitute a prohibited transaction unless an exemption is available. On the other hand, the existing service providers have a conflict in that if money leaves the plan they will lose compensation, unless the money is rolled over to an IRA maintained by that service provider. Rather than choose sides, the Department's rules should require that any discussion of distribution options contains disclosures sufficient to allow the participant to make an informed decision.

C. Current Regulatory Protections

We believe brokers play a critical role in helping Americans save for retirement. Brokers work with 401(k) participants and IRA owners every day to help them reach their retirement goals. It appears, from comments made by the Department, that it believes that brokers and commission-based recommendations are harmful to investors; yet we would challenge this premise given our experience and belief that brokers often lend critical assistance to IRA account holders and small business owners. We find it noteworthy that the SEC, who has considerable knowledge regarding the practices of brokers, appears to have a very different view of the value of brokers than does the Department.

The only basis given for the Department's proposed regulations involved harm to plan participants by pension consultants providing services to defined benefit plans and ESOP appraisers. Neither of those examples has any relationship to the services provided by brokers to IRA owners or retail retirement plan participants. We further note that the Department asked several proponents to the regulations for evidence of harm to 401(k) plan participants and IRA owners and none could point to any empirical evidence to support this contention. We do not believe a few anecdotal examples should form the basis for the Department's viewpoint on the value of the services provided today by brokers.

Financial services firms and their professionals currently working with retirement savers to meet their retirement needs are currently subject to a myriad of federal, state, and self-regulatory organization rules. Securities professionals providing retirement saving services to investors are typically subject to regulation under broker-dealer, investment advisory, and insurance regimes and, in many cases, some combination of the three.

Investment advisers are significant providers of retirement services to consumers and have long been held to a fiduciary standard that is substantially similar to the definition adopted by the Department. In furtherance of this fiduciary standard, the SEC imposes detailed disclosure requirements on advisers, requiring advisers to disclose conflicts of interest, compensation, methods of securities analysis, and other information important to investors.

We respectfully suggest that this extensive disclosure regime renders the Department's proposed rule unwarranted and confusing as applied to retail investors, as these consumers are already receiving the information they need to make an informed retirement investment decisions. In addition to SEC regulation, the states register smaller investment advisory firms and regulate the activities of investment advisers by imposing registration, licensing or qualification requirements on investment adviser representatives with a place of business within the state. States also retain authority over

SEC-registered investment advisers under state investment adviser statutes to investigate and bring enforcement actions with respect to fraud or deceit against an investment adviser and an investment adviser's associated persons.

Broker-dealers providing retirement services similarly are subject to extensive regulation at the federal and state level. In addition to a dual system of federal and state oversight, broker-dealers are required to be members of the Financial Industry Regulatory Association (FINRA), which imposes detailed standards on broker-dealers relating to capital, advertising, reporting, and disclosure issues. Firms must disclose the commissions they receive, as well as comply with explicit risk disclosure standards when recommending investments. Brokers must know their clients and only recommend products that are suitable based on a particular's client's needs, time horizon, and risk profile. Courts have even held broker-dealers to a fiduciary standard, particularly in cases where the firm exercises discretion or control of client assets. For both discretionary and non-discretionary broker-dealers, the SEC and FINRA have imposed an extensive scheme of mandated supervision and prophylactic regulation to protect investors that many would argue goes far beyond traditional fiduciary obligations.

Insurance agents servicing retirement investors also are subject to a complex array of state licensing and conduct requirements. Each state has an insurance official who oversees the financial strength, policy content, market conduct, claims settlement practices, and distribution and marketing systems of insurance companies doing business in his or her state.

It is critical to note that the overwhelming majority of financial services professionals are subject to regulation by a combination of insurance, broker-dealer, and investment adviser regulation. We believe the Department's efforts to reinterpret the fiduciary definition, in a manner that imposes fiduciary status on a person who has no authority or control over a plan or its assets, would do little to promote investor protection or the safety of retirement assets, but instead, would result in firms limiting the retirement investment choices available to investors and raising fees to offset the additional associated costs. Therefore, we recommend that the Department undertake an in depth cost-benefit analysis to determine whether the additional regulatory costs triggered by this proposed rule are warranted.

D. **Economic Impact Analysis**

Given the broad range of concerns raised by numerous comment letters and the lack of economic analysis relating to IRAs, we are concerned with the Department's intention to finalize these regulations by the end of the year. We do not believe this timeframe allows the Department to assess the economic impact of its regulations on the 48 million Americans who use IRAs to help fund their retirement. At this time, the Department's economic impact analysis under the proposed regulations does not take into account the potential impact on the IRA marketplace.[16] The economics to consumers of common products and services held in IRAs and other retail qualified accounts should be taken into account.[17]

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[16] This fact was pointed out by several commentators and at no time was it rebutted by the Panel or any proponents to the regulations.

[17] The economics of the small account prevent an asset based fee arrangement from working. This is why it is dangerous to extrapolate concepts that work in the large 401(k) market to IRAs. Some proponents of the proposed regulations inferred that a new fee-based arrangement market might develop to serve middle-income Americans. In other words, if the Department prohibits commission-based recommendations, these proponents argued that the investment advisors will

The testimony by SIFMA suggested that 90% of households with an IRA invest in a non-fiduciary commission based account. The Department questioned whether it is fair to assume from this statistic that these investors prefer non-fiduciary accounts over fiduciary ones. Embedded in that comment we suspect is a concern that perhaps these IRA owners are unsophisticated investors that are being taken advantage of by the financial community. We disagree with this premise and would encourage the Department to dig deeper into this statistic, perhaps even commissioning a study. What the Department would quickly discover is that commission-based accounts are less expensive for many Americans and that advisory-fee based accounts are not available to Americans with small account balances. The reason is scale and service level. An individual with a $10,000 account balance cannot afford to pay a $3,000 advisory fee. No matter how good the advice is, we believe it cannot make up for the fact that it cost the investor 30% of his or her account balance.

If the Department does not carve out IRAs and other retail retirement accounts in the final regulation, we are concerned that the Department may revise its economic impact to consider the impact on these accounts as part of the final regulations. Such a process would give the financial services community no opportunity to comment on the Department's economic impact analysis. We agree with the Department that it is important to comment not only on the substance of a proposed regulation but also on the economic impact assessment. We also agree with the Department's view that the only way to get an accurate estimate of what a regulation is going to cost is through comments provided by the regulated community as to the accuracy of the Department's economic impact assessment.[18] Therefore, before it finalizes these regulations, we believe it vitally important that the Department conduct an economic impact assessment on IRAs and give the regulated community an opportunity to comment.

For instance, we are troubled by the line of questions asked by Mr. Piacentini relating to whether the Department's proposed regulations would likely result in increased investment returns by IRA owners and 401(k) plan participants. Mr. Piacentini pointed to the GAO study on pension consultants to large defined benefit plans where the GAO determined that those plans that obtained advice from advisers with concealed conflicts did in fact receive lower investment returns. We do not think such an extrapolation to the IRA market would make sense nor do we think it would be appropriate to make such an assumption without any empirical data to support it. Further, we would point out that many low and moderate income investors will be left with no advice and in that situation are unlikely to save as much for retirement as those serviced by commissioned brokers. And of course, the cost of the advice must be factored into the analysis as well. Neither of these factors is relevant to the GAO's study on pension consultants.

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start working with small accounts on a level advisory-fee basis. Lest the Department find these arguments persuasive, we would point to some of the studies commissioned by PriceMetrix and found on their website, PriceMetrix.com. Most of their studies focus on how wealth managers (e.g., those who offer investment advice on an advisory fee basis) can increase their profitability by getting rid of small accounts. Not surprisingly, we have heard no testimony or read any comment letter suggesting that fee-only advisors were planning to pick up the millions of IRA accounts that hold less than $25,000 in assets.

[18] See interchange between Assistant Secretary Borzi and Mr. McCarthy from Morgan Stanley relating to the importance of the economic impact assessment.

Conclusion

Again we thank the Department for giving us the opportunity to provide additional comments relating to the proposed regulations. We very much would like to take advantage of any opportunity the Department would make available to us to continue a dialogue relating to the unique structure of the retail marketplace.

Furthermore, though we stressed in our comments the areas where the Department's regulation troubles us greatly, there certainly are areas of common ground to build upon. For instance, we strongly agree that where a service provider acknowledges in its contract that investment recommendations are intended to be ERISA fiduciary advice, such acknowledgment should be binding on the service provider.

We also thoroughly agree that the recipients of investment recommendations should know whether the service provider making the recommendation is paid differently depending on the investments being recommended and whether the service provider is acting as an ERISA fiduciary. On the other hand, we believe strongly that brokers and insurance agents provide valuable services to IRA owners and other retail investors and that a commission-based compensation structure is often the most appropriate method to deliver products and services to these investors.

We fear that the Department's proposed regulations, without a carve out for IRAs and similar retail retirement accounts, or a broad disclosure-based exclusion or exemption, will eliminate commission based sales and prevent IRA owners and other retail investors from working with the investment professional of their choice, and pursuing the products they desire, at the very time when such assistance is critical.

Sincerely,

Catherine J. Weatherford
President & CEO