April 12, 2011

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

Re: Public Hearing on Definition of Fiduciary

Dear Sir or Madam:

The American Federation of State, County and Municipal Employees ("AFSCME") is the largest union in the AFL-CIO representing 1.6 million state and local government, health care and child care workers. AFSCME members participate in over 150 public pension systems whose assets total over $1 trillion. In addition, the AFSCME Employees Pension Plan is a long-term shareholder governed by the Employee Retirement Income Security Act ("ERISA") that manages $850 million in assets for its participants, who are staff members of AFSCME and its affiliates.

AFSCME is pleased to have this opportunity to comment on the proposed definition of "fiduciary" by the Employee Benefits Security Administration ("EBSA") of the Department of Labor ("DoL"). We applaud the effort to update this 35-year old rule. We urge the DoL to adopt a definition that reflects the evolution of investment products, sales and fee structures, and retirement plans since the enactment of ERISA.

AFSCME advocates retirement security for all Americans, and there are conditions which need to be specifically addressed in this rulemaking to ensure that plan participants are protected. We encourage EBSA to coordinate with the SEC and ensure that fiduciary duty includes the moment when retirees receive distributions. The investment platforms used to narrow selections for plans and participants also need special treatment. Special caution and skepticism are warranted regarding any "sellers' exception" that attempts to differentiate the sales process from the provision of investment advice.

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The adoption of an updated definition should not be delayed. However, consultation with other regulators will ensure that financial products, processes and fees do not fall outside the scope of investor protections. Financial services firms may seek to shield cross-selling practices, revenue sharing arrangements, and fee comparisons from the obligations of transparency that could accompany fiduciary duty. Business lines such as target date funds, default investment guidance, lifetime income products, sales and marketing 12b-1 fees, revenue sharing, and even derivatives involve complex relationships and regulatory structures. It is essential that EBSA coordinate with other regulators so that investors are protected.

During consideration of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), AFSCME strongly supported the inclusion of provisions establishing the strongest possible market reforms, oversight and transparency for the "shadow markets" and other major provisions addressing corporate governance and investor protection. Investor protections important to AFSCME members include new market reforms addressing the sale of derivatives products and strategies, duties owed by those offering investment advice to investors, greater transparency for the advisors to hedge funds and private equity investments, and improved safeguards for municipal markets.

In each of these rulemaking contexts, vendors of various investment products and services have raised concerns that new obligations of disclosure or other investor protection remedies are not workable. Perhaps unsurprisingly, many Wall Street firms and their different lobbying entities argue that new investor protections under Dodd Frank may also trigger obligations under federal pension law. Banks, broker-dealers, insurers and mutual funds particularly point to the proposal by EBSA which would modernize its interpretation of the facts and circumstances that give rise to a fiduciary duty toward pension plans, the employers who sponsor plans, and the workers who contribute to plans. Financial firms call for a delay in the process of updating the definition of fiduciary duty and for "coordination" with other regulators who are implementing important investor protections pursuant to Dodd-Frank. Coordination is needed – but it must be the kind of coordination that closes gaps, not the kind that creates them.

<u>AFSCME's suggestion that DoL coordinate with other agencies is a recommendation for simultaneous development, not a suggestion to go to the back of the line.</u>

Upon review of regulatory comment letters, a pattern emerges. Firms with revenue at risk will often say, for example, "Don't do A until you do B"; then "Don't do B until you do C"; and finally, "C can't be done."

This year, in approaching the numerous new rules that real financial reform requires, many representatives of the financial services industry make the following suggestions:

> "DoL, withdraw your proposal to define fiduciary duty toward pension plans and participants, start over, and refrain from finalizing action until at least two years after SEC action is completed." SEC action has been authorized but stymied for years.
>
> "SEC, do not do anything to implement a fiduciary duty toward individual investors until you develop more proof that investors need help and more proof that small business will not be hurt."
>
> "SEC and CFTC, do not require disclosure of pricing or risks or other information from swaps dealers who are advising investors, because it may conflict with the DoL's interpretation of the kind of guidance that triggers a fiduciary duty to pension plans and participants; it may, in fact, trigger enhanced disclosure obligations regarding costs and conflicts of interest and inhibit our ability to cross-sell products and services."
>
> "SEC, do not move forward on your latest effort to protect investors by reforming the use of sales and marketing fees investors pay under Rule 12b-1. Instead, since there are so many new Dodd-Frank rules to talk about, put that 12b-1 issue on the back burner one more time."

The combined messages sound less like "coordination" and more like the same old regulatory arbitrage that has a lot to do with where the economy is today. There is a big difference between genuine consultation and coordination – the kind that avoids gaps in regulation and dangerous risk – and a call for coordination that simply pushes the goalposts further down the field, and further from each other, leaving a regulatory overlay that looks like Swiss cheese. Real coordination must take place. But just dodging and delaying – that is an old tactic that regulators and Congress must see through.

<u>DoL's interpretation of "investment advice" is an important guide – not only for the pensions directly regulated by ERISA, but also for other plans not regulated by DoL.</u>

Rendering investment advice is not the only way in which one becomes a fiduciary to an ERISA plan – but it is certainly one of the most important. When ERISA was enacted in 1974, most private sector workers who were offered a retirement plan on the job were offered a defined benefit (DB) plan in which the employer promised workers a certain benefit at retirement and the employer made investment decisions in order to accumulate assets with which to satisfy those promises. Since that time, the DB landscape has changed dramatically. Much has been made of the challenges involved in "guaranteeing" a defined benefit – less attention has been paid to the Wall Street practices that make growing plan assets so difficult. DB plans have struggled with the effects of hard-to-penetrate conflicts of interest, hidden fees, opaque derivatives recommendations, and more. And pension guidance that fits what we have seen through 2011 is needed.

Public and private sector plans, employers and employees, are now faced with deciphering new and constantly evolving investment options, risks and costs, and in need of the protection of rules that recognize the growing complexity behind the products and arrangements presented to them. Allowing misimpressions around ERISA's reach – or a dated and inappropriately limited assertion of ERISA's reach – to cast undue influence on the shape of investor protections outside ERISA would be a shameful distortion of the purposes of Dodd-Frank.

<u>DoL's current definition of advice that gives rise to fiduciary duty is outdated and far too narrow – written at a time when pensions were very different than they are today.</u>

As currently and narrowly interpreted, ERISA fiduciary responsibility for rendering investment advice does not arise unless each element in a five-part test is satisfied:

1. Advice is rendered as to the value of securities or other property, or recommendations are made as to the advisability of investing in, purchasing or selling securities or other property,
2. On a regular basis
3. Pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary, that
4. The advice will serve as a primary basis for investment decisions with respect to plan assets, and that
5. The advice will be individualized based on the particular needs of the plan.

Sponsors and trustees of DB plans often desire expert assistance in evaluating the investment scenarios that will enable them to meet the plans' long-term promises. This narrow definition means that much of the guidance they seek will be structured to fall outside a fiduciary's duty in ways that plans large and small may find hard to discern.

In its proposed rule updating this definition, EBSA appropriately concluded that plan officials and participants are poorly served by several of these conditions that limit the scope of ERISA's protections. Many plan officials and participants would be surprised by the way the current interpretation artfully limits the scope of ERISA's fiduciary definition. For example, the EBSA proposal notes that a plan's purchase of annuity contracts to meet benefit obligations when the plan is being terminated is a major transaction involving a recommendation that participants will be counting on for years. Yet even if the insurance brokerage made recommendations that were undoubtedly the primary basis for the plan's choice among annuity providers, and accepted kickbacks from insurance carriers while taking fees to advise plans regarding the selection of annuity contracts, DoL concludes it could not hold the brokers accountable as fiduciaries because the advice would not have been offered on a regular basis and would not be enough to confer fiduciary status.

<u>DoL's 35-year old regulation was written at a time when investment advice was very different – that, too, is part of the need for an update that is coordinated with the other regulatory contexts in which the scope of covered advice is key.</u>

While AFSCME advocates the DB plan as the most cost-effective way for employers to provide a retirement benefit, we are also concerned about the retirement security of those workers in defined contribution (DC) plans. These workers often must decide how much to contribute from their paychecks and how to allocate those contributions among the investment options available to them in the employer plan. Workers in a DC plan bear the investment risks and usually the costs of the plan and its investments.

As of 2007, 60 million active workers held roughly $ 3 trillion in assets in defined contribution plans that allowed for participant direction. To improve their access to this market, the financial industry has for years urged EBSA to issue guidance broadening the list of activities that would be considered "educational" and without fiduciary risk to the provider versus "advice" and therefore a trigger to fiduciary responsibility. Though regulatory guidance has been issued in various forms over the years, the distinction between education and advice - and between fiduciary and non-fiduciary – remains unclear and debated. Employers are under no obligation to provide either.

The ways in which "advice" is delivered have become more varied and complex, and that, too, adds to the challenge. For example, early DoL positions suggested that asset allocation services could constitute investment advice. If vendors become fiduciaries by virtue of the advice they provide, they not only face potential liability – they also face strict restrictions, known as prohibited transactions, which prohibit fiduciaries from self-dealing, and from acting on behalf of a party whose interests are adverse to the interests of the plan or its participants. Guidance from DoL in 1996 concluded that asset allocation services would not constitute advice, to the relief of financial services providers.

It is important to examine more carefully what asset allocation services could be. Asset allocation is often used as a broad description meant to sweep in generic tips on diversification among equities and bonds, or among Morningstar style boxes. However, asset allocation also refers to products that bundle together investment choices (maybe stock and bond funds), rebalancing services changing your overall allocations from time to time, and the investor's payment for that asset allocation into the dollars invested. This could include a target date fund much more complex than an illustrative pie chart on diversification, perhaps one that maps investments from one lineup to another if participants are given the chance to make a selection and do not respond.

It seems increasingly likely that advice is being provided – and paid for by workers – at the same moment in time as automatic enrollment, automatic increases of pay deferrals, and automatic changes in the investment lineup. Encouraging retirement savings is good, and automatic payroll-based savings is the most efficient way of gathering assets for investment managers. Workers need to share in that efficiency and need to be sure that Wall Street's access to automatic enrollment practices does not lower pension safeguards regarding fees, fiduciaries, and conflicts of interest.

DoL has granted a number of exemptions from the prohibited transaction rules beginning almost immediately after ERISA's passage, and mutual funds and certain other investment vehicles are accorded special status under ERISA. However, the following types of questions have nevertheless been raised:

- Can plan fiduciaries and service providers invest plan assets in mutual funds to which they provide services, without violating the prohibited transaction rules?
- Can investment advisers, banks, or other managers offer asset allocation programs to plan clients that involve investments in the advisers' own funds without violating the prohibited transaction rules?
- Can mutual funds pay 12b-1 fees, or other revenue sharing or administrative service fees to plan fiduciaries and service providers whose clients invest in the funds, without a violation?

The prohibited transaction exemptions are important to Wall Street -- unlike SEC rules, disclosure will not cure a conflict of interest under ERISA. Certain kinds of fee leveling or offsetting of compensation received against other fees may suffice. But most vendors would prefer to avoid fiduciary status and to avoid triggering these restrictions altogether.

One component in particular that should get close attention from DoL is compensation for "embedded advice," paid for by 12b-1 or "trail fees," often described as part of a target date or other asset allocation option. What should plan sponsors know in order to prudently evaluate these investment options on which an exceptional degree of reliance is placed? Sellers insist to the SEC that these fees compensate for the time brokers must allot to advising clients, while at the same time insisting to DoL that this money is not for advice but for compensating record keepers. DoL and SEC have said they are continuing to develop guidance that will address target date funds – that work must continue.

If a strong case can be made for re-examining prohibited transactions, it should be made. Legislative modifications are not unprecedented. Regulatory modifications are well within DoL's existing authority. In fact, DoL has pending now a proposal to update its current procedure for granting prohibited transaction exemptions. But avoiding fiduciary status by denying that advice is being rendered is not acceptable.

ERISA does not define "advice" – so the SEC is the logical place to look – and ordinarily that is what the financial services industry urges.

Typically, financial industry players commenting to DoL urge deference to the SEC on matters of investment regulation and disclosure, limiting its own rules so as not to require anything incompatible with SEC guidance, and conformity even though DoL is administering a different statute with different policy goals. But in this proceeding, industry comments are different and urge DoL to avoid using the '40 Act definition of advice as sufficient to define advice for ERISA purposes. Is advice really different in the ERISA world than it is in individual investing outside a pension plan?

SEC efforts are underway to update the definition of investment advice for purposes of addressing the duties owed to retail investors, the obligations of municipal advisors and the duties of swap dealers toward special entities including ERISA and other retirement plans. ERISA's definition should be developed in coordination with specifics in these other contexts. DoL has taken a constructive step in proposing that what the SEC determines to be advice for '40 Act purposes will constitute advice for ERISA purposes such that if other required factors are present, the advice provider will be an ERISA fiduciary. DoL recently dedicated two days of agency hearings to this issue and heard from a long line of Wall Street witnesses, assuring them the consultation is taking place. That is the way regulatory consultation should work.

EBSA's proposed update eliminates several of the unexpected limitations and opens the door to a more practical understanding of what kind of input constitutes advice:

EBSA reports that this update is needed to more fully implement ERISA's ability to address abuses by those who recommend investments in exchange for undisclosed kickbacks from investment providers, engage in bid rigging, mislead plan trustees about the nature and risks associated with investments, fail to disclose fees, misrepresent compensation arrangements, or give biased or incompetent valuation opinions.

The proposed rule will better address these risks to pension plans by, among other things:

- specifically including the provision of appraisals and fairness opinions in the investment-related advice and recommendations that trigger fiduciary duty;
- specifically including advice and recommendations as to the management of securities or other property, including for example advice and recommendations regarding the exercise of rights attached to stock ownership, such as voting proxies;
- deleting the requirement that only advice provided *on a regular basis* triggers fiduciary duty; and
- deleting the condition that fiduciary status is only triggered with a mutual understanding that advice will form the primary basis of decisions, since the relative importance of the individual advisor's input does not control whether it is in fact advice or subject to a fiduciary obligation.

EBSA notes that trustees often seek out the assistance of other kinds of particular expertise. Pension consultants and advisors are able to shape their roles to escape falling under the fiduciary obligations that do cover those seeking their assistance, and so avoid triggering a duty to disclose their compensation or conflicts of interest. Reversing the unnecessary limits on the scope of ERISA's fiduciary duty for advice-givers will help to address what right now is a "buyer beware" situation not in keeping with the high fiduciary standard ERISA otherwise provides.

EBSA also modified the test to make more explicit its long-standing position that fiduciary status may result from the provision of advice, not only to a plan fiduciary, but also to a plan participant or beneficiary.

<u>Retirement Rollovers and Distributions should not be carved out of protections – they can represent a lifetime of retirement savings at a very vulnerable point.</u>

EBSA also invited comment as to whether it should reconsider its 2005 conclusion that advice rules would not include recommendations related to taking a distribution from the plan at retirement.

EBSA is right to seize this moment – while it is considering ERISA advice and while the SEC is considering retail investor advice – to revisit its 2005 guidance suggesting that advice about taking a plan distribution was not advice under ERISA. Advice about plan accumulations should not change legal status when it becomes advice at the point of converting an account balance to a "benefit" or to another investment vehicle. The biggest investment most people will make is what to do with retirement benefits at their eligibility to retire. It is creative to suggest that plan protections should end at the point of figuring out what to do with the plans' "benefit." Coordinated definitions by DoL and SEC should put an end to this effort to avoid fiduciary duty just when it is needed most.

Retirement Platforms require a closer look – one that goes beyond their role in narrowing investment options and examines their concentration of market power

Another offshoot of the asset allocation issue is the use of retirement "platforms" to narrow available investment options that might be used to set up individual employers' plans. This may consist of an insurer's wrap product or an "architecture" set up by a fund company, wirehouse or brokerage. Serious questions have been documented publicly regarding the use of these platforms as gatekeepers to plan purchasers who may have outsize economic ability to control the price of access, to shape the "shelf space" for investment products, and to squeeze the margins of competing investment products and distributors who need access to broader distribution networks. EBSA invited comment on how platforms should be treated under its proposed fiduciary definition; several analyses made public by Edward Seidle, former SEC official, now with Benchmark Financial Services, Inc., are illuminating on this issue and we urge EBSA's attention to the interplay they reveal.[1]

Several industry groups have suggested that no serious conflict of interest is presented by investment options that provide different levels of revenue sharing to the brokers who provide "education and guidance" to plan participants. They suggest that variations in broker compensation generated by allocations to investment options with different embedded revenue sharing are not a real incentive to distort advice offered. But that approach is not the right way to see how conflicts can be embedded and how participants' investment choices and risks and costs are shaped by those incentives.

A better illustration is provided in a 2007 submission to DoL's ERISA Advisory Council by a registered investment adviser and consultant. This submission shows that it is not the person-by-person difference in broker compensation that reveals the troubling conflict of interest. Instead, it is the way in which investment menus are assembled in order to ensure that the investment expenses paid by participants generate sufficient revenue sharing payments from the investment providers to the financial advisor and the plan sponsor. As a result, no billable fees will be assessed, the "plan" will appear to be "free," and the seller

[1] "Secrets of the 401k Industry: How Employers and Mutual Fund Advisers prospered as Workers' Dreams of Retirement Security Evaporated", "'Capping' 401k Revenue Sharing: Recordkeepers Block Rebates to Participants" and "The Siedle Guide to the Securities Industry", both by Edward Siedle.

will be attractive for repeat business.[2] That practice, known as "solving for X," deserves careful attention in unraveling the kinds of decisions or recommendations that go into assembling an investment menu and might trigger fiduciary status.

AFSCME urges caution regarding the "sellers' exception" that DoL has put out for comment.

It appears that DoL has tried to carve out a category of communications that would clearly fall outside the definition of advice and fiduciary activity because it would include an explicit label of a sales message not intended to be independent or unbiased investment advice. AFSCME can appreciate the effort to not only broaden fiduciary activity but help define what would not be fiduciary activity. However, we suspect that the sellers' exemption is not likely to work as intended.

Major providers with household names will easily continue a marketing pitch that says, in essence, "We are experts at helping you plan for the future. Naturally we also offer products built from the best of our in-house expertise and of course we are proud to bring you those, too – what else would we offer you but the products we built ourselves and know best and believe in?" It seems that would satisfy the notice DoL has suggested, and yet it could come across more as a proud endorsement, rather than a clear statement that "this does not constitute investment advice, neither the company nor the individual broker or agent or advisor is a fiduciary with an obligation to act in your best interest; therefore I have no obligation to forego added compensation from the products I sell you and no obligation to limit or disclose it, either." AFSCME strongly suggests that this exception go back to the drawing board and we would be happy to join you in trying again to craft something more effective.

The bottom line is this - DoL is right to act now.

DoL's proposal is a well-timed and necessary complement to the investor protections in Dodd-Frank; they must be updated in coordinated fashion if they are to deliver the added protection consumers, workers and investors expect.

Clearly, in the last 35 years, much has changed -- plans have changed, individuals' responsibilities for making decisions about how to participate in plans have changed, and the financial industry that serves plans and participants has changed – including the products, services and combinations that are made available to employers and employees. EBSA is right to take on this issue now. The

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[2] Testimony Before the ERISA Advisory Council Working Group on Fiduciary Responsibilities Update and Revenue sharing, September 20, 2007, by Michael J. Malone of MJM401k.

financial sector is facing a wide variety of proposals to improve outdated regulatory tools. None will substitute for this – none should be allowed to delay or dilute this protection.

* * *

We appreciate the opportunity to express our views on this matter. Should you have questions regarding our comments, please contact Lisa Lindsley at (202) 429-1275.

Sincerely,

GERALD W. McENTEE
International President