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April 12, 2011

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

Submitted Electronically

Re: Definition of Fiduciary Proposed Rule (RIN: 1210–AB32)

These comments present the views of the National Association of Insurance and Financial Advisors (NAIFA) on the proposed rule regarding the definition of the term "fiduciary," 75 FR 65263 (Oct. 22, 2010) (the Proposed Rule), and related statements made by the Department of Labor (the Department) and others during the hearings held March 1 & 2, 2011.

NAIFA comprises more than 700 state and local associations representing the interests of 200,000 members and their associates nationwide. NAIFA members focus their practices on one or more of the following: life insurance and annuities, health insurance, pension plans, employee benefits, multiline, and financial advising and investments. Founded in 1890 as The National Association of Life Underwriters, NAIFA is the nation's largest financial services membership association. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of our members who assist the public in achieving financial security.

Virtually all NAIFA members sell life insurance. In addition, nearly two-thirds of NAIFA members are licensed as registered representatives of broker-dealers (RRs) and sell securities to their clients. Of our members who deal in securities, 41% are "dual-registered" as both RRs and as investment advisers (IAs) under the Investment Advisers Act of 1940. Two-thirds of all NAIFA members, and 93% of our dual-registered members, provide retirement planning services.

NAIFA appreciates the Department's effort to make sure that its regulations are suitable for the retirement savings marketplace as it has evolved since the Department issued its initial rules soon after ERISA's enactment in 1974. As the number of defined benefit plans has decreased and individually directed defined contribution plans have become dominant, there is a strong and ever-growing need for workers to have access to quality, affordable investment education and investment advice. However, NAIFA is concerned that the current proposal to expand the definition of "fiduciary" will have the effect of substantially *reducing* consumer access to investment education and advice, and thus create a substantial advice gap for potentially millions of individuals who need professional guidance to understand and make investments decisions about their retirement accounts.

Investment Advice for the Middle Market Depends on Commission-Based Compensation

The effect of newly defining persons as fiduciaries if they provide investment recommendations to plan participants or IRA holders is to prohibit or impose a thick new layer of regulation on the receipt of compensation in the form of commissions. Yet commissions are the dominant form of compensation for advice given to middle market investors. In December 2010, LIMRA surveyed 3,372 NAIFA members and a representative sample of 1,008 American adults to better understand consumer preferences and how financial advisory services are actually delivered to "Main Street" investors.[1] While 50% of consumers surveyed said they have used a financial advisor, only 19% of this group (less than 10% of all consumers) had more than $250,000 invested with the help of professional advisors. Most registered investment advisers will not service accounts below this threshold,[2] so the vast majority of American households have access to professional investment advice only through commission-based arrangements.

Even if they have a choice between commission and other forms of payment for advice, many consumers would prefer to pay commissions. The LIMRA survey found that 71% of consumers say that, if their advisor charged a $2,500 upfront fee for a financial plan, they would seek another advisor or go without professional services (19% were unsure what they would do). A mere 5% of consumers disagree with the statement that "most people want a choice of how they pay for professional financial advice — compensating the advisor by paying a fee, or compensating the advisor through commissions on the purchase of financial products."

The proposed new definition of fiduciary imposes rules that would make it difficult, if not impossible, for an adviser who is compensated by commission to provide advice, unless the adviser qualifies under the proposal's "seller's exception." Even if the Department were to issue additional prohibited transaction exemptions (PTEs) to allow commission-based payments to the new class of fiduciaries, the accompanying compliance requirements would significantly raise the cost of providing investment guidance to plans, plan participants and IRA holders. These compliance costs would reduce access to professional recommendations and/or raise costs for investors. When the LIMRA survey asked NAIFA's security-selling members what they would do if regulatory compliance costs increased by 15%, only about a third said they could absorb that level of cost increase. 31% said they would limit their practice to high-asset clients, 14% would increase the fees charged, and 20% would stop selling securities.

Retirement Investors Will Lose Access to Investment Recommendations without a Robust Seller's Exception

The Proposed Rule greatly broadens the nature of "investment advice" that would give rise to fiduciary status, making a "seller's exception" such as the proposed Sec. 2510.3-21(c)(2)(i) essential for preserving consumer access to investment recommendations. The essence of this exception is to accommodate situations where an investor considers advice from an adviser who the investor knows is not impartial; i.e., one whose compensation is affected by the investment chosen by the person being advised. This is the essence of commission-based investment purchasing and selling, and as noted above, reflects the preference of a large majority of middle-income investors.

As currently drafted, the "seller's exception" in the Proposed Rule contemplates an adversarial relationship between the seller and the client. This is unwarranted. The exception characterizes the interests of the seller and the customer as "adverse," suggesting that what is good for one party is bad for the other even though this may not be true.

[1] More information about the NAIFA-LIMRA survey is available at http://www.naifa.org/ServingMainStreetInvestors/.

[2] The 2008 RAND study commissioned by the Securities and Exchange Commission, "Investor and Industry Perspectives on Investment Advisers and Broker-Dealers," found that half of investment advisors had $1 million account minimums, and most of the remainder had account minimums ranging from $100,000 to $500,000.

We note that the "Fact Sheet" recently released by the Department[3] restates the seller's exception as applying to "persons who do not represent themselves to be ERISA fiduciaries, and who make it clear to the plan that they are acting for a purchaser/seller on the opposite side of the transaction from the plan rather than providing impartial advice." This language is a substantial improvement over the Proposed Rule. It reflects the reality that the investor's choice may affect the adviser's compensation, but also the equal reality that where the investor knows this, the advice provided still has real value to the person being advised. In fact, it may be the only professional advice to which the investor has (affordable) access. In fact, the phrase "opposite side of the transaction" is more accurate than the term "adverse," as the advice is provided in the context of a legitimate, arms-length transaction between a willing buyer and a willing seller.

The Proposed Rule also requires the *seller* to demonstrate that the recipient of the advice knows or should know that they are dealing with an adviser whose interests are adverse to the interest of the plan or its participants, and not someone undertaking to provide impartial advice. As a matter of legal proof, it is difficult to establish what another person knows or should know, so cautious compliance departments are likely to shy away from using this exception. The "Fact Sheet" language is also an improvement in this respect, because the requirement for the seller is to "make it clear" that a recommendation is not impartial advice, rather than trying to prove what the customer knows.

We encourage the Department to use this improved language requiring advisers to "make it clear" they are acting on the "opposite side of the transaction" in any modifications to the Proposed Rule, if the proposed rule is not withdrawn. We also encourage the Department to add clarifying language to the seller's exception noting that this standard applies to situations where the adviser is working with plan participants or IRA holders, as well as with the plan itself.

At the March 1-2 hearings, some participants suggested that the seller's exception should *not* apply to investment recommendations made to individual plan participants or IRA holders. We vigorously disagree with this position. As noted previously, investment recommendations with commission-based compensation are the only affordable source of personalized advice available to most small, individual investors. As a result, the seller's exception is *particularly* necessary for individuals to receive professional assistance in selecting investments. IRA holders and small businesses face an array of investment choices that have not been vetted by a plan sponsor's investment committee, and are less likely to have access to computer models that will appropriately help them allocate investments. Moreover, standard computer models for asset allocation may not adequately reflect the priorities and needs of individual investors even where they are available. Restricting the seller's exception to transactions with other plan fiduciaries could obliterate small investor access to individualized investment guidance regarding their tax-advantaged retirement accounts.

The Expanded Fiduciary Definition Should Not Apply to IRAs

The Proposed Rule would apply the new definition of fiduciary not only to employer-provided retirement plans subject to ERISA, but also to arrangements named in Internal Revenue Code section 4975(e)(1). Thus, for the first time, persons advising the holders of individual retirement accounts, individual retirement annuities, and other tax-advantaged accounts for medical or education savings (hereinafter referred to as IRAs for simplicity) could be subject to prohibited transaction rules similar to investment professionals dealing with ERISA plans. This would be a sea change that could decimate consumer access to advice regarding their investments in IRAs.

Unlike employer-provided retirement plans, IRAs contain the assets of only one individual. In addition, contributions are subject to a much lower annual cap than qualified plans, and are not allowed for high-income individuals. As a result, IRAs will rarely contain enough assets to make flat or asset-based fees workable. Commissions earned by brokers from IRA accounts are correspondingly small, so there is very little margin for

[3] Available at http://www.dol.gov/ebsa/newsroom/fsfiduciary.html.

absorbing higher compliance costs. The Proposed Rule contained no analysis of the regulatory impact costs for the IRA market—a critical omission in light of these key differences between the IRA and qualified plan markets.

The Department recently recognized the fundamentally different nature of IRAs when it excluded these accounts from the new fee disclosure requirements for the IRC sec. 4975(d)(2) exemption.[4] The preamble to the interim final rule correctly observes that "IRAs generally are marketed alongside other personal investment vehicles. Imposing the regulation's disclosure regime on IRAs could increase the costs associated with IRAs relative to similar vehicles that are not covered by the regulation." By implication, it can be expected that brokers and advisers will not want to serve the IRA market and/or consumers will not choose the locked-in, long-term savings associated with IRAs. The same concerns apply to disclosures required for PTE qualification.

The Fiduciary Definition Is Overly Broad for Investment Advisers Registered Under the 1940 Act

As noted above, 41% of NAIFA's members who sell securities are registered both as RRs of broker-dealers and as IAs. Though these IAs are already "fiduciaries" under the SEC definition with respect to their advisory clients, SEC fiduciaries are subject to different standards than ERISA fiduciaries. Moreover, dual-registered persons typically act as non-fiduciary RRs with respect to some clients even while they act as fiduciary IAs with respect to other clients.

It is a well-established principle that the ERISA definition of fiduciary is functional, so that registered investment advisers are only fiduciaries with respect to the plan assets for which they provide investment advisory services of a fiduciary nature. The Proposed Rule would upend this settled understanding and presumptively treat any person registered under the Investment Adviser Act of 1940 as a fiduciary whenever such a person makes investment recommendations. This apparently would include investment recommendations made by any dual-registered person, even if those recommendations are made in a broker-dealer capacity subject to SEC suitability standards. Moreover, the Proposed Rule applies this fiduciary presumption to any person who "through or together with any affiliate" is an investment adviser, potentially reaching broker-dealers and RRs who are *not* dual-registered simply because they have dual-registered affiliates. Because of the new costs and prohibitions associated with ERISA fiduciary status, this Proposed Rule would likely cause many investment advisers with broker-dealer or record-keeper affiliates to either de-register as investment advisers or stop all affiliates from providing any services to employee benefit plans and IRAs.

The Fiduciary Definition Is Overly Broad for Any Person Making Individualized Investment Recommendations

The Proposed Rule also contains a functional element, but it is much broader than the present definition. Under the proposed definition, a *one-time investment* recommendation, which *may be considered* in connection with making plan or IRA investment decisions, if the recipient of the advice understands the advice to be individualized to the needs of the plan, plan fiduciary, participant, or beneficiary, would be fiduciary advice.

As a practical matter, this definition could transform every discussion about investment options that appears to be individualized into a fiduciary recommendation. Broker-dealers and insurance agents who are unwilling or unable to assume fiduciary status would be relegated to a mere clerical role of executing instructions from clients without providing any professional guidance about the suitability of different investment options. Such a restriction on brokers and agents would not serve the interests of clients seeking assistance in understanding their investment options. It would result in individuals either making uninformed choices, or incurring substantially higher costs associated with getting the advice they need.

[4] 29 C.F.R. Sec. 2550.408b-2(c)(1)(ii), effective January 1, 2012.

Conclusion

The current Proposed Rule would have a predictable negative impact on the availability of investment guidance for retirement plans, plan participants and IRA holders. Yet other regulatory initiatives proceeding at the same time will likely alleviate or ameliorate the concerns that prompted the Department to propose the new fiduciary definition, including the Department's own interim final rule requiring specific fee disclosures under ERISA Section 408(b)(2),[5] and the ongoing Securities and Exchange Commissions ("SEC") consideration of the standard of care obligations for broker-dealers and investment advisers. NAIFA urges the Department to carefully consider the full impact of its fiduciary definition proposal, and to reassess its necessity in light of these other regulatory initiatives, before proceeding with any final rulemaking.

Sincerely,

Terry K. Headley

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NAIFA President

[5] 29 C.F.R. Sec. 2550.408b-2, effective January 1, 2012.