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Via Electronic Mail to e-ORI@dol.gov

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

Re: Definition of Fiduciary Proposed Rule

To The Office of Regulation and Interpretations:

I am writing to provide these comments on the rule proposed by the Labor Department's Employee Benefits Security Administration to broaden the definition of "fiduciary" under ERISA. I write to address, in particular, the proposed rule from the perspective of registered broker-dealers, and its consequences for Individual Retirement Accounts ("IRAs").

Numerous parties have already submitted comments demonstrating the significant adverse economic effects the proposed rule would have on the market for IRAs. *See, e.g.*, Oliver Wyman Inc., Oliver Wyman Report: Assessment of the Impact of the Department of Labor's Proposed "Fiduciary" Definition Rule on IRA Consumers (2011); Comment Letter of Davis & Harman, LLP (Feb. 3, 2011); Comment Letter of The Financial Services Roundtable (Feb. 3, 2011); Comment Letter of the U.S. Chamber of Commerce (Feb. 3, 2011); and Comment Letter of Daniel R. Fischel & Todd D. Kendall (Apr. 12, 2011). In brief, IRAs—which are not employee benefits plans subject to ERISA—are marketed primarily by broker-dealers who are registered and regulated as such by the Securities and Exchange Commission. In the prevailing practice of the industry, when a client opens an IRA, the broker-dealer is compensated through commissions, marketing and distribution fees, and recordkeeping fees paid by the product provider that the client selects to fund the IRA. Under the proposed rule, we expect that broker-dealers marketing IRAs would be defined as fiduciaries for purposes of Section 4975(e)(3) of the Internal Revenue Code ("IRC"), and that consequently this method of compensation would constitute a prohibited transaction. The effect would be to compel broker-dealers marketing IRAs to adopt an asset-based advisory model, which is fundamentally incompatible with the small accounts that dominate the IRA market. *See* SEC Study on Investment Advisers & Broker-Dealers 152 (2011) ("If, in response to the elimination of the broker-dealer exclusion, broker-dealers elected to convert their brokerage accounts from commission-based accounts to fee-based accounts, certain retail customers might face increased costs, and consequently the profitability of their investment decisions could be eroded, *especially accounts that are not* *actively traded*[.]") (emphasis added). IRAs would become far less attractive retirement vehicles, with significant adverse consequences for Americans' retirement planning at the very time Congress is weighing extensive changes to the federal retirement system to address the budget crisis.

The purpose of this comment is to makes two legal points. First, the Department lacks the statutory authority to adopt the broad definition of fiduciary that it has proposed. ERISA's reference to "render[ing] investment advice for a fee or other compensation" incorporates terminology from the Investment Advisers' Act of 1940 ("IAA") which specifically excludes sales executed by broker-dealers. When ERISA incorporated this terminology it incorporated the IAA's express recognition that broker-dealers do not provide investment advice because, as with all salespeople, any "advice" they offer is merely incidental to making sales. That limitation was properly recognized in DOL's existing fiduciary definition, and cannot be excised now. Indeed, it is clear on the face of Section 3(21)(A)(ii) and in the context of the section as a whole that to "render investment advice for a fee or other compensation" is different in kind from selling a financial product and receiving the commission for doing so; for these reasons also, the proposed interpretation is impermissible.

DOL's foray into this area is inappropriate for other reasons, particularly at this time. IRAs are not ERISA-regulated employee benefit plans; DOL should not undertake to regulate them based on ERISA-based notions of the fiduciary duties associated with such plans. Indeed, for DOL to establish a fiduciary standard of care for broker-dealers in connection with IRAs would interfere with an authority specifically committed to the SEC by the Dodd-Frank legislation.

Second, this letter briefly addresses the proposed rule's cost-benefit analysis, which is deeply flawed and wholly fails to account for the sweeping changes and devastating costs the new definition would impose. The proposal has "entirely failed to consider an important aspect of the problem," *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983), and a further round of notice and comment must be provided for this reason alone.

We hope that you find this letter helpful. We would be interested in meeting with the appropriate personnel at the Department to discuss the points we address below.

DISCUSSION

I. THE DEPARTMENT LACKS STATUTORY AUTHORITY TO ADOPT THE PROPOSED DEFINITION OF FIDUCIARY.

A. ERISA's plain language precludes DOL's proposed definition.

As defined in ERISA,

> [A] person is a fiduciary with respect to a plan to the extent (i) he exercises any discretionary authority or discretionary control respecting management of such plan or exercises any authority or control respecting management or disposition of its assets, (ii) he renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so, or (iii) he has any discretionary authority or discretionary responsibility in the administration of such plan.

29 U.S.C. § 1002(21)(A).

The subsection directly in issue here is of course subsection (ii), referring to a person who "renders investment advice for a fee or other compensation." That language was not new to the U.S. Code when it was enacted as part of ERISA. Rather, it had been an important part of the financial regulatory lexicon since enactment of the Investment Advisers Act of 1940, which defines "investment adviser" as a person who "*for compensation* . . . *advises* others . . . as to the value of securities or as to the advisability of investing in, purchasing, or selling securities." 15 U.S.C. § 80b-2(a)(11) (emphasis added). When Congress included the term "investment advice for a fee or other compensation" in ERISA, therefore, it is presumed as a matter of law to have been mindful of the meaning given investment advice in the Investment Advisers Act. *See Goodyear Atomic Corp. v. Miller*, 486 U.S. 174, 184-85 (1988) ("We generally presume that Congress is knowledgeable about existing law pertinent to the legislation it enacts.").

An essential aspect of the established meaning of "investment advice" is that it does not include sales—even though "advice" is given when sales are made in a broad range of circumstances. Indeed, the IAA excludes "sales" from its definition of investment advisers by referring specifically to the financial representatives in issue here—broker-dealers. An investment adviser does not include, the Act states, "any broker or dealer whose performance of such [advisory] services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." 15 U.S.C. § 80b-2(a)(11)(C). Thus, for example, in the case of *Kaufman v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 464 F. Supp. 528, 538 (D. Md. 1978), a broker was not acting as an investment adviser because "even assuming [he] did give investment advice," "such advice was incidental to his position as a broker for the plaintiffs' accounts. There is no indication that [defendant] received any fees specifically for his advising [plaintiff]; rather it appears that the commissions received were for his services in effecting the transactions, not for his rendering of advice."[1]

Accordingly, when Congress enacted ERISA's definition of fiduciary, it codified this limitation on the meaning of "investment advice" that had developed around the Investment Advisers Act for the preceding three decades. That limitation is plain, and cannot be altered by a Department of Labor regulation. *See Chevron, Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 842-43 (1984) ("If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress."); *see also Thiess v. Witt*, 100 F.3d 915, 918 (Fed. Cir. 1996) (agency's interpretation of the term "compensation" unacceptable because it conflicted with the term's established meaning in the employment context); *Corning Glass Works v. Brennan*, 417 U.S. 188, 201 (1974) ("[W]here Congress has used technical words or terms of art, 'it [is] proper to explain them by reference to the art or science to which they [are] appropriate." (quoting *Greenleaf v. Goodrich*, 101 U.S. 278, 284 (1880))). To put the same point slightly differently, the characterization of a broker-dealer as selling advice—rather than selling securities—is barred by the Investment Advisers Act's explicit provision that a broker does *not* provide investment advice. A broker is a "person engaged in the business of effecting transactions in securities for the account of others," 15 U.S.C. § 78c(a); by definition, he does not provide investment advice for a fee.

Even if the proposed rule's expansive definition of "render[ing] investment advice for a fee" were not barred by the Investment Advisers Act, moreover, it would be precluded by the plain meaning of the phrase standing on its own terms. To "render investment advice for a fee or other compensation" means that the *thing being paid for is the advice*, rather than a product that the purchaser selects as an incidental consequence of the advice. A broker-dealer receives a commission when a sale is made; if there is no sale, there is no commission,

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1 The Treasury Department, which has authority to enforce IRC § 4975 under Reorganization Act No. 4 of 1978, § 105, also recognizes the broker-dealer exception to the definition of "investment adviser." *See* 12 C.F.R. § 9.101(a) (defining "providing investment advice for a fee" in context of national banks' fiduciary duties and recognizing that "the qualifying phrase 'if the bank receives a fee for its investment advice' excludes those activities in which the investment advice is merely incidental to other services'").

even if the broker-dealer has advised that a particular product be purchased. Plainly, the client's payment is for the product.[2]

No one would speak of a car salesman who recommends a particular make or model as having rendered "car advice for a fee." Yet, that is effectively what DOL's proposed rule says with regard to broker-dealers. That is an absurd interpretation of ERISA that, under familiar principles of statutory construction, may not be adopted. *See Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 575 (1982) ("[I]nterpretations of a statute which would produce absurd results are to be avoided if alternative interpretations consistent with the legislative purpose are available.").

It is notable, finally, that the understanding set forth above is embodied in DOL's existing definition of fiduciary. DOL's current regulation appropriately clarifies that investment advice will only trigger fiduciary duties when rendered "on a regular basis to the plan," "pursuant to a mutual agreement" that the services will be a "primary basis" on which the plan makes investment decisions. 29 C.F.R. § 2510.3–21(c). There has been no change in the relationship of broker-dealers and their customers that suddenly would justify a different rule regarding advice incidental to sales. Accordingly, even supposing DOL had the interpretative discretion to sweep broker-dealers into the definition of investment advisers—which it does not—any attempt to do so would be a change from the existing rule that could not be satisfactorily justified. *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983).

B. The error of the agency's proposed definition is also apparent in the context of ERISA's "fiduciary" definition as a whole.

As noted, in adopting its new fiduciary definition, DOL would be discarding the requirements of the current regulation that a fiduciary's advice be "on a regular basis to the plan"; "pursuant to a mutual agreement" between the parties; and that the services be a "primary basis" on which the plan will make investment decisions. 29 C.F.R. § 2510.3–21(c). Instead, the definition would sweep in people with far less significant contacts with the plan.

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2 The term "render" also is inconsistent with DOL's proposed interpretation. To "render" is "to pronounce or declare (a judgment, verdict, etc.), as in court," *Webster's New World Dictionary* 1136 (3d ed. 1988), or "to furnish for consideration, approval, or information: as (1) to hand down (a legal judgment) (2) to agree on and report (a verdict)." *Merriam-Webster's Collegiate Dictionary* 1054 (11th ed. 2003). That means something more than merely making investment suggestions in the context of a sales transaction.

That is error, as is apparent when considered in the context of Congress's definition of fiduciary as a whole. Section 3(21) identifies three ways that a person or entity becomes a fiduciary: by (i) "exercis[ing] any discretionary authority or discretionary control" over the "management" of a plan or its assets; (ii) "render[ing] investment advice for a fee or other compensation, direct or indirect"; and (iii) exercising "discretionary authority or discretionary responsibility in" the plan's "administration." 29 U.S.C. § 1002(21)(A). The management and administration of a plan are central functions, involving a meaningful, substantial, and ongoing relationship to the plan. Subsection (ii) is properly read in light of these provisions—Congress would not, for two of the provisions, have required a substantial and direct connection to the essence of plan operation, and for the middle provision required a short-term relationship whose essence was sales rather than significant investment advice. *See Pollard v. E.I. du Pont de Nemours & Co.*, 532 U.S. 843, 852 (2001) ("'[W]e must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law.'" (quoting *Gade v. Nat'l Solid Wastes Mgmt. Assn.*, 505 U.S. 88, 99 (1992))); *Garcia v. Vanguard Car Rental USA, Inc.*, 540 F.3d 1242, 1247 (11th Cir. 2008) ("By construing proximate statutory terms in light of one another, courts avoid giving 'unintended breadth to the acts of Congress.'" (quoting *Gustafson v. Alloyd Co. Inc.*, 513 U.S. 561, 575 (1995))). This is further demonstration that the definition in the proposed regulation is mistaken.

C. The proposed definition improperly attempts to regulate products that are not employee benefit plans over which the Labor Department lacks ERISA fiduciary regulatory authority, and intrudes on matters committed by Congress to the Securities and Exchange Commission.

Comments filed in the past have demonstrated that the proposed rule would have sweeping adverse consequences for the IRA market, harming the broker-dealers who offer them and the clients who historically have purchased them. A rule with such serious consequences is particularly inappropriate coming from DOL, because IRAs are not employee benefit plans over which DOL possesses ERISA fiduciary regulatory authority, and because Congress has expressly tasked the Securities and Exchange Commission with determining whether a new standard of care should be imposed on broker-dealers.

DOL does not have direct regulatory authority over IRAs because IRAs—when sold to individual clients—are not "employee welfare benefit plans" or "employee pension benefit plans," that are "established or maintained by an employer or by an employee organization." *See* 29 U.S.C. § 1002(1) & (2). The DOL does not have authority to enforce § 4975; rather, the Treasury Department has that authority under Reorganization Act No. 4 of 1978, § 105.

To be sure, DOL has been given authority to issue regulations under Internal Revenue Code § 4975, which imposes certain restrictions and taxes on ERISA plans and a handful of tax-favored savings vehicles, including IRAs. But that authority was given on the basis of DOL's expertise with regard to ERISA plans, and with the understanding that it would be exercised accordingly—it is not authority to purposely impose its view of the appropriate standard of care on a large and critical sector of the economy that does not involve employee benefit plans at all. Yet that is what is being done here. *See* Phyllis C. Borzi, *Time to Update ERISA Fiduciary Rule* (April 18, 2011) available at http://www.dol.gov/ebsa/newsroom/published/041811.html (repeatedly expressing intent to establish standards of care toward individual retirement accounts).

Second, the regulatory action that DOL is now proposing toward broker-dealers and IRAs is one that Congress specifically declined to take in light of its potential widespread effects, instead directing the Securities and Exchange Commission to study those effects prior to any action. In Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank"), Congress directed the SEC to evaluate the standards of care that currently govern broker-dealers and investment advisers. Pub. L. No. 111-203, § 913, 124 Stat. 1376, 1824 (2010). It specifically directed the SEC to consider "the potential impact of eliminating the broker and dealer exclusion from the definition of 'investment adviser' under section 202(a)(11)(C) of the Investment Advisers Act of 1940[.]" *Id.* § 913(c)(10). Further, Dodd-Frank empowered the SEC to "promulgate rules to provide that, with respect to a broker or dealer, when providing personalized investment advice about securities to a retail customer . . . the standard of conduct . . . shall be the same as the standard of conduct applicable to an investment adviser." *Id.* § 913(g)(1).

This section of Dodd-Frank is a clear expression of congressional intent that the SEC, not DOL, consider and possibly revise the standard of care applied to broker-dealers. DOL is therefore precluded from acting as to the same matter. *See FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 143, 161 (2000). In that case, the Supreme Court held that the Food and Drug Administration did not have authority to regulate tobacco because of the "tobacco-specific legislation that Congress ha[d] enacted over the [previous] 35 years." The Court explained that at the time a statute is enacted—in that case, the Food, Drug and Cosmetic Act—it may have "a range of plausible meanings" that could seem to permit agency regulation, but "[o]ver time . . . subsequent acts can shape or focus those meanings." In particular, later-enacted statutes that "more specifically address the topic at hand" may occupy the field in a manner that forecloses agency action, even if the subsequent legislation does not explicitly block the agency's jurisdiction. *See id.* at 127, 143, 157. That is the case here: Dodd-Frank "more specifically address[es]" procedures for evaluating the standard of care for broker-dealers, committing it to SEC review and, possibly, regulation. Action on the same subject matter is foreclosed to DOL.

In addition to this legal bar to DOL's proposed rule, it would be particularly inappropriate for DOL to proceed with the proposed rule given the findings of SEC staff in their study under Dodd-Frank. After examining the potential impact of eliminating the broker-dealer exclusion, SEC staff recommended against such an amendment, in view of the negative impact on consumers. SEC Study on Investment Advisers & Broker-Dealers 140, 152 (2011) ("If, in response to the elimination of the broker-dealer exclusion, broker-dealers elected to convert their brokerage accounts from commission-based accounts to fee-based accounts, certain retail customers might face increased costs, and consequently the profitability of their investment decisions could be eroded, especially accounts that are not actively traded[.]"). IRAs are just such accounts.

D. The Department's proposed "seller" exception is unacceptable.

The proposed rule's "seller" exception is insufficient to cure the problems outlined above.[3] As has been noted in others' comment letters, there are practical problems with the proposed "seller" exception. *See, e.g.*, Comment Letter of The Financial Services Roundtable 5-6 (Feb. 3, 2011). The exception is flawed as a legal matter as well. DOL's statutory authority under Section 3(21) is limited to defining fiduciaries—a non-sales function. That definitional authority cannot—under the guise of "creating" an exception—be converted to a power to *regulate* activities that plainly are outside the statutory language. No reasonable definition of sales activity involves the seller telling the buyer that their interests are adverse. That is not a customary part of sales activity, indeed it is essentially unheard of. The SEC, which regulates broker-dealers, imposes no such requirement. It therefore is arbitrary and impermissible under step 1 of *Chevron* for the Department to attempt to regulate such sales activities, and to require that they include communications that are not a recognized feature of sales.

II. THE PROPOSED RULE'S COST ANALYSIS IS DEEPLY FLAWED

In proposing its new fiduciary definition, the Department is obligated "to use the best available techniques to quantify anticipated present and future benefits and costs as accurately as possible." Executive Order 13563, *Improving Regulation and Regulatory Review* (Jan. 18, 2011), available at 76 Fed. Reg. 3,821. DOL should then "adopt a

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[3] The provision would exclude from the definition of fiduciary a person who can demonstrate "that the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in its capacity or as a purchaser or seller of a security or other property . . . whose interests are adverse to the interests of the plan or it participants and beneficiaries, and that the person is not undertaking to provide impartial investment advice." Proposed 29 C.F.R. § 2510.3-21(c)(2)(i).

regulation only upon a reasoned determination that its benefits justify its costs," and should "tailor its regulations to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations. . . ." *Id.*

The proposed rule is seriously flawed in this regard, as reflected in the fact that the only costs it accounts for are legal fees associated with compliance, which it estimates at $119 an hour. 75 Fed. Reg. at 65,274. Fees for experienced ERISA counsel will be at least 4 times that amount, and often more; there is no basis whatsoever for the Department's fee estimate. More importantly, the proposed rule completely fails to account for the rule's sweeping consequences for the IRA industry. *See* Comment Letter of Daniel R. Fischel & Todd D. Kendall 5 (Apr. 12, 2011) (noting that in addition to inaccurately estimating legal fees, the DOL's "cost-benefit analysis does not quantify likely potential costs of the Proposed Rule due to (a) higher certification requirements for IRA service providers, (b) increased expenses paid by IRA investors, and (c) lower returns on investors' retirement funds."). Thousands of registered broker-dealers no longer will be able to support themselves by selling IRAs—the Labor Department, of all agencies, must recognize those employment costs of that and account for them. Other commenters have demonstrated at length that the entire market for IRAs would have to be restructured, and that this new structure would impose costs that the majority of IRAs—and IRA owners—cannot bear. The effects of this on firms in this industry; on IRA owners; and on American retirement savings generally all must be addressed.

It is plain that in failing to address these issues, DOL has "entirely failed to consider an important aspect of the problem," the very definition of agency action that fails to satisfy the Administrative Procedure Act. *State Farm*, 463 U.S. at 43. It is also plain that to accurately appraise the new definition's costs and putative benefits, DOL must conduct an entirely new cost-benefit analysis, relying on evidence and findings that were not set forth in the proposed rule. That will require a new round of notice and comment. *See Chamber of Commerce v. SEC*, 443 F.3d 890, 894, 900 (D.C. Cir. 2006) (invalidating SEC rule that was adopted using cost-benefit analysis, data, and studies that were not identified for public comment and did not merely "confirm" the cost calculations of the initial rule).

CONCLUSION

Respectfully, we believe there are serious legal flaws in the Department's proposed rule and in the cost-benefit assessment that accompanied its release. If the Department nonetheless intends to move forward with the rule, it should revise the definition to make clear that IRAs are not covered. Before adopting the rule, the Department must also conduct a thorough cost-benefit analysis, and re-propose the rule for additional comment. We would welcome the opportunity to meet with appropriate personnel from EBSA and the Solicitor's Office to discuss these matters further.

Very truly yours,

Eugene Scalia

cc: Ivan Strasfeld
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