SIFMA®
Securities Industry and
Financial Markets Association

May 5, 2010

The 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: Proposed Investment Advice Exemption on Investment Advice

Ladies and Gentlemen:

On behalf of the Securities Industry and Financial Markets Association ("SIFMA")[1], I am writing in response to the Department of Labor's ("Department") reproposed regulation under the Employee Retirement Income Security Act of 1974 ("ERISA") that will provide additional guidance on the statutory exemption for investment advice.

SIFMA and its members appreciate the opportunity to comment on the reproposed regulations. We support the proposed regulation but believe it may be utilized more widely in the advisor community if the final regulation is modified. SIFMA believes that that with the modifications suggested below, more firms may find it feasible to rely on the exemption.

SIFMA appreciates that the Department has affirmed that the proposed regulations are not intended to alter past guidance. We particularly believe that the Department has hewed to Congressional intent in defining a fiduciary advisor as the entity that employs the individual who provides advice and that individual, and not all of such entity's affiliates.

Scope of Relief

The scope of the exemptions should be clarified to explicitly include relief for extensions of credit, and uses of plan assets that are intrinsic to trading and that have been previously covered in trading exemptions such as PTE 75-1 and 86-128. In addition, the relief should extend to transactions such as overdrafts, float, settlement extensions of credit, short sales, debt instruments, etc. Finally, we hope the Department will confirm that where a plan used a broker dealer for brokerage without advice, that service has no effect on the availability of the

[1] The Securities Industry and Financial Markets Association (SIFMA) brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit www.sifma.org.

statutory or class exemption where other, separate transactions are engaged in with that broker dealer after a fiduciary advisor provides investment advice to a participant.

The Department should also include ministerial rebalancing of a portfolio in the scope of the exemption. Under this type of activity, the fiduciary advisor would be covered under the exemption when an IRA owner or participant has given standing instructions to rebalance the portfolio on a pre-determined basis. This should not be deemed to be a discretionary action on the part of the advisor but will occur solely at the direction of the participant within the meaning of the statutory and class exemption. We also urge the Department to include the kind of re-optimization or re-allocation that has been permitted in the TRAK, Target and PACE exemptions, which permit changes to a portfolio when the model changes and clients receive advance notice.

Many IRA owners and plan participants in brokerage windows use investment advisers to help them select discretionary managers, who may or may not be affiliated with the advisor. That process usually takes place in wrap programs but need not be limited to that format. We urge the Department to make clear that that the statutory exemption does apply to recommendations made by the financial advisor that will enable a participant to select different discretionary managers for different asset classes and does not simply apply to investments in securities or other property.[2] The preamble for last year's final rule recognized that investment manager recommendations would be covered and clarification on this point would be helpful.

In addition, the proposed regulation provides that self-directed brokerage accounts are accepted from the requirement that the computer model take into account "all designated investment options" under the plan. As the Department knows from the voluminous record established on the question of whether computer models are feasible for IRAs, there is no model found which takes into account the full range of investments available. Therefore, we ask that the Department confirm that this exception applies equally to IRAs.

Finally, the proposed regulation should make clear that it applies to participants in the self-directed plans of financial institutions (or such individuals' IRAs) that provide advice. We think that this application is consistent with the Department's and Congress' long held view that it would be inappropriate to make the plans of a particular institution use products of competitor institutions. See for example, ERISA section 408(b)(4) (permitting plans maintained by a bank to invest in its own deposits), section 408(b)(5) (permitting plans maintained by an insurer to use the insurer's own products), section 408(b)(6) (permitting plans of a bank to receive ancillary services from the bank), section 408(b)(8) (permitting plans of a bank or insurance company to invest in that institution's pooled funds), PTE 77-3 (permitting plans of mutual fund advisors to invest in the affiliated mutual funds, and PTE 79-13 (permitting plans of closed end investment companies to invest in the affiliated closed end fund), and PTE 79-41 (permitting plans of insurers to invest in their own products). We think there should be no different result here. Plans of financial

[2] As a technical matter, the substance of the regulation appears to cover both ERISA Title I plans as well as IRAs, Keoghs and other plans covered only by section 4975 of the Internal Revenue Code ("Title II Plans"). We assume that a regulation will be issued under section 4975 of the Code to cover Title II Plans and that the references to IRAs in this regulation will be eliminated.

institutions should not have to select their competitor's advice product and the competitors may not be willing to provide advice if they thought there was any possibility of reverse engineering a trade secret. The result of this impasse would be that participants in a financial institution plan would be unable to have advice and they are no less in need of advice than any other group of employees.

<u>Computer Models</u>

The preamble to the proposed rule seeks comment on a variety of questions regarding the Department's role in defining investment methodologies, particularly with respect to the computer model portion of the exemption. SIFMA believes that any attempt by the Department to restrict or specify the factors involved in r prudent advice is a very troublesome departure from the Department's long-held view that determining prudence is a facts and circumstances inquiry. The questions suggested by the Department may create a static rule with the Department's imprimatur that would be substituted for the appropriate consideration that a prudent fiduciary is required, under section 404, to bring to his duties.

When the Department issued the fiduciary regulations under 29 CFR 2550.404a-1 in 1979, it was careful to make clear that there is no per se prudent outcome but instead, that prudence is judged by whether "the fiduciary has acted in a manner consistent with appropriate consideration of the facts and circumstances that the fiduciary knows or should know are relevant", 44 FR 37255, June 26, 1979. The Department noted:

> "However, the Department does not consider it appropriate to include in the regulation any list of investments, classes of investment or investment techniques that might be permissible under the 'prudence' rule. No such list could be complete; moreover, the Department does not intend to create or suggest a 'legal list' of investments for plan fiduciaries." Id.

One of the areas the Department is seeking more information on include inputs which cannot be confidently expected to persist into the future. This statement appears to be targeted at the uncertainty of active manager returns. A significant number of computer model inputs carry some degree of uncertainty. For example, one critical input into deciding an appropriate mix between stocks and bonds is the expected volatility of stocks relative to that of bonds. Equities might have a 25 percent or more annualized volatility in some market conditions, and a 10 percent or less annualized volatility in others. If it were known with certainty that stocks carried a 10 percent risk, one might allocate a great deal to stocks in the portfolio, but much less at 25 percent risk. One might use a 17 percent expected volatility for modeling purposes, recognizing that future realized volatility might differ.

The Department also sought comment on what historical data should be taken into account. Generally speaking, historical data is useful, but one might apply less weight (i.e., less confidence and an associated greater degree of uncertainty) when the historical observations are few. Importantly, the historical length is not the only criteria to judge confidence. The type of information one is seeking from the historical data and the structure of the data matters too. For example, less than a year of daily observations might be sufficient to confidently estimate the tracking error of an investment manager versus a benchmark, yet a decade of annual data might be insufficient to confidently estimate an active manager's excess return versus the same benchmark.

The Department also sought comment on whether it should consider providing a list of appropriate criteria or designate which criteria are not important. The risk in expressly designating what criteria should be used by investors to structure their retirement investments is that important criteria may be omitted. No matter how carefully one chooses criteria appropriate for the average investor, there will always be specific individuals for whom other criteria might apply or for whom the criteria might have dramatically different weights. Even if the regulations should only suggest a partial list of criteria, the risk is that such a partial list would rapidly become the complete list, as designers of the computer models would be reluctant to add criteria that had not been blessed by explicit mention in the regulations. One strength of the "prudent man" rule is that the rule leaves open the question of what criteria to consider in making a prudent decision, thereby forcing the decision maker both to prudently make the judgment but also to prudently consider the factors entering into such a judgment.

Audit Requirements

The proposed regulation and class exemption require the fiduciary advisor to obtain an independent audit on an annual basis. SIFMA has a number of comments regarding the audit requirements. First, it appears that the auditor may not be required to be a certified public accountant but it is not completely clear. If the Department believes that being an accountant is not required, it would be helpful to include a statement in the preamble that audits could be performed by professionals other than traditional accounting firms. It would be helpful if the Department provided some examples of appropriate experience that might qualify a firm for this role.

Another issue relates to auditor independence. The proposed auditor independence requirement is defined by reference to affiliation. We would like to confirm that there is no prohibition on using the same firm to certify the model as well as perform the annual audit referenced in the regulations as long as the certifying firm does not receive more than 10 percent of its revenue from the fiduciary advisor. In addition, we would appreciate the Department's confirmation that the fact that the auditor may audit the company that is providing the advice or certifying the model, an affiliate of either, or a fund maintained by the entity providing the advice or an affiliate does not disqualify the auditor in any way. Any other answer is impractical in light of the small number of firms that will offer their services to perform these audits.

The audit requirements could also benefit from some additional clarity. For example, we believe that it should meet the audit requirements of the regulation and the class exemption if the auditor reviews the fiduciary advisor's policies and procedures, and reviews a reasonable sample of accounts for the documentation required to be maintained. In connection with sampling, we urge the Department to clarify that the exemption does not require each IRA to be audited, so long as the sampling of documentation includes at least some IRAs. In addition, it is assumed that the regulation will not require that actual transactions be audited at all, and we would appreciate clarification on that point. We urge the Department to consider the cost and time required of any other approach; for a firm with 15,000 registered representatives, thousands of IRAs that elect to retain an adviser for a fiduciary advice program and hundreds of plan clients, the audits would consume the entire year and millions of dollars.

We also believe that the timing of the audit report should be the same for IRAs and plans – 60 days. A shorter time is very impractical for a large institution and there appears to be no particular reason for the shorter period for IRAs. Especially where the audit must be mailed or otherwise delivered to all accounts, where hundreds of thousands of accounts are concerned, 60 days is quite a short period of time. We also hope that the Department will make clear that the auditor need not send its audit report directly to clients, but rather, the fiduciary advisor will bear the responsibility for delivering the report.

The proposed regulation and the proposed exemption require notification of the Department in the case of any evidence of noncompliance. There is concern that this standard will result in thousands of reports to the Department detailing immaterial errors of recordkeeping and record retention. It would be very helpful if the Department added a standard of materiality to this requirement. In addition, we strongly urge a cure period. The audit provisions should make clear that if there is a problem that is capable of cure and cure is effected within 15 days, no notice need be sent to the DOL.

Scope of Fee Leveling

We believe that the Department has correctly recognized that the level fee requirement should relate to the individual giving the advice, and his or her employer but not to the employer's affiliates. SIFMA is concerned about the expansiveness of the language requiring fee leveling under the proposed exemption. The fee-leveling provisions prohibit a fiduciary advisor from receiving compensation, commissions, fees, bonuses, awards or promotions that vary based on advice given. The Department should recognize, however, that advisors are paid and promoted based on total sales or total assets under management; not just those resulting from fiduciary investment advice. If financial advisor entities are required to exclude advice activities to plan participants or IRAs from any bonus, award or promotion decision of a fiduciary advisor, advisors may refuse to give advice because of the dampening effect it will have on the opportunity to advance.

SIFMA recommends that the language be revised so that the advisor's compensation will be level, and no award, bonus or promotion will be *specifically correlated* to particular investment advice given under the Department's rules. In addition, it would be helpful for the Department to clarify that broad performance metrics may apply to any bonus or promotion standards, so long as they are not specifically correlated to advice under this exemption. Finally, we hope the Department will clarify that an advisor's decision to invest his 401(k) balance in a company stock fund, or his employer's decision to make its discretionary contribution or match in company stock, will not be deemed to violate the level fee requirement, solely because the performance of the company may include the performance of all of the company's affiliates. Finally, we urge the Department to make clear that under proposed 29 CFR 2550.408(g)-

1(b)(3)(i)(D) that rather than charge the plan or participant a fee for advice, the fiduciary advisor may receive revenue sharing from each vehicle in which the plan invests, so long as those amounts do not vary from vehicle to vehicle.[3]

Disclosure Information

SIFMA appreciates that the Department has provided a model disclosure document in the guidance. However, we suggest that the Department revise the disclosure requirements to ensure that it doesn't require disclosure of all information regarding all investments that are available in the market. Perhaps some examples would be helpful that make clear that the disclosure is related to the general types of products that will be recommended (i.e., "We will be recommending stocks, bonds, mutual funds and insurance products; however, there are many other investment products available in the market that we do not typically recommend under this program, and those might result in higher or lower fees for us than the universe of products that we will recommend.") In addition, both the regulation and the exemption use the term "all" fees and compensation, and "all" services. As we have commented before in other contexts, we are concerned that the term "all" will either drown the participant in disclosure in a non-helpful manner, or will be used to deny the exemption to an advisor for an inadvertent or immaterial failure to disclose a particular fee or fact. We urge the Department to provide a materiality standard.

In addition, as the Department has recognized in the Form 5500 disclosure, spreads on principal transactions are not disclosed. We believe it is very important for the Department to reiterate this point in the final exemption and final regulation so that advisors will not be required to estimate or guess at spreads that are not disclosed to any other investor and that at best would be haphazard and misleading.

It would also be extremely helpful to indicate in the final guidance that the required disclosures may be provided in another disclosure document that is already provided to plan participants or IRA holders. For example, broker-dealer firms that are also registered as investment advisers may offer certain advice programs to ERISA plan accounts or IRAs. Under SEC Rule 204-3, these firms already provide a disclosure brochure or form to clients and prospective clients. Some of the disclosures required under the proposed regulations and class exemption overlap with these SEC Form ADV Part II disclosures. Provided that both SEC and DOL requirements are met in a single disclosure brochure (including the "clear and conspicuous" requirement), allowing a single disclosure document would reduce the overall burden and result in more efficient and clear disclosure to plan participants and IRA holders. This would be consistent with Section III(g) of the class exemption that the fiduciary adviser provides appropriate disclosure in accordance with all applicable securities laws.

In addition, SIFMA would urge the Department to provide more flexibility to utilize disclosure by electronic means. The statutory exemption requires that the participant be provided

[3] Thus, if a fiduciary advisor recommends 5 mutual funds and each mutual fund pays 25 basis points to the fiduciary advisor's employer, the compensation of that advisor should be deemed not to vary based on the advice of the advisor.

with a number of disclosures prior to the initial provision of advice. The statute specifically provides that the written disclosures “may consist of notification by means of electronic communication.” In implementing the participants statement changes provided under the Pension Protection Act in 2006, the Department concluded that access to a secure website would constitute delivery, subject to the condition that participants are provided with notice and their right to request paper documentation.[4]

Definition of Affiliate

Both the proposed regulation and the proposed class exemption define affiliate as owning, controlling or holding with the power to vote. We believe this is a mistake; as the Department recognized in the preamble to its changes to QPAM, the holding reference sweeps in every investment manager whose accounts hold a particular security. That definition would make virtually every financial institution an affiliate of each other. We urge the Department to use the definition of affiliate in 29 CFR 2510.3-21.

Application of Bonding Rules

It is noted that the proposed regulation require the entity that certifies the model to be a fiduciary. Under section 412 of ERISA, every fiduciary to a plan must be bonded; regardless of whether that fiduciary handles plan assets, unless an exemption applies. An explicit statement regarding whether the certifier would need to comply with the bonding rules would be helpful. Accordingly, it would be beneficial for the Department to amend section 412 to exempt the entity certifying the model from the bonding requirements.

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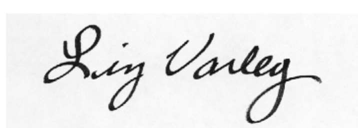
We look forward to continuing to work with the Department on these important issues and hope you will call upon us and our members if you have particular questions on which we might be helpful.

Best regards,



Liz Varley

cc: Robert Doyle

[4] See Field Assistance Bulletin 2006-03 which provided transition guidance for the participant statements required under PPA.