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VIA ELECTRONIC MAIL

May 5, 2010

Office of Regulations and Interpretations
Employee Benefits Securities Administration
Attn: 2010 Investment Advice Proposed Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Dear Sir or Madam:

On March 2, 2010, the U.S. Department of Labor (DOL) published in the Federal Register[1] a Proposed Regulation (Proposed Regulation) under the Employee Retirement Income Security Act (ERISA)[2], and parallel provisions of the Internal Revenue Code of 1986[3], relating to the providing of investment advice to participants and beneficiaries in individual account plans, such as 401(k) plans, and beneficiaries of individual retirement accounts (IRAs). The Proposed Regulation will implement the statutory exemption for investment advice to participants in participant-directed individual account plans that were enacted as part of the Pension Protection Act of 2006.[4] Under the statutory exemption, the investment advice must be provided by a "fiduciary adviser" under an "eligible investment advice arrangement," which may be structured in one of two ways: (1) a "level fees" approach, where the fiduciary adviser's fees do not vary depending on the investment option selected, or (2) pursuant to a "computer model" that is periodically certified by an "eligible investment expert."

The Financial Services Institute (FSI)[5] welcomes this opportunity to comment on the Proposed Regulation. We believe that the Proposed Regulation should be withdrawn and the 2009 Final Investment Advice Regulation and Class Exemptions (2009 Rule)[6] should be re-introduced by the DOL. However, if the DOL chooses not to follow our recommended course of action, we believe that the Proposed Regulation could be improved by providing greater clarity in the sections dealing with the difference between "historical risk and return characteristics" and "historical performance," the impact to IRA accounts on the DOL's decisions not to invalidate prior DOL guidance, and issues related to compensation. In addition, we believe that the Proposed Regulation's exclusion of historical performance from computer models does a disservice to investors and should be corrected. Finally, we have concerns with the implementation date of the

[1] Department of Labor, Investment Advice – Participants and Beneficiaries, 29 CFR 2550, RIN 1210-AB35, available at http://www.dol.gov/federalregister/PdfDisplay.aspx?DocId=23559 (March 2, 2010).
[2] *See generally*, The Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1 - 3058 (1974).
[3] *See generally*, Internal Revenue Code of 1986, 26 U.S.C. §§ 1 - 9834 (1986).
[4] See generally, Pension Protection Act of 2006, Pub. L. 109-280, 120 Stat. 780 (2006).
[5] The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 120 Broker-Dealer member firms that have more than 188,000 affiliated registered representatives serving more than 15 million American households. FSI also has more than 14,000 Financial Advisor members.
[6] Department of Labor, Investment Advice – Participants and Beneficiaries, 29 CFR 2550, RIN 1210-AB13, available at http://edocket.access.gpo.gov/2009/E9-710.htm (January 21, 2009).

Proposed Regulation and recommend an extension to allow firms to implement necessary changes to policies, procedures, and systems.

Background on FSI Members

The IBD community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisors are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 180,000 financial advisors – or approximately 61.7% percent of all practicing registered representatives – operate as self-employed independent contractors, rather than employees, of their affiliated broker-dealer firm.[7] These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisors are typically "main street America" – it is, in fact, almost part of the "charter" of the independent channel. The core market of advisors affiliated with IBDs is clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisors are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.[8] Independent financial advisors get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate their small businesses, we believe these financial advisors have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisors. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisors play in helping Americans plan for and achieve their financial goals. FSI's mission is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

Comments on the Proposed Regulation

FSI's vision is that all individuals have access to competent and affordable financial advice, products, and services. In the preamble of the 2009 Rule, the DOL recognized the importance of investment advice to participants in ERISA plans and beneficiaries of IRAs. Unfortunately, contrary to the language in the preamble of the 2009 Rule, the DOL has taken an overly restrictive view of those who should be allowed to provide investment advice to participants and

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[7] Cerulli Associates at http://www.cerulli.com/.

[8] These "centers of influence" may include lawyers, accountants, human resources managers, or other trusted advisors.

beneficiaries in the Proposed Regulation.

Under the statutory exemption of the Proposed Regulation, investment advice must be provided by a "fiduciary adviser" under an "eligible investment advice arrangement," which may be structured in one of two ways: (1) a "level fees" approach, where the fiduciary adviser's fees do not vary depending on the investment option selected, or (2) pursuant to a "computer model" that is periodically certified by an "eligible investment expert."[9] By creating the exemption for "level fees" and a "computer model" to provide investment advice, the Proposed Regulation would appear to expand the sub-set of individuals that can provide such advice to participants and beneficiaries. However, in practice, given the current structure of the majority of financial services firms, and their affiliated relationships, firms that provide investment advice to participants and beneficiaries will find it difficult to meet these exemptions. This effectively limits the professionals available to give advice unless the firms drastically alter their business practices. The result is that the pool of qualified professionals available to help participants and beneficiaries in making investment decisions related to their plans is greatly reduced.

The 2009 Rule gave broader relief than the 2010 Proposed Regulation. In the 2009 Rule, there were three class exemptions related to fees. These three exemptions included: 1) the pure level fee arrangement, where the fees of the individual adviser, his firm, and any affiliates do not vary; 2) the limited level fee arrangement, where the fees of the individual adviser and the fiduciary advisor do not vary, but the fees of affiliates may vary based on the options selected; and 3) the class level fee exemption that permits individualized advice under a level fee approach.[10] The class fee leveling requirement applied solely to the compensation received by the individual providing the advice on behalf of the entity (*e.g.*, the broker-dealer or the Register Investment Adviser (RIA)) and not to the compensation of that entity, or other employees of that entity (*e.g.*, the individual's manager), or affiliates of that entity. By limiting the level fee to the individual, rather than the entity, the 2009 Rule recognized the fact that if firms were required to be fee neutral, participants and beneficiaries could be harmed because they would have limited options available for investment advice. This approach provided reasonable protections to participants and beneficiaries while helping to insure universal access to professional advice and service. Accordingly, we believe that the DOL should re-issue the 2009 Rule and withdrawal the 2010 Proposed Rule.

Should the DOL reject this approach, we urge the DOL to address our concerns with the Proposed Regulation and clarify several its provisions. Our specific concerns on the Proposed Regulation are discussed in detail below:

- **Clarification of difference between "historical risk and return characteristics" and "historical performance"** – The preamble of the release provides "that a computer model shall be designed and operated to avoid investment recommendations that inappropriately distinguish among investment options within a single asset class on the basis of a factor that cannot confidently be expected to persist in the future."[11] It goes on to says that "some differences between investment options within a single asset class, such as differences in fees and expenses or management style, are likely to persist in the future and therefore to constitute appropriate criteria for asset allocation, other differences, such as differences in *historic performance*, are less likely to persist and

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[9] Department of Labor, Investment Advice – Participants and Beneficiaries, 29 CFR 2550, RIN 1210-AB35, available at http://www.dol.gov/federalregister/PdfDisplay.aspx?DocId=23559 (March 2, 2010).
[10] Department of Labor, Investment Advice – Participants and Beneficiaries, 29 CFR 2550, RIN 1210-AB13, available at http://edocket.access.gpo.gov/2009/E9-710.htm (January 21, 2009).
[11] Department of Labor, Investment Advice – Participants and Beneficiaries, 2.

therefore less likely to constitute appropriate criteria for asset allocation."[12] This section concludes with the following, "[a]sset classes, in contrast, can more often be distinguished from one another based on the basis of differences in their *historical risk and return*."[13]

We request further clarification on the differences between "historical risk and return characteristics" and "historical performance" within the context of this portion of the release. We believe a clear and concise distinction will provide additional guidance to firms and will help ensure compliance. Failure to provide this clarification will create a myriad of interpretations leading to a lack of consistency in application.

- **Invalidation of Prior Regulation** – Section 2550.408g-1(a)(3) of the Proposed Regulation provides that "[n]othing contained in ERISA section 408(g)(1), Code section 4975(f)(8), or this regulation invalidates or otherwise affects prior regulations, exemptions, interpretive or other guidance issued by the Department of Labor pertaining to the provision of investment advice and the circumstances under which such advice may or may not constitute a prohibited transaction under section 406 of ERISA or section 4975 of the Code."[14]

  We request further clarification as to how any prior guidance related to an IRA account is impacted because of this Proposed Regulation. Specifically, are prior ERISA regulations now applicable to IRAs? Are prior DOL advisory opinions, exemptive orders, and field assistance bulletins that the DOL issued for ERISA now applicable to IRAs?[15] These issues must be clarified for firms to have confidence in their ability to comply with the Proposed Regulation.

- **Computer Models** – With respect to investment advice arrangements that use computer models, the Proposed Regulation prohibits recommendations that inappropriately distinguish among investment options within a single asset class based on a factor that cannot confidently be expected to persist in the future.[16] The DOL contemplates that historical performance is unlikely to persist in the future and is, therefore, an inappropriate criteria for asset allocation.[17] The Proposed Regulation contemplates that differences in fees and expenses or management style are likely to persist in the future and therefore are appropriate criteria for asset allocations.[18]

  We believe that if fees, expenses, and management style are the primary factors taken into consideration when providing advice to participants and beneficiaries via computer models, and that advice does not take into consideration historical performance, participants and beneficiaries will not have the information needed to make informed investment decisions. There is little information more important to investor making investment decisions than historical performance. In 2006, the Investment Company Institute (ICI) surveyed investors to understand the types of information they reviewed before and after a purchase of a mutual fund. The results were published in a report

[12] *Id.* at 2
[13] *Id.* at 3
[14] Department of Labor, Investment Advice – Participants and Beneficiaries, 29 CFR 2550, RIN 1210-AB35, 7.
[15] *See generally,* Field Assistance Bulletin No. 2007-01 (February 2, 2007), available at http://www.dol.gov/ebsa/regs/fab_2007-1.html; SunAmerica Advisory Opinion 2001-09A (December 14, 2001), available at http://www.reish.com/pa/benefits/2001-09a.pdf, and Frost National Bank Advisory Opinion, 1997-15A, ERISA SEC. 406(b)(3), available at http://www.dol.gov/ebsa/programs/ori/advisory97/97-15a.htm.
[16] *Id.* at 7, See generally, Section 2550.408g-1(b)(4)(i)(E)(3) of the Proposed Regulation.
[17] *Id.* at 3.
[18] *Id.* at 2.

titled, "Understanding Investor Preferences for Mutual Fund Information."[19] The survey revealed that in addition to fees and expenses, one of the most frequently reviewed items prior to the purchase of a fund was the historical performance of that fund.[20] The survey found that 69% of those surveyed looked at and reviewed the historical performance prior to purchase.[21] Historical performance ranked as the second most reviewed item, after fees and expenses.[22]

Excluding historical performance from computer modeling unwisely overemphasizes the cost of investments in the decision making process. Accordingly, we request that DOL include historical performance as an appropriate criterion for asset allocation determinations in the final version of the Proposed Regulation. Failure to include past performance in investment models will deprive participants and beneficiaries of information they desire in making these important investment decisions. We believe this would be an extremely unfortunate result that must not be allowed to happen.

- **Compensation** – Sections 408(b)(14) and 408(g)(1) of ERISA provide an exemption from the prohibitions of section 406 of ERISA for transactions described in section 408(b)(14) of ERISA in connection with the provision of investment advice to a participant or a beneficiary if the investment advice is provided by a fiduciary adviser under an "eligible investment advice arrangement." Sections 4975(d)(17) and (f)(8) of the Code contain parallel provisions to ERISA sections 408(b)(14) and (g)(1). The Proposed Regulation provides that an "eligible investment advice arrangement" is defined as an arrangement that meets either the requirements of paragraph (b)(3) (use of fees) or paragraph (b)(4) (use of computer models).[23] Finally, Section 2550.408g-1(b)(3)(i)(D) of the Proposed Regulation provides that a fiduciary adviser (including any employee, agent, or registered representative) that provides investment advice cannot receive from any party (including an affiliate of the fiduciary adviser), directly or indirectly, any fee or other compensation (including commissions, salary, bonuses, awards, promotions, or other things of value) that is based in whole or in part on a participant's or beneficiary's selection of an investment option.[24]

  1. **Affiliated Firms** – The preamble of the Proposed Regulation provides that "the receipt by a fiduciary adviser of any payment from any party (including an affiliate of the fiduciary adviser), or used for the benefit of such fiduciary adviser, that is based, in whole or part, on the investment selected by participations or beneficiaries would be inconsistent with the fee-leveling requirement of the statutory exemption."[25]

     We seek clarification of the use of the term "affiliate." Specifically, we are concerned about the extent to which a broker-dealer/RIA is considered an affiliate of other related legal entities. For example, is an independent RIA an affiliate of a product manufacturer that may be owned by the broker-dealer or may own the broker-dealer simply because the broker-dealer could be deemed to exercise control (and an affiliate by having the ability to

[19] Understanding Investor Preferences for Mutual Fund Information, Insurance Company Institute (2006), available at http://www.ici.org/pdf/rpt_06_inv_prefs_summary.pdf
[20] *Id.* at 2.
[21] *Id.* at 3.
[22] *Id.*
[23] *Id.* at 7.
[24] *Id.* at 7.
[25] Department of Labor, Investment Advice – Participants and Beneficiaries, 29 CFR 2550, RIN 1210-AB35, 2.

influence the management or policies of the RIA) simply in executing its supervisory obligations? Simply, how far up the ownership chain does the term "affiliate" run?

II. **Mutual Fund Networking Fees** – We seek clarification of this provision's application to compensation derived from mutual fund networking fees. Mutual fund companies with mutual funds electronically linked or "networked" with a broker-dealer often reimburse the broker-dealer for a portion of their account servicing and administrative costs, which may include accounting, statement preparation and mailing, tax reporting, and other shareholder services. Networking is a service that enables data sharing between the broker-dealer and mutual fund providers and/or their transfer agents. Participants and beneficiaries benefit from these arrangements because it allows the mutual fund companies to pay for plan expenses, rather than having these costs passed on to the investor.

Many dually registered broker-dealers/RIAs receive networking fees from mutual fund companies. These fees assist the firms in ensuring that participants and beneficiaries receive appropriate and timely services and ultimately benefit the clients of the dual registrant. We believe that these fees are appropriate, as long as they are fully disclosed to participants and beneficiaries. We ask the DOL to provide clear guidance that the payment of networking fees to a dual registrant would not be considered a violation of the above-mentioned section of the Proposed Regulation.

- **Effective Date** – The Proposed Regulation provides that it will be effective within 60 days of publication of the final regulation in the Federal Register. We believe that 60 days is insufficient time given the expansive nature and scope of the Proposed Regulation. We request that the effective date be extended to 180 days after the publication of the final regulation in the Federal Register to ensure firms can comply with the Proposed Regulations.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you to clarify and improve the Proposed Regulation for the benefit of all ERISA participants and IRA beneficiaries.

Thank you for your consideration of our comments. Should you have any questions, please contact me at 202 379-0943.

Respectfully submitted,

Dale E. Brown, CAE
President & CEO