

October 6, 2008

*Sent via Electronic Mail*

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

**Re: Proposed Rules on Investment Advice for Participants, Beneficiaries**

To whom it may concern:

The Financial Planning Association®<sup>1</sup> ("FPA®") is pleased to submit comments regarding rules governing the delivery of personalized investment advice to plan participants under Section 601 of the Pension Protection Act of 2006 ("PPA") and similar provisions governing Individual Retirement Accounts ("IRAs").

Retirement planning is a core area of practice for financial planners. In addition to providing advice on a broad array of personal finance issues, many offer investment advice to clients<sup>2</sup> on qualified plan and IRA accounts as part of their overall retirement goals. Some financial planners also serve as investment managers who select the investment options for plan sponsors. Most are generally subject to a broad fiduciary duty

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<sup>1</sup> The Financial Planning Association is the largest organization in the United States representing financial planners and affiliated firms. Most of FPA's 29,500 members are affiliated with investment adviser firms registered with the Securities and Exchange Commission, state securities administrators, or both. FPA is incorporated in Washington, D.C., where it maintains an advocacy office, with headquarters in Denver, Colorado.

<sup>2</sup> For ease of reference, the term "client" is used to refer to qualified plan participants, their beneficiaries, and IRA account holders.

as affiliates of registered investment advisers, and FPA members are also subject to a fiduciary duty for their financial planning activities under ethical rules promulgated by CFP Board of Standards, Inc., a separate 501(c)3 standards-setting organization,<sup>3</sup> and incorporated by FPA in its own bylaws.<sup>4</sup>

FPA supports the broad goals of the PPA to expand the pool of investment advisers eligible to help qualified plan participants and beneficiaries make wise investment decisions. We agree with the Department of Labor's (the "Department") view that unbiased investment advice will help workers take a more disciplined approach to investing in the equity markets at a time when they are saving far less than they need for retirement. Last year, in anticipation that many FPA members would begin using the new safe harbor, we published a best practices handbook as guidance.<sup>5</sup> The handbook offers a 19-step process for complying with the requirements of an eligible investment advice arrangement ("advice arrangement"), including a sample agreement, disclosures, and investment policy statement.

## **Overview**

Under the proposed rules, fiduciary advisers would be able to provide investment advice to participant-directed, non-taxable investment accounts without such activity being deemed to be a prohibited transaction under the Employee Retirement Income Security Act of 1974 ("ERISA"). In order to take advantage of this safe harbor, a fiduciary adviser would be required to act solely in the interest of the client, generally recommend a diversified asset allocation among the investment options available, disclose conflicts of interest, and restrict compensation received by the adviser to "level" fees. Alternatively, the rules also permit the use of computer-generated advice. Both approaches would require annual audits or certifications, respectively, by an independent third-party. In this letter, FPA addresses the rules affecting individual advisers, but not the use of computer-generated advice, in its comments below.<sup>6</sup>

## **Disclosure of Conflicts in an Advice Arrangement**

Under the proposed rules, the fiduciary adviser is required to furnish detailed information about the advice arrangement prior to providing advice and annually

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<sup>3</sup> See <http://www.cfp.net/> for more information. The mission of Certified Financial Planner Board of Standards, Inc. is to benefit the public by granting the CFP® certification and upholding it as the recognized standard of excellence for personal financial planning.

<sup>4</sup> See page 3, Article IV, at <http://www.fpanet.org/docs/assets/BylawsapprovedJune2008.pdf>

<sup>5</sup> Copies of "Prudent Practices for Fiduciary Advisers" (copyright 2007 by FPA Press) were distributed to the Department upon publication. FPA would be pleased to provide additional copies upon request.

<sup>6</sup> Separately, the Department is proposing a class exemption for a hybrid investment advice model that combines either a computer-generated asset allocation or the use of educational materials with specific investment recommendations of the fiduciary adviser. The FPA is not submitting comment on this proposed exemption.

thereafter. Also, information needs to be provided upon the client's request, or when there is a material change in the information. The disclosure must be written in a "clear and conspicuous manner ...calculated to be understood by the average plan participant."<sup>7</sup> While we believe the model disclosure document developed by the Department contains most of the necessary information needed to help prospective clients make informed decisions, the specific language used to disclose conflicts is overly nuanced and legalistic. The disclosure of compensation sources and other conflicts is meaningful only if understandable to the typical worker. In its present form, it is not. It is doubtful that this language would be clearly understood by the client.

For example, the model disclosure form described conflicts by using language such as

"affiliates of [fiduciary adviser] also will be providing services for which they will be compensated" and

"When [the fiduciary adviser] recommends that you invest your assets in an investment fund of its own or one of its affiliates and you follow that advice, [the fiduciary adviser] or that affiliate will receive compensation from the investment fund based on the amount that you invest.... This information should be reviewed carefully before you make an investment decision."<sup>8</sup>

In order to provide a clear context for the client, we would suggest that the bold-faced heading "Compensation of the Fiduciary Advisor and Related Parties" be replaced with "Conflicts of Interest – Please Read," or something to that effect. This term should also be noted in the text.

### **Disclosure of Conflicts Outside of Advice Arrangements**

The Department estimates that approximately 16,000 "investment advisory firms" will take advantage of the statutory exemption, although it is unclear how many of these adviser firms are broker-dealers, banks, insurance companies, or registered investment adviser firms ("RIAs"). As noted in an earlier comment letter,<sup>9</sup> the PPA does not address the need to disclose other, non-fiduciary services outside of the ERISA advice arrangement that may lead to self-dealing. As such, many of these non-RIAs – particularly those subject to regulation under insurance and brokerage laws – are not required to fully disclose conflicts. Indeed, even though bank employees offering trust and investment management services are subject to a fiduciary duty, they are not required under banking laws to offer comprehensive disclosure, making it more difficult to manage conflicts of interest.

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<sup>7</sup> Proposed DoL Regulation §2550.408g-1(g)(1) and (2).

<sup>8</sup> Fiduciary Adviser Disclosure Statement, Appendix to Proposed Regulation §2550.408g-1.

<sup>9</sup> Letter to Office of Regulations and Interpretations, U.S. Department of Labor, from Duane R. Thompson, Financial Planning Association, re: Request for Information...on Investment Advice (Jan. 30, 2007).

To put it plainly, there is a disclosure gap between the PPA and other financial services laws. In cross-selling products, a fiduciary adviser can easily change regulatory hats and be subject to a lower standard of accountability. Moreover, job titles commonly used across the financial services industry – such as financial advisor – imply a relationship of trust.<sup>10</sup> There is nothing in the rules that would lead the client to appreciate that the fiduciary adviser has reverted to a sales agent’s role, i.e., subject to the laws of agency. At worst, the laws of agency require the agent to act as a fiduciary to his or her employer, not the client; at best, the laws of agency create divided loyalties.<sup>11</sup>

The suitability standards<sup>12</sup> contained in the rule require a fiduciary adviser to collect data on the client’s various assets and sources of income, providing a lucrative incentive for affiliates of the fiduciary adviser to cross-sell other products outside of the advice arrangement. For example, an insurance producer who acted as a fiduciary adviser would be able to sell equity-indexed annuities as part of a complementary retirement plan. Equity-indexed annuity sales in some states are not subject to suitability standards or disclosure requirements. Other products could also be sold, such as 529 plans or life insurance, without notification that the adviser is no longer acting in a fiduciary capacity.

Only one disclosure seems to touch on this problem<sup>13</sup> and it generally appears to relate more to privacy restrictions than cross-selling. FPA strongly recommends that, at a minimum, the disclosure rules be strengthened by adding language that the fiduciary adviser must disclose that he or she is permitted under law to use personal client data under the advice arrangement to sell other products or services. Further, the disclosure should suggest that clients ask if the adviser is required under law to continue to place the clients’ interests first.

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<sup>10</sup> For a detailed discussion of confusion among consumers over various titles used by agents in the securities industry, please see consumer focus group study by the Securities and Exchange Committee: *Investor and Industry Perspectives on Investment Advisers and Broker-Dealers*, by Angela A. Hung et al., RAND Corporation Technical Report (2008).

<sup>11</sup> See “Report of the Committee on Compensation Practices,” *Executive Summary*, April 10, 1995 (also known as the “Tully Report”):

*The RR [registered representative], however, is not just a representative of the customer, but is also an employee of the firm. This means that the RR and the firm each have three interests to balance: the broker has the customer, the employer, and his or her own well-being; and the firm has the customer, the broker, and the firm’s own interest (including its shareholders, if it is publicly held).*

<sup>12</sup> Proposed Regulation at §2550.408g-1(e)(1)(i) and (ii).

<sup>13</sup> Proposed Regulation at §2550.408g-1(g)(1)(v). This provision requires disclosure “[o]f the manner, and under what circumstances, any participant or beneficiary information provided under the arrangement will be used or disclosed.”

Given the incentives for cross-selling, the Department should be greatly concerned with this overlooked and glaring weakness in the PPA. In discussions with independent advisers, the upfront costs needed to adequately research, document, and provide competent advice to plan participants raise serious questions about the financial feasibility of providing investment advice without other revenue streams. Of course, there is nothing inherently wrong with such business strategies as long as there is disclosure of conflicts outside of the advice arrangement and compliance with those laws. This regulatory gap hearkens to the finger-pointing in Washington over gaps in regulatory oversight that have resulted in the current financial crisis. Similarly, we believe the Department should be acutely aware of this flaw in its own rulemaking.

### **Disclosure of Investment Expenses**

The model disclosure statement<sup>14</sup> under “Investment Returns” references the need for the client to understand “investment-related fees and expenses,” although it does not clearly distinguish between plan costs and investment options. We assume that the Department intends to address any gaps in information on various fees in a separate proposed rule to improve 401(k) fee disclosure to participants.<sup>15</sup> As noted by the Department in the preamble, there is strong evidence that poorly performing mutual funds have higher fees compared to lower-cost, comparable funds, even between two funds tracking the same market index. Clear disclosure – whether in this format or the other proposed rule -- is especially important in light of the growing trend by some qualified plans to offer annuity products. Annuities are generally more expensive than traditional mutual fund investment options, as well as proprietary funds when compared to an open platform of similar, lower-cost investment options.

### **Disclosure of Separate Arrangements for Advice**

The proposed rules also require fiduciary advisers to notify clients that they are free to use independent investment advisers, not just those approved in an advice arrangement. The current language states

You should carefully consider the impact of any such fees and compensation in your evaluation of the investment that [name of fiduciary adviser] provides to you. In this regard, you may arrange for the provision of advice by another adviser that may [not] *sic* have [a] material affiliation with or receive compensation in connection with the investment funds or products offered under the plan. This advice is/is not available through your plan.

We believe that the disclosure language could be made stronger. The language could say something like

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<sup>14</sup> Fiduciary Adviser Disclosure Statement, Appendix to Proposed Regulation §2550.408g-1.

<sup>15</sup> Proposed Regulation §2550.404a-5 and 2550.404c-1.

You should carefully consider the long-term negative impact on your investment returns from any fees received by the firm that employs [name of fiduciary adviser]. In this regard, you are permitted under law to select another adviser not subject to conflicts of interest unique to [plan sponsor's] qualified plan. Please keep in mind that while most advisers recommend diversified investments, their strategies may vary.

## **Tax Factors**

The proposed suitability rule does not require a review of tax issues associated with the client's retirement goals. We strongly believe tax advice is an integral part of a fiduciary's duty of care, and should be required in all advice arrangements. The Department appears to base its lack of tax analysis on studies of tax-efficient portfolios that suggest the benefits of investment advice in this area are inconclusive.<sup>16</sup> We understand this concern and appreciate the practical limitations of a tax-efficiency analysis. However, a basic review of taxable and non-taxable client assets in an advice arrangement should be a standard component of the suitability requirement.

An example of a basic tax analysis would involve data-gathering that reveals ownership of a variable annuity policy by a client who is not fully matching the employer's contributions. Assuming the client needed to save as much as possible to meet his or her retirement goals, it would then be incumbent upon the fiduciary adviser, as part of the suitability analysis, to explain the advantages of matching the employer's contributions as well as meeting the contribution limits before investing additional money in a variable annuity.

At an absolute minimum, such limitations in advice should be a required and important disclosure under the rules.

## **Compliance with Other Laws as Fiduciary Advisers**

Although compliance with other laws affecting investment advice is obviously outside of the Department's jurisdiction, it should nonetheless promulgate a rule that fiduciary advisers should be registered as investment advisers under federal or state law unless otherwise exempt.<sup>17</sup>

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<sup>16</sup> "In any event it is unclear whether or to what extent investment advisers would be positioned to provide advice on tax efficiency." Preamble to the proposed regulation, §2550.408g-1.

<sup>17</sup> Banking and other depository institutions are generally excepted from registration under the IAA or state laws. Sec. 202(a)11(A) of the IAA provides an exception from registration for a bank, or any bank holding company as defined in the Bank Holding Company Act of 1956 [12 U.S.C. 1841 et seq.] which is not an investment company, except that the term "investment adviser" includes any bank or bank holding company to the extent that such bank or bank holding company serves or acts as an investment adviser to a registered investment company, but if, in the case of a bank, such services or actions are performed through a separately identifiable department or division, the department or division, and not the bank itself, shall be deemed to be the investment adviser.

In reviewing the definition of “investment adviser” under the Investment Advisers Act of 1940 (“IAA”), it would appear that agents of broker-dealers and insurance firms would be required to register as investment advisers when servicing advice arrangements under the PPA.

Sec. 202(a)(11) of the IAA defines an “investment adviser” as

Any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities....

Broker-dealers have a limited exception from IAA registration; however, it requires them to register if they receive “special compensation” (i.e. a fee for their advice) and the advice is not solely incidental to their business as brokers. We believe the Department’s rules should make clear, i.e., that while agents in all four areas of the financial services industry are *eligible* [emphasis added] to act as fiduciary advisers, only those who are registered under the IAA or excepted from registration, i.e. banking institutions, should be permitted to provide advice to qualified plan and IRA account holders.<sup>18</sup>

## Definitions

The rules include investment adviser representatives within the definition of “registered representative.”<sup>19</sup> This should be amended to remove investment adviser representatives (“IARs”) and creating a separate definition for them. There are a number of reasons to separate IARs from registered representatives. First, each is regulated under distinctly separate securities laws. Secondly, even though most registered representatives have dropped the stockbroker moniker for advisor-like titles such as “financial advisor” and “wealth manager,” they are regulated differently from investment adviser representatives.

The substitution by the Department of an anachronistic Depression-era term (adopted by the NASD in 1938 for stock brokers) for investment adviser representatives is puzzling. Investment advisers have a fiduciary duty<sup>20</sup> to their clients, provide investment advice as a core component of their business, and consider themselves to be part of a

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<sup>18</sup> See also “Applicability of the Investment Advisers Act to Financial Planners, Pension Consultants, and Other Persons Who Provide Investment Advisory Services as a Component of Other Financial Services,” Investment Advisers Act Release No. 1092 (Oct. 8, 1987) [52 FR 38400 (Oct. 16, 1987)] (“Advisers Act Release No. 1092”).

<sup>19</sup> Proposed Regulation §2550.408g-1(j).

<sup>20</sup> See *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180 (1963).

profession.<sup>21</sup> Registered representatives of a broker-dealer are not fiduciaries and are only permitted under law to provide “solely incidental” investment advice.<sup>22</sup>

FPA also prefers a separate category for investment advisers since generic labeling involves a reputation issue for the financial planning community. FPA prevailed in court<sup>23</sup> against the SEC in 2005 over an exemption from the IAA that allowed broker-dealers to engage in advisory activities. FPA remains concerned with consumer confusion in the marketplace and, it appears, with regulators over this distinction. The term “registered representative” is not only inaccurate when applied to investment adviser representatives, it is needlessly confusing and will lead to numerous questions from investment adviser representatives about their registration status under the PPA.

We would urge the Department to simply add “investment adviser representative” to the list of definitions, using the current definition referenced in the rules.

### **Fee-Leveling**

FPA appreciates and supports the efforts of the Department to impose a “level fee” on individual fiduciary advisers to ensure there are no financial incentives to steer clients to investment options that would violate the adviser’s fiduciary duty of loyalty. In addition, they must follow generally accepted investment theories, i.e., diversification of assets, and undertake a suitability analysis in providing investment advice. An annual audit by an independent third-party is required to monitor compliance by the fiduciary adviser

FPA is concerned, however, whether an audit trail will detect any self-dealing activities of the fiduciary adviser’s affiliates without additional guidelines. Although affiliates are required to act in a fiduciary capacity, they are not subject to the audit. It is unclear to us how the audit will take place and under what conditions. Will the auditor review overall management expenses of the funds recommended by the fiduciary adviser and compare them to comparable investment options in other audited plans? More broadly speaking, will the DoL compare average expenses and rates of return between plans of one fiduciary adviser to unrelated advisers? Should it request auditors provide overall rates of return and expense ratios for different plans to assess auditor performance as fiduciaries? How subjective can the auditors be in assessing appropriate asset weighting and diversification absent Department guidance?

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<sup>21</sup> The SEC, in an adopting release several years ago, noted that “financial planners today belong to a distinct profession, and financial planning is a separate discipline from, for example, portfolio management.”<sup>21</sup> Advisers Act Release No. 2376, at 54.

<sup>22</sup> Sec. 202(a)(11)(c) of the IAA.

<sup>23</sup> *Financial Planning Assn. v. SEC*. 482 F.3d 481 (D.C. Cir. 2007). The court noted that the intent of Congress in passing the IAA was to protect the public from unscrupulous tipsters and touts and “to safeguard the honest investment adviser against the stigma of the activities of these individuals by making fraudulent practices by investment advisers unlawful.”



Although we appreciate the practical problem with charging level fees for different fund options, we remain concerned that exceptions in the rule from fee-leveling will encourage self-dealing if audit procedures are not designed to detect such activities.

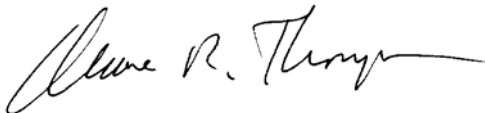
Finally, the Department may also want to consider requiring certification of auditors under nationally recognized training programs that we understand are being developed in the private sector. At an absolute minimum, the Department should assess the weaknesses in auditor controls beyond the level fee safeguard, and consider guidelines or rules that require a specific audit focus on this potential problem.

### **Summary**

We appreciate the opportunity to provide comment on rules that are critical to helping Americans reach financial independence at retirement, and with standards that allow for the delivery of competent, objective investment advice.

Please contact the undersigned at 202-449-6341 for any questions or comment.

Very truly yours,

A handwritten signature in black ink, appearing to read "Duane R. Thompson". The signature is fluid and cursive, with a long horizontal stroke at the end.

Duane Thompson  
Managing Director, Washington Office

cc: Andrew Donohue, SEC Division of Investment Management