PENSION RIGHTS CENTER

1350 CONNECTICUT AVENUE, NW SUITE 206 WASHINGTON, DC 20036
TEL: 202-296-3776 FAX: 202-833-2472
WWW.PENSIONRIGHTS.ORG

October 6, 2008

Office of Regulations
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: Comments on Proposed Regulations and Class Exemption on Investment Advice

The Pension Rights Center submits the following comments on the Department of Labor's proposed regulations on investment advice provided by certain fiduciary investment advisers, and on a related class exemption from the prohibited transaction rules. The Pension Rights Center is a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families.

Background

Professional investment advice can help guide creation of age-appropriate retirement investment portfolios that give consideration to a participant's total circumstances and tolerance for risk – *if* the investment advice is provided by advisers who are educated in investment theory, experienced, and operating free of conflicts. Ideally, investment advice should be provided by professional advisers who are independent and do not receive compensation, direct or indirect, from the vendors of investment products.

In the Pension Protection Act of 2006, Congress amended ERISA to permit conflicted parties to provide investment advice in certain situations without violating ERISA's prohibited transaction sections. The amendments to ERISA reflected a compromise under which a conflicted individual or entity could furnish investment advice, but only under certain carefully crafted conditions.

The Labor Department has proposed regulations interpreting these amendments that in our view are flawed. At the same time, the Department has proposed a class exemption that goes well beyond the limited legislation that Congress enacted. In these comments, we provide suggestions for improving the proposed regulations and urge the Department to withdraw the class exemption. Not only does the class exemption violate the statutory conditions for a class

exemption, it also fails to conform to administrative requirements, which, among other things, require that the Department hold a hearing. Our comments follow:

Proposed Regulations

1. Fee-Leveling.

One type of qualified investment advice arrangement permitted by the Pension Protection Act is an arrangement under which the fiduciary investment adviser's compensation does not vary depending on the basis of any investment option selected by the plan participant. This has been referred to as "fee-leveling," since the adviser's fees are not related to the specific investment options selected by the participant.

In determining whether this fee-leveling requirement of the statute is satisfied, the proposed regulations ignore the relationship between the advisers providing investment advice to participants and the firm providing investment products to the plan. Some investment advisers will have strong incentive to steer participants to products that will result in greater profitability for a related entity. The regulations will permit such advice unless it can be shown that there is an *actual relationship* between the fees and compensation earned by the investment adviser and the adviser's recommendations. We believe showing that such a relationship exists will often be exceedingly difficult for both the Department of Labor and participants.

We note that the statute and proposed regulations reflect the opposite position when defining the scope of eligible investment advice using computer models. Here, following the statute, the proposed regulations provide that a computer model must be designed to avoid (i) investment recommendations that inappropriately favor investment options offered by the fiduciary adviser or *a person with a material affiliation or material contractual relationship with the fiduciary adviser* over other investment options, and (ii) or inappropriately favor investment options that may generate greater income for the fiduciary adviser or *a person with a material affiliation or material contractual relationship with the fiduciary adviser.*

2. Fee-Leveling, Investment Theories, and Investment Fees.

The proposed regulations indicate that investment advice using a fee-leveling arrangement must be based on generally accepted investment theory that takes into account, among other things, historic rates of return of different assets classes, and personal information about the participant. The regulations, however, are oddly silent with respect to consideration of the effect that investment management fees and other expenses, direct and indirect, will have on the rate of return.[1] Final regulations should clarify that a fiduciary investment adviser must take fees into account in offering investment advice. This is especially critical if the Department rejects the viewpoint we suggested in Comment 1.

[1] We note that the model disclosure notice for participants, which the Department has included as an appendix to the proposed regulations, discusses the importance of fees to the participant.

3. Audit.

We strongly endorse the requirement that there be an annual audit to ensure that conflicted fiduciary investment advisers conform to the requirements of the statute for conflicted investment advice. Because the audit is central to the protection of plan participants and the proper investment of plan assets, it is our view that the audit function under the regulations is a fiduciary activity. Thus, we would recommend that the auditor affirmatively acknowledge that it is acting in a fiduciary capacity when it conducts an audit under the regulations.

4. Disclosure Statement.

The model disclosure statement appended to the proposed regulations is too complex to convey the desired information to a typical plan participant. We suggest that the Department convene focus groups to review the comprehensibility of the proposed notice to actual participants of varying levels of investment experience and education, and to make revisions in the notice following such study.

Class Exemption

The Department has issued a class exemption from the prohibited transaction rules for certain investment advice that goes well beyond the statutory exemption that is the subject of the proposed regulations. The exemption permits conflicted investment advice so long as the advice is preceded by investment recommendations generated by a computer model (similar to that described in the proposed regulation). Alternatively, the exemption permits advice so long as the compensation earned by the actual person giving advice (rather than the entity employing them) does not vary depending on the basis of any investment option selected by the participant. In our view, the potential for conflicted advice is even greater in these situations than in the more circumscribed statutory exceptions interpreted by the proposed regulations.

We are also concerned that the class exemption will make it more difficult for *independent* financial advisers to retain a footing in the marketplace for investment advice. Conflicted entities that provide investment products will be able to bundle investment-advice fees with other administrative fees and thus cloud the actual compensation they are receiving for the provision of the investment advice. Independent investment advisers, who have to charge a transparent fee, will be at a serious competitive disadvantage competing against conflicted entities whose advice appears to be free.

Section 408 of ERISA permits the Department to issue an exemption only if it finds that the exemption is (1) administratively feasible, (2) in the interests of the plan and of its participants and beneficiaries, and (3) protective of the rights of participants and beneficiaries of such plan. Given that Congress specifically enacted legislation that offered limited exemptions for fiduciary investment advisers, the Department, in issuing the proposed exemption, is substituting its judgment for the legislative judgment of Congress as to what types of conflicted investment advice are in the interests of the plan and participants and provide adequate protection of the rights of participants and beneficiaries. We urge the withdrawal of the proposed exemption on the ground that it exceeds the Department's authority.

We also note that the Secretary may not grant an exemption under Section 406(b) "unless he affords an opportunity for a hearing and makes a determination on the record with respect to the findings required by ERISA section 408(a)(1), (2), and (3)." See ERISA § 408(a). If the Department does not withdraw the class exemption, we request an opportunity to present our views at any hearing that is scheduled to consider the exemption.

Thank you for consideration of these comments.

Norman P. Stein
Policy Advisor

Rebecca A. Davis
Staff Attorney