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Via e-ORI@dol.gov

March 6, 2009

Office of Regulation and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210

Re: Comments on provisions of 29 CFR §§ 2550.408g-1 and 2550.408g-2 as published in January 21, 2009 Federal Register

To Whom It May Concern:

AARP appreciates the opportunity to comment on the significant concerns involving law and policy raised by the Department of Labor's (DOL or Department) regulation and Class Exemption regarding Investment Advice.

AARP submits that the published regulation and the Class Exemption go far beyond the intent of Congress and the carefully crafted compromise between the House and the Senate. *E.g.*, Recorded Vote 328, 109th Congress, November 16, 2005. Indeed, Congressional representatives, who struck the compromise, informed the Department that provisions in the proposed regulation and Class Exemption, which were not changed in the published version, did not reflect their agreement. *See* October 6, 2008, Letter to Assistant Secretary Brad Campbell from Sen. Jeff Bingaman, Sen. Edward M. Kennedy and Sen. Charles E. Grassley, and October 8, 2008, Letter to Assistant Secretary Brad Campbell from Rep. George Miller and Rep. Rob Andrews.

AARP submits that, contrary to the statute's mandate, the published regulation and Class Exemption provide inadequate restrictions on the provision of conflicted investment advice. More significantly, the published regulation and the Class Exemption neither are in the interests of participants and beneficiaries nor provide the necessary substantive protections for participants and beneficiaries. *See* ERISA §§ 408(a)(2) & (3), 29 U.S.C. §§ 1108(a)(2) & (3).

Recent financial scandals such as those affecting Madoff securities and Stanford investments starkly illustrate the need for increased, significant and substantive protections for participants. Accordingly, AARP urges the Department to rescind the published regulation and Class Exemption, and to re-propose, subject to notice and comment, a new regulation that is both consistent with the statute and protective of participants and beneficiaries.

AARP's Interest

With 40 million members, AARP is the largest nonprofit, nonpartisan organization representing the interests of Americans age 50 and older and their families. Nearly half of our members are employed full or part-time with many of those employers providing retirement plans. A major priority for AARP is to assist Americans in accumulating and effectively managing adequate retirement assets to supplement Social Security. The shift away from defined pension plans to defined contribution plans places significant responsibility on individuals to make appropriate investment choices so that they have adequate income to fund their retirement years. Therefore, AARP has a strong interest in promoting the requirement of effective, high quality, conflict-free and timely investment advice.

AARP shares the goal of increasing access to investment advice for individual account plan participants. To that end, we have consistently asserted that such advice must be subject to the Employee Retirement Income Security Act's (ERISA) fiduciary rules, based on sound investment principles and protected from conflicts of interest. The recent financial turmoil and scandals underscore the imperative that such advice be independent and non-conflicted.

Background

Pension Protection Act

The financial industry's protracted campaign to legitimize the furnishing of direct investment advice to 401(k) participants resulted in hearings and extensive debate in Congress and public policy circles, spanning three separate Congresses. See Doug Halonen, *Delay on Advice Rule May Lead to Revamp*, PENSIONS & INVESTMENT (January 26, 2009). Against this background, the Pension Protection Act (PPA) created an exemption from ERISA's prohibited transaction rules to permit plan fiduciaries to structure investment advice arrangements where the advice provider is affiliated with the provider of the underlying investment options. However, Congress mandated certain restrictions and participant protections as a condition to providers giving conflicted advice to participants.

The statutory exemption to ERISA's prohibited transaction rules permits one of two models. First, a compensation model may meet the exemption if the compensation received by the provider of advice does not vary based on the investment option selected. Second, a computer model may meet the exemption if the model uses generally accepted investment theories and is certified by an independent expert. The PPA offers plan sponsors protection from fiduciary liability only for the advice given under these specific models. The PPA confirms that the plan sponsor has a fiduciary duty to prudently select and monitor the entity providing the advice.

Although the PPA tracked most of the language set forth in the House-passed bill, H.R. 2830, *see* H.R. 2830, 109th Cong., 1st Sess. (June 9, 2005), 2005 CONG US HR 2830, there were three significant modifications relevant here. One modification was the change in the provisions regarding compensation of fiduciary advisers. Both H.R. 2830 and the PPA state that "compensation received by the fiduciary adviser and affiliates thereof in connection with the sale, acquisition, or holding of the security or other property [must be] reasonable." However, the PPA further limits compensation received specifically by the fiduciary adviser. Discussing criteria for meeting requirements of an "eligible investment advice arrangement," section 408(g)(2) of ERISA states that "fees (including any commission or other compensation) received by the fiduciary adviser for investment advice or with respect to the sale, holding, or acquisition of any security or other property for purposes of investment of plan assets *do not vary* depending on the basis of any investment option selected." 29 U.S.C. § 1108(g)(2) (emphasis added). A second critical distinction between H.R. 2830 and the PPA concerns the timing of the required disclosures. H.R. 2830 called for disclosure, via written notification, to be made to the recipient of the investment advice, "at a time reasonably contemporaneous with the initial provision of the advice." The PPA, however, requires that disclosure by a fiduciary adviser, also via written notification, be provided to a participant or a beneficiary "*before* the initial provision of the investment advice." 29 U.S.C. § 1108(g)(6) (emphasis added). Finally, although H.R. 2830 did not address the issue of investment advice procured using a computer model, the PPA permits the use of computer models to meet the definition of an "eligible investment advice arrangement" as long as the specific requirements are met.

Class Exemptions

Under ERISA § 408(a), 29 U.S.C. § 1108(a), the Secretary is authorized to "grant a conditional or unconditional exemption of any fiduciary or transaction, or class of fiduciaries or transactions, from all or part of the restrictions imposed by §§ 406 and 407(a)." Congress intended that the exemptions it established from ERISA's prohibited transaction rules were to be construed narrowly. *See* S. REP. NO. 93-127, 93d Cong., 1st Sess. (1973), *as reprinted in* 1974 U.S.C.C.A.N. 4838, 4853 ("[E]xemptions should be confined to their narrow purpose.")

(discussing an earlier version of the bill); *see also McDannold v. Star Bank, N.A.*, 261 F.3d 478, 481 (6th Cir. 2001) ("Under ERISA, Congress sought to protect plan assets by placing narrow restrictions on the types and terms of stock purchase transactions in which plans may engage. *See* 29 U.S.C. §§ 1106-1108 (prohibiting certain transactions with benefit plans and outlining stringent exemptions)."); *Reich v. Hall Holding Co*., 990 F. Supp. 955 (N.D. Ohio 1998) ("In order to allow *appropriate* transactions between a plan and its sponsor, however, Congress enacted ERISA § 408, which carves out narrow exemptions from the prohibited transactions listed in § 406. Congress' goal of preventing insider abuse should not be undermined by the unnecessary expansion of the scope of these narrowly carved exemptions."), *aff'd sub nom*., *Chao v. Hall Holding Co*., 285 F.3d 415 (6th Cir. 2002).

The Secretary's authority to issue such exemptions is limited to those exemptions which are: "(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." 29 U.S.C. § 1108(a). Further, the Department is only authorized to grant an exemption after first "considering all the facts and representations submitted by an applicant in support of an exemption application, all the comments received in response to a notice of proposed exemption, and the record of any hearing held in connection with the proposed exemption." 29 C.F.R. § 2570.48(a). Accordingly, because ERISA provides not only disclosure rights, but, more importantly, substantive rights and protections, the exemption must address the conflicts presented by the prohibited transaction before any exemption from the prohibited transaction rules is granted.

In the published regulation and Class Exemption, the DOL, for the first time, deviated from its standard practice of issuing a prohibited transaction class exemption with an identifying number, and instead, imbedded the class exemption in the regulation. It is unclear whether this change in format has any impact on the validity or use of the prohibited transaction class exemption.

Published Regulation And Class Exemption

By his January 21, 2009, memorandum, Office of Management and Budget Director Peter Orszag instructed agency heads to consider reopening the rulemaking process for regulations that were not yet effective. Among the suggested considerations were whether the rule reflected proper consideration of all relevant facts; whether the rule reflected due consideration of the agency's statutory or other legal obligations; and whether the rule is based on a reasonable judgment about legally relevant policy consideration. AARP submits that analysis of these three considerations requires reopening the rulemaking process.

The Department of Labor vigorously argued in the preamble to the published regulation and Class Exemption that any heightened risk from conflicts of interest under the prohibited class exemption was outweighed by the increase in advice availability. Quite simply, the underlying premise of the published regulation and Class Exemption is that bad advice is better than no advice. AARP does not agree. Not only is this a false choice, but it also is not a reasonable judgment about legally relevant policy considerations.

Moreover, the published regulation and Class Exemption is internally inconsistent in its rationale. It cites the concern that participants cannot properly evaluate investment options to achieve their retirement security, yet it requires these same participants to evaluate the magnitude of a permitted conflict and its effect on the investment advice provided.

Instead, in accordance with section 408 and its statutory legal obligations, the Department should take this opportunity to establish significant and substantive participant protections to ensure that the limited investment advice permitted by the PPA assists, rather than hinders, participants in achieving their retirement security goals.

AARP submits that there are five provisions in the published regulation and Class Exemption which raise significant concerns involving law and policy.[1] First and foremost, the fee-leveling conditions in the published regulation and Class Exemption specifically exclude affiliates, thereby undercutting the PPA requirements. Second, the published regulation and Class Exemption permits individualized investment advice after furnishing computer model recommendations, thereby sanctioning off-model advice, in direct contrast to the PPA language. Moreover, in this instance, in conflict with PPA provisions, the published regulation and Class Exemption do not require disclosure of the products or service being sold prior to the advice. Fourth, given the remarkably quick turnaround between the issuance of the proposed regulation and the published regulation and Class Exemption, it is clear that the model disclosure form was not tested; it should be. Finally, the published regulation and Class Exemption do not provide guidance on the audit process, the scope of the audit, or even the auditor's minimum qualifications. We will discuss each of these provisions in turn.

[1] AARP is focusing only on the most significant law and policy concerns. Accordingly, we are reserving other comments on the details of the published regulation and Class Exemption.

Compensation of Fiduciary Advisers

In contrast to H.R. 2830, the PPA limits compensation received by the fiduciary adviser which also includes affiliates. Section 408(g)(2) of ERISA, discussing criteria for meeting requirements of an "eligible investment advice arrangement", provides that "fees (including any commission or other compensation) received by the fiduciary adviser for investment advice or with respect to the sale, holding, or acquisition of any security or other property for purposes of investment of plan assets *do not vary* depending on the basis of any investment option selected." 29 U.S.C. § 1108(g)(2) (emphasis added). In the published regulation and Class Exemption, the Department exempts affiliates from the PPA fee-leveling requirements, in essence, adopting the House bill. This interpretation directly conflicts with the carefully crafted Congressional compromise, and, on that basis alone, the Department should withdraw the published regulation and Class Exemption.

By exempting "affiliates" from the fee-leveling requirements and thus permitting the fees and compensation of affiliates to vary depending on the products that are recommended by the fiduciary advisers, the Department completely undermines the protections specifically enacted by Congress. Moreover, there are no restrictions on individual fiduciary advisers who are employed by the affiliates to recommend products that have a high margin of profit for the affiliate, even if there are other products that are more appropriate for the participant. Affiliates should be covered by the fee leveling provision as Congress clearly intended.

Model-Driven Advice

AARP submits that, contrary to the PPA, the published regulation and Class Exemption permit "off-model" advice by permitting individualized investment advice after furnishing the computer model recommendations. Congress saw the computer model as an objective source of independent analysis that could be easily evaluated by regulators. The same cannot be said for oral individualized advice. Treating the computer model as merely providing "context" gives the investment adviser permission to simply move on from the computer model results. Given the stated concern that participants cannot properly evaluate investment options, the inconsistency shown in the published regulation or Class Exemption that participants would do better at evaluating the degree of conflict is startling. Not only is there an utter absence in the preamble to the published regulation or Class Exemption of any rationale indicating that participants would do any better at assessing and evaluating this individualized advice, but the Department did not even see fit to provide any additional protections, disclosures or manner of enforcement. *See* AARP's October 6, 2008 Comments at pages 6-7 attached

hereto. [2] Because this provision also is in direct contrast to the carefully crafted Congressional compromise, it also should compel the Department to withdraw the published regulation and Class Exemption.

Timing and Type of Disclosure

When computer models are utilized, the published regulation and Class Exemption do not require disclosure of the products or service being sold prior to the provision of investment advice. This provision also conflicts with the specific requirements of the PPA. AARP notes that the PPA differs from H.R. 2830 in that all disclosures must be provided prior to the initial provision of investment advice. AARP submits that "prior" means some period of time before the advice is provided. AARP suggests that fourteen calendar days prior to the provision of investment advice would be a reasonable period of time. Any shorter period would not give participants sufficient time to read, digest and give meaningful consideration to the information in the disclosures.

In addition, AARP submits that there should be disclosure of the adviser's conflict every single time the adviser and a participant have contact. The published regulation and Class Exemption should require that this disclosure be bolded, highlighted and in larger typeface than the remainder of the disclosure. There should be an acknowledgement, in writing, that the participant is aware of and consents to the transaction, notwithstanding the conflict of interest.

As demonstrated in AARP's last survey concerning fee disclosure, *Comparison of 401(k) Participants' Understanding of Model Fee Disclosure Forms Developed by Department of Labor and AARP* (September 2008),[3] the manner in which investment information is presented is of paramount importance in determining whether participants are able to use and understand the information. For

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[2] As the Department is well aware, after-the-fact enforcement is no enforcement. If the adviser were to violate the regulation's requirements and the participant loses money due to the adviser's advice, under current case law, the participant may well be left without a remedy under ERISA. *See, e.g., Amschwand v. Spherion Corp*., 505 F.3d 342 (5th Cir. 2007), *cert. denied*, 128 S. Ct. 2995 (2008). Moreover, fiduciary advisers may not be responsible for losses resulting from investment choices made by participants, *see* ERISA § 404(c)(1)(B), because even if an investment adviser gives bad advice breaching its fiduciary duty, a court might find that the participant is making the "decision" to rely on the advice. *See, e.g., Hecker v. Deere & Co*., -- F.3d --, 2009 WL 331285 (7th Cir. Feb. 12, 2009) (No. 07-3605, 08-1224) (taking a position contrary to the Department of Labor's *amicus* brief, the Seventh Circuit held that ERISA § 404(c) is a defense to claims where there may be a breach of fiduciary duty in the selection and monitoring of investment options). The published regulation and Class Exemption should be reviewed to assess the impact of this decision.

[3] *Available at* http://www.aarp.org/research/financial/ira/fee_disclosure.html.

example, both the DOL and suggested AARP form included information directing the reader how to find additional information; however, a significant percentage of people surveyed who reviewed the Department's form did not believe that this information was on the form. If confusion can arise based merely on the design of the form, then it should be apparent that information can be easily obfuscated and of little significance to participants. Given the remarkably quick turnaround between the issuance of the proposed regulation and the published regulation and Class Exemption, it is clear that the model disclosure form was not tested. AARP submits that in order to assess comprehension and determine adequacy, the model disclosure form should be tested with a random sample of 401(k) plan participants weighted to be nationally representative of all 401(k) participants.

Audit

The published regulation and Class Exemption rely too heavily on the annual audits to protect participants. The required audits will neither remedy nor compensate for conflicted advice, especially if participant protections are as weak as they are in the published regulation and Class Exemption. Although audits may be one tool for a fiduciary to assess and monitor how well an investment advice program is working, the audits must be meaningful and effective. Consequently, the Department should establish minimum criteria concerning the scope of the audit, the audit process itself, and the minimum criteria for the auditor's qualifications. The continued availability of the Class Exemption to a particular plan should be conditioned upon continued compliance with the exemption requirements. Finally, the published regulation and Class Exemption provide no remedies for participants who are the victims of fiduciary breaches by conflicted advisers. Notably, there are no significant penalties for violations. *See* n. 2, *supra*.

Conclusion

A review of the recent market upheaval and scandals in the financial world should make it obvious that conflict-driven advice should be avoided, and to the extent permitted by law, common sense compels far more substantial and significant participant protections than the Department has thus far published. Without stronger participant protections, the published Class Exemption and regulation will lead us down a road of conflict of interest problems that ERISA has long sought to prevent. The published regulation and Class Exemption open the door to inappropriate treatment of plan participants by those plan fiduciaries that double as investment advisers.

Three of the OMB's suggested considerations endorse withdrawing the published regulation and Class Exemption because, as shown, the rule does not reflect proper consideration of all relevant facts; did not give due consideration of the

agency's statutory or other legal obligations; and is not based on a reasonable judgment about legally relevant policy considerations.

ERISA is designed to ensure that fiduciaries act solely in the interest of plan participants. The published regulation and Class Exemption falls far short of that standard, and is thus highly objectionable and not in keeping with Congressional intent in the PPA. Accordingly, we urge the Department to rescind the published regulation and Class Exemption at the earliest date which satisfies the Administrative Procedure Act, and to re-propose a new regulation that is both consistent with the statute and Congressional intent, and that protects participants and beneficiaries.

AARP appreciates the opportunity to present its views on the Department's published regulation and Class Exemption concerning investment advice. Please do not hesitate to contact me at 202/434-3750 or Mary Ellen Signorille at 202/434-2072.

Sincerely,

David Certner
Legislative Counsel and Legislative Policy Director
Government Relations and Advocacy

cc: Alan D. Lebowitz, Deputy Assistant Secretary
Robert Doyle, Director, Office of Regulations and Interpretations
Joseph Piacentini, Chief Economist and Director of the Office of Policy and Research
Timothy D. Hauser, Associate Solicitor
William Taylor, Regulation Counsel, Plan Benefits Security Division
Fred Wong, Senior Pension Law Specialist