DAVIS & HARMAN LLP

ATTORNEYS AT LAW

THE WILLARD
1455 PENNSYLVANIA AVENUE, NW, SUITE 1200
WASHINGTON, DC 20004

TEL 202-347-2230
FAX 202-393-3310 WWW.DAVIS-HARMAN.COM

February 3, 2011

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

Re: RIN 1210-AB32, Definition of Fiduciary Proposed Rule

Dear Sir or Madam:

This letter is submitted with respect to the Department of Labor's (the "Department") proposed regulations addressing the definition of a fiduciary. We are writing on behalf of a range of clients, including insurance companies, mutual funds, and brokerage firms.

On behalf of such clients, Davis & Harman requests to testify at the March 1, 2011 hearing on the topics addressed in this letter. We will submit an outline of our testimony.

The Department's proposed regulations would have far-reaching and very significant effects in numerous respects. This letter focuses on one critical aspect of the proposed regulations: the effect on the investment assistance provided by brokers and dealers.

At the same time that the Department is working on the definition of a fiduciary under ERISA, the Securities and Exchange Commission (the "Commission") is also embarking on an important project related to the duties owed by brokers and dealers to their customers. As discussed below, the Department's proposed regulations and the Commission's project have great potential to conflict in substantial ways and thereby (1) impede the provision of investment assistance to individuals, and (2) cause widespread disruption of a critical segment of the financial industry. Consistent with the President's recent Executive Order discussed further below, it is critical that these projects be coordinated, so that broker/dealers are subject to a clear single standard in providing investment assistance to customers.

The Department's Proposed Regulations. If finalized in their proposed form, the Department's regulations would, by converting broker/dealers into fiduciaries in countless

circumstances, require enormous business changes with respect to brokers and dealers and thereby could have dramatic effects on the provision of investment assistance to retirement plan participants and IRA owners. For example, standard broker/dealer compensation arrangements may need to be completely restructured rather than simply and clearly disclosed to customers.

The Commission's Study. The Commission's staff ("Staff") recently completed the study required by section 913 of the Dodd-Frank Act regarding the standards of care applicable to broker/dealers and investment advisers with respect to the provision of investment advice to retail customers (the "Study"). The Dodd-Frank Act specifically directs the Commission to study the effects of subjecting broker/dealers to the rules applicable to investment advisers. In addition, the Commission is authorized to issue regulations subjecting broker/dealers to such rules.

The Dodd-Frank Act is, however, clear that, unlike the Department's proposed regulations, any possible change in the standard of care applicable to broker/dealers is not intended to require "standard compensation" arrangements to be restructured: the "receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer." On the contrary, the Dodd-Frank Act clearly emphasizes addressing broker/dealers' compensation structures through disclosures of "material conflicts of interest."

In the Study, the Staff recommended:

> the consideration of rulemakings that would apply expressly and uniformly to both broker-dealers and investment advisers, when providing personalized investment advice about securities to retail customers, a fiduciary standard no less stringent than currently applied to investment advisers. . . .

Study at v-vi.

The Staff's reasoning for this conclusion included the following:

> a harmonization of regulation – where such harmonization adds meaningful investor protection – would offer several advantages, including that it would provide retail investors the same or substantially similar protections when obtaining the same or substantially similar services from investment advisers and broker-dealers. . . .
>
> [R]etail customers do not understand and are confused by the roles played by investment advisers and broker-dealers, and more importantly, the standards of care applicable to investment advisers and broker-dealers when providing personalized investment advice and recommendations about securities.

Study at viii, 101.

Coordination. The regulatory projects undertaken by the Department and the Commission have enormous overlap; i.e., they overlap with respect to all retail customers saving for retirement under arrangements subject to the Department's regulations. Yet neither the Study nor the Department's proposed regulations indicate that there will be any coordination with the other project. The Study states that "the requirements of ERISA are beyond the scope of the Study." Study at 87. The Department's proposed regulations do not mention the upcoming Study, despite the fact that it addresses the same issue.

This lack of coordination is of great concern for many reasons:

- **Executive Order.** This lack of coordination is directly contrary to the Executive Order issued by the President on January 18, 2011, which requires coordination, not simply notifying other agencies of pending projects. The Order is critical of regulatory requirements that are "inconsistent or overlapping" and requires agencies to attempt to promote "coordination, simplification, and harmonization."

- **Inconsistent with the Study.** The Study concludes that the existence of differing standards harms and confuses investors. Yet without coordination between the two agencies, we appear to be moving toward enshrining a system whereby broker/dealers providing advice to the same customer would be subject to two very different standards with respect to different parts of the customer's portfolio.

  The Study also emphasizes "business model neutrality" by not prohibiting any business model and thus preserving "investor choice among… services and products and how to pay for these services and products (e.g., by preserving commission-based accounts, episodic advice, principal trading and the ability to offer only proprietary products to customers)." Study at 113. The Department's proposed regulations would directly conflict with the Study's business model neutrality.

  The Executive Order also stresses that, consistent with the law and regulatory objectives, it is important to "reduce burdens and maintain flexibility and freedom of choice for the public."

- **Significance of the Regulations.** These two regulatory projects have great potential to modify the investment information available to millions of Americans and to have enormous effects on the financial industry. Projects of this magnitude deserve coordinated, careful consideration. In this regard, a Presidential Memorandum issued concurrently with the Executive Order states that, "[i]n the current economic environment, it is especially important for agencies to design regulations in a cost-effective manner consistent with the goals of promoting economic growth, innovation, competitiveness, and job creation." President Obama echoed this sentiment in the recent State of the Union address.

- **Small Businesses.** Without coordination, there is a great risk that IRA owners and employees of small businesses in particular will be cut off from a main source of investment advice, since broker/dealers provide substantial assistance in these areas. This is not what anyone wants. The President has made clear that his objective is "to promote innovation" – not eliminate business opportunities. Moreover, the Presidential Memorandum places emphasis on "ensuring that regulations are designed with careful consideration of their effects . . . on small businesses." The lack of coordination with respect to broker/dealers does not reflect consideration of small business interests.

Recommendation. The Department and the Commission should coordinate and articulate a single standard of conduct applicable to brokers and dealers in providing investment advice. That single standard should apply with respect to (1) the retirement savings of "retail customers" (as defined for purposes of the Dodd-Frank Act) and (2) any other advice related to retirement savings to which the Commission applies the retail customer standard.

In developing that single standard, the Department and the Commission will need to work within the statutory framework of the Dodd-Frank Act, which permits brokers and dealers to receive "standard compensation." Standard compensation should be interpreted to include, for example, commissions, sales incentives, and the benefits of principal trading. Under the Dodd-Frank Act, any issue related to such compensation is to be addressed through disclosure of "material conflicts of interests."

In addition, the single standard developed by the Department and the Commission should reflect ERISA's protections of participants. We envision this occurring through the creation of fiduciary rules and, if necessary, prohibited transaction class exemptions that are designed to permit arrangements that comply with the protective provisions developed jointly by the Department and the Commission within the framework of the Dodd-Frank Act.

We appreciate the opportunity to present our views.

Sincerely,

Kent A. Mason

Randolf H. Hardock

James M. Delaplane, Jr.