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VOICE OF INDEPENDENT BROKER-DEALERS AND INDEPENDENT FINANCIAL ADVISORS

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VIA ELECTRONIC MAIL

February 3, 2011

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

Re: Proposed Definition of the Term "Fiduciary"

Ladies and Gentlemen:

On October 22, 2010, the Department of Labor (Department) proposed a regulation that would redefine the circumstances in which a person is considered an investment advice fiduciary under the Employee Retirement Income Security Act of 1974, as amended (ERISA) and section 4975 of the Internal Revenue Code of 1986, as amended (Code). The Financial Services Institute (FSI)[1] appreciates the opportunity to comment on this important proposal.

Background on FSI and its Members

The independent broker-dealer community has been an important and active part of the retirement community for more than 30 years. The independent broker-dealer business model focuses on comprehensive financial planning services and unbiased investment services. Independent broker-dealer 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 to individual investors and retirement plans; 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, independent broker-dealers and their affiliated representatives are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their retirement security and other financial goals and objectives.

In the U.S., approximately 201,000 registered representatives – or 64% percent of all practicing registered representatives – operate as self-employed independent contractors of independent broker-dealers, rather than employees of their affiliated broker-dealer firm.[2] Our members' representatives 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 registered representatives are

[1] The Financial Services Institute is an advocacy organization for the financial services industry – the only one of its kind. FSI is the voice of independent broker-dealers and independent financial advisors in Washington, D.C. Established in January 2004, FSI's mission is to create a healthier regulatory environment for its members through aggressive and effective advocacy, education and public awareness. FSI represents more than 120 independent broker-dealers and more than 15,000 independent financial advisers, reaching more than 15 million households. FSI is headquartered in Atlanta, Georgia with an office in Washington, D.C. For more information, visit financialservices.org.

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

typically "main street America" – it is, in fact, almost part of the "charter" of the independent broker-dealers. The core market for representatives affiliated with independent broker-dealers is clients, including retirement plans, that have tens and hundreds of thousands, as opposed to millions, of dollars to invest. Independent registered representatives 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 professional or other trusted advisers in the community. Independent registered representatives get to know their clients personally and provide them services in face-to-face meetings. Due to their close ties to the communities they serve, we believe these registered representatives have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for independent broker-dealers and independent registered representatives. Member firms formed FSI to improve their compliance efforts and promote the independent broker-dealer business model. FSI is committed to preserving the valuable role that independent broker-dealers and independent registered representatives play in helping Americans plan for and achieve their financial and retirement savings goals.

Specific Comments on the Department's Proposal

The proposed redefinition of "fiduciary" is without question among the most consequential rulemakings the Department could undertake. "Fiduciary" status is of course the central concept around which the management of employee benefit plans is organized under ERISA. The existing regulatory definition of "investment advice fiduciary," promulgated in 1975 just after the enactment of ERISA, has informed 35 years of practice for employee benefit plans and the providers of investment services fundamental to the purposes and operations of those plans. As the preamble to the proposed regulation reflects, the Department expects and intends that its proposed redefinition will cause dislocations in the marketplace. More specifically, the redefinition will impact the number of providers of investment services available to plans, and the terms of and costs for those necessary services. It is therefore essential that the proposal, if adopted, be strictly tailored to address the circumstances for which a redefinition is justified on both a policy and a cost-benefit basis, and that unintended or unjustified consequences be rigorously avoided. For these reasons, we very much appreciate the opportunity to comment on the proposal.

At bottom, the Department's proposal is premised on an argument that ERISA plans would be better served if more investment service providers were treated as "fiduciaries":

> Beneficial arrangements generally are those in which a plan's service providers, in competition to provide the best value to the plan, deliver high quality services to the plan at the lowest cost, and act solely in the interest of their plan clients and the plan's participants and beneficiaries. According fiduciary status to certain service providers that provide investment advice and valuation services to plans and their participants, and subjecting them to the full extent of remedies under ERISA, would discourage harmful conflicts and create more beneficial arrangements in the pension plan service provider market ….[3]

While we can understand the Department's view given its mission, the financial services industry in the main is not and cannot be organized as ERISA fiduciaries. Financial services companies manufacture and *sell* investment products and services. In the case of our industry, independent broker-dealers and their independent registered representatives provide highly regulated, professional investment services

[3] *Definition of the Term "Fiduciary"*, 75 Fed. Reg. 65263, 65272-73 (Oct. 22, 2010).

to investors in accordance with standards of conduct specified by the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), state insurance commissioners and other regulators, and most often are lawfully compensated on a commission basis – a form of compensation allowed service providers under ERISA but not investment advice fiduciaries, as the Department interprets the statute. There is nothing in ERISA that bars salespeople from doing business with ERISA plans, and necessarily so; for example, the investment services provided by broker-dealers are both exclusively available from them in many cases, as a matter of federal and state law, and integral to the purposes of ERISA plans.

From the earliest days of ERISA, the Department has devoted considerable time and resources to the development of a workable regulatory structure under ERISA for broker-dealer services. For the reasons discussed below, the Department's proposed redefinition of "fiduciary" will undo decades of this important work, to the detriment of plans and their participants, unless significant changes are made to the final regulation.

1. Broker-dealers are not ERISA fiduciaries in the ordinary course, and the regulation should so provide without ambiguity.

The Department has a long and thoughtful history of fitting broker-dealers into the regulatory structure of ERISA. Immediately after the statute was enacted, the Department was made aware, by the SEC as well as the industry, that:

- Securities firms perform a unique, essential and highly regulated function for employee benefit plans;
- Plans, as a result of their normal selling and purchasing of securities, have varied and ongoing relationships with broker-dealers incidental to their securities transactions, including for brokerage, investment research, custodial, portfolio evaluation and other services;
- Broker-dealers recommend and effect securities transactions with or for plans (as with all other investors) under "suitability" and "best execution" principles regardless of whether the firm is acting as an agent for the buyer, the seller or both, or as a principal for its own account; and
- ERISA, if applied inappropriately, has the potential to disrupt severely the market for securities transactions to the detriment of (i) plans and their participants and beneficiaries specifically and (ii) capital formation and the functioning of capital markets in this country generally.

Over the decades, the Department and the Congress have, with care and purpose, assured that ERISA does not inappropriately impede the essential services provided by securities firms for plans. The authorization in the ERISA legislative history for blind market transactions is an early example. The Department's first regulatory actions after the enactment of ERISA included a series of temporary exemptions to permit securities transactions and other broker-dealer services to continue. The Department also provided interim guidance that a broker-dealer would not be treated as an ERISA investment advice fiduciary by reason of (i) advice incidental to a securities transaction, (ii) portfolio evaluation services, (iii) securities custodial services, or (iv) execution of securities transactions on the

specific instructions of an unrelated fiduciary.[4] Later in 1975, the Department replaced those interim steps with, simultaneously:

- PTE 75-1, which provides conditional relief for (i) agency transactions by broker-dealers and advice attendant to those transactions, if the broker-dealer is not acting in a fiduciary capacity; (ii) principal transactions, again if the broker-dealer is not acting as a fiduciary; (iii) transactions in mutual funds unaffiliated with the broker-dealer; and (iv) extensions of credit in connection with the purchase or sale of securities, provided the broker-dealer either is not a fiduciary or receives no interest or other consideration for the extension of credit; and

- Its 1975 definition of investment advice fiduciary. As the preambles to the proposed and final regulation reflect,[5] the Department was much concerned, both in the construction of the five-part test and in other provisions of the regulation, with delineating the circumstances in which broker-dealers would or would not be investment advice fiduciaries.

Over time, this initial accommodation of broker-dealer services with ERISA has been augmented by, for example:

- Class exemptions for transactions in proprietary insurance products or mutual funds (currently, PTE 84-24) and for agency transactions (currently PTE 86-128) where the broker-dealer is an investment advice fiduciary, for securities lending (currently, PTE 2006-16), for foreign exchange transactions (PTE 94-20 and PTE 98-54), for relationship brokerage (PTE 97-11), for passive cross-trades (PTE 2002-12);

- Statutory exemptions enacted in the Pension Protection Act of 2006 for block trades, alternative execution systems, foreign exchange transactions, cross-trading and inadvertent prohibited transactions. At least with respect to foreign exchange transactions, this statutory relief is unavailable if the broker-dealer is acting as an investment advice fiduciary;

- Guidance on soft dollars, directed brokerage, investment education, and other matters related to broker-dealers.

In the design and operation of this regulatory structure, traditional recommendations by broker-dealers have generally been understood not to constitute "investment advice."

Thus, over 35 years, the Department, with the support of the regulated community and the Congress, has built a regulatory structure that makes it possible, on terms that have largely proven to be workable, for broker-dealers to continue their necessary and important services for plans and their participants. The requirements of this regulatory structure turn in many instances on whether the broker-dealer is or is not acting as an investment advice fiduciary for the plan.

- If an independent broker-dealer is not such a fiduciary, its registered representatives can facilitate agency and principal transactions in accordance with PTE 75-1, and offer mutual fund transactions, insurance products, credit in connection with securities transactions, bank deposit sweep programs, and many of the firm's other normal services.

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[4] *Interim Exemption for Prohibitions on Securities Transactions with Certain Broker-Dealers, Reporting Dealers and Banks,* 40 Fed. Reg. 5201 (Feb. 4, 1975).
[5] 40 Fed. Reg. 33561 (Aug. 8, 1975); 40 Fed. Reg. 50842 (Oct. 31, 1975).

- If the broker-dealer is such a fiduciary, agency transactions must comply with the less conventional and more expensive procedures of PTE 86-128. Mutual funds and insurance products must be offered in accordance with PTE 84-24 or other applicable relief, or not at all. The firm may not engage in principal transactions of any type with the plan, although its registered representatives may be able to arrange for those transactions "away from" the firm. A variety of other, commonplace trades and firm services are unavailable to the plan, or available only on a limited and/or abnormal basis.

And whatever its perceived faults, the five-part test of Reg. §2510.3-21(c) provides a reasonably reliable way for independent broker-dealers to structure their activities in a manner that conforms to ERISA.

- Broker-dealers unwilling to offer their services on an ERISA fiduciary basis – and many are not, because of the incremental legal exposure, the expense of maintaining effective compliance programs,[6] limitations in typical liability insurance coverages,[7] constraints on otherwise permissible business activities, and other reasons – are able to limit their relationships with plans in a manner intended not to give rise to fiduciary status.

- In the less typical circumstance where a broker-dealer is willing to offer services in an ERISA fiduciary capacity and a plan wishes to engage the firm on that basis (with the attendant incremental costs and service limitations), the five-part test provides a means for effectuating that relationship as well.

Since independent broker-dealer firms are most fundamentally selling firms doing business in the ordinary course on a commission basis inconsistent with the requirements for ERISA fiduciaries, this distinction between non-fiduciary and fiduciary activity by broker-dealers is sensible both in the marketplace and at law; the courts have generally been able to distinguish when broker-dealers and their representatives have been functioning in their usual sales capacity, and when they have in unusual circumstances become functional ERISA fiduciaries.[8]

The Department's proposed redefinition of fiduciary status upsets this carefully crafted and balanced regulatory structure. The proposed replacement of the five-part test with the new multi-factor test[9] would substantially prevent a broker-dealer and a plan (the named fiduciaries of which are also at risk for prohibited transactions arising from unintended fiduciary status for investment service providers) from purposefully and reliably arranging their relationship on a nonfiduciary basis. It may even be that ordinary broker-dealer sales activity incidental to securities transactions (i.e., calling suitable investment opportunities to the attention of the plan) would be treated as investment advice under the proposed multi-factor test. Moreover, the new exceptions in the proposed regulation, as drafted, neither provide a reliable means for a broker-dealer to avoid fiduciary status when that status is both unintended and

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[6] Independent broker-dealer firms supervise the activities of independent contractor registered representatives usually operating on a geographically diverse basis, and have extensive practical experience with the particular demands and expenses of operating an effective compliance program in those circumstances.

[7] The errors and omissions coverage conventionally available for independent registered representatives usually does not cover ERISA fiduciary activity. This is no small matter.

[8] *See, e.g., Olson v. E.F. Hutton & Co.*, 957 F.2d 622 (8th Cir. 1992); *Farm King Supply, Inc. Integrated Profit Sharing Plan and Trust v. Edward D. Jones & Co.*, 884 F.2d 288 (7th Cir. 1989); *Ellis v. Rycenga Homes*, 484 F. Supp. 2d 694 (W.D. Mich. 2007); *Blevins Screw Products v. Prudential Bach Securities*, 835 F. Supp. 984 (W.D. Mich. 1993).

[9] Prop. Reg. §2510.3-21(c)(1)(ii)(D).

unwarranted, nor reflect the distinction under ERISA between marketing and fiduciary activity recognized by the courts. In short, the proposal threatens to disrupt 35 years of work by the Department to assure that the necessary investment services provided by securities firms remain available on viable terms to ERISA plans.

There is nothing in the preamble to the proposed regulation to suggest that a radical outcome of this magnitude is purposeful. There is nothing, in either the justifications offered by the Department in the preamble or the public and private enforcement history of ERISA since 1974, to suggest that independent broker-dealers have abused plans in a systemic manner that demands a "fiduciary" cure. And more broadly, there is nothing to suggest that the existing regulatory structure conceived by the Department over the past 35 years for securities firms, usually acting in a non-fiduciary capacity, has on balance failed to serve the interests of plan participants and beneficiaries.

Given the detriment to plans and their participants of leaving this issue unaddressed, we respectfully submit it is essential that any final regulation explicitly and unambiguously provide a means for broker-dealers to continue to provide in the ordinary course their necessary services to plans other than as ERISA fiduciaries. The proposed regulation already includes some elements accommodating the current and effective treatment of broker-dealers under ERISA:

- The proposal preserves the current exception for the execution of securities transactions on a non-fiduciary basis (Reg. §1.3-21(d)), which we support.

- The proposal also preserves the distinction between investment education and investment advice, which we also support.

- In providing that "investment advisers" are fiduciaries, the proposed regulation incorporates the definition in section 202(a)(11) of the Investment Advisers Act of 1940 (Advisers Act), including the exclusions thereunder. Subsection (C) of that provision excludes "any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefor." Many of our member firms are "dual registered" as both brokers or dealers under the Exchange Act of 1934 and advisers under the Advisers Act; section 202(a)(11)(C) effectively provides that (i) when a dual registered firm is acting in an investment adviser capacity, it is regulated by the Advisers Act, and (ii) when the firm is acting in its broker-dealer capacity, it is not acting as an adviser within the meaning of the Advisers Act.

We read the Department's proposed regulation to mean that a dual registered firm when acting in its broker-dealer capacity is not described in Prop. Reg. §2510.3-21(c)(1)(ii)(C), and we request clarification of this point in any final regulation.

Fundamentally, though, the final regulation must be clear that broker-dealers are not in the ordinary course investment advice fiduciaries. This might be accomplished in a variety of ways, including the following:

- As a drafting matter, the most effective way to accomplish that result is to include in the final regulation a specific exception for broker-dealers unless they have committed in writing to act as ERISA fiduciaries. This approach would substantially preserve the current, functional treatment of broker-dealers under section 3(21) – a treatment that has appropriately and

effectively maintained the access of plans to the essential services broker-dealers uniquely provide.

- The proposed "purchase or sale" exception for counterparties to investment transactions with plans (Prop. Reg. §2510.3-21(c)(2)(i)) as drafted is inadequate for this purpose – the exception may be limited to principal transactions and omit agency transactions; its reference to the adversity of interest of the counterparty has caused considerable confusion; it is unclear how the exception applies when advice incidental to the transaction is provided in periods after the investment is purchased; and registered representatives routinely undertake in good faith to provide impartial advice (and thus fail to qualify for the exception) in circumstances where the Department would conclude the representative is not in a position to comply with ERISA's fiduciary requirements. Moreover, the Department's proposal that the counterparty must prove up this exception as an affirmative defense when the exception as drafted depends on the knowledge of a different person, i.e., of the "recipient of the advice," is contrary to sound jurisprudential practice. This exception should be reframed in simple and direct terms – to cover both counterparties and intermediaries to investment transactions who state in writing they are not undertaking to act as fiduciaries in the manner required by ERISA – that can be (i) reliably effectuated by plans and broker-dealers, and (ii) readily verified by the Department in its enforcement activities.

- It might be possible to modify the proposed multi-factor test to clarify this issue, but we acknowledge that approach could have broader consequences than intended.

Any of these approaches can be crafted so as to afford plans continuing access to the services of securities firms in their broker-dealer (as opposed to investment adviser) capacity, and to allow the regulatory structure devised by the Department for broker-dealer services to function as intended.[10]

In sum, in the interest of plans and their participants and the sound functioning of the capital markets, as well as for the purposes of our member firms and their registered representatives,[11] we urge the Department in the strongest terms to explicitly provide a reliable means for independent broker-dealers and their registered representatives to continue to provide their services in the ordinary course to plans, i.e., on a basis other than as ERISA fiduciaries.

II. Platform providers are not in the ordinary course investment advice fiduciaries.

Consistent with our preceding comments, we note that retirement platform providers – and certain services offered by independent broker-dealers for retirement plans sometimes are intended or perceived as such a platform – very often cannot operate in the manner the Department requires of investment advice fiduciaries. As the Department is aware, platform providers offer a variety of services for which they may be compensated in a variety of ways – direct compensation from the plan or plan sponsor, charges to participant accounts or otherwise to the trust, and indirect compensation in a number of forms that may vary in amount with the particular investments made for the plan. The platform provider must be able to offer those services on an economic basis, taking into account (i) all

[10] In all events, before adopting any final regulation, the Department should review the effect of the redefinition on existing class exemptions premised on the current definition, in the interest of avoiding unintended disruption of investment services currently enjoyed and relied on by plans.

[11] For the most part, the businesses operated by independent contractor registered representatives are "small entities" within the meaning of the Regulatory Flexibility Act, 5 U.S.C. §601 *et seq.*

these revenue flows and (ii) the objectives and the requirements of the plan. The support the platform provider offers the plan in, e.g., selecting a lineup of designated investment options that meets the plan's requirements will also take into account the need for the platform to be economic for the platform provider. This arrangement can appropriately operate under ERISA if the platform provider is just a service provider, and the Department's recent regulation under section 408(b)(2) is intended to assure that is so. To date, the ordinary services of platform providers have not been understood to constitute fiduciary activity.

The proposed regulation clouds the status of platform providers under section 3(21), for the following reasons:

- It is entirely unclear if and when responding to the requirements of the plan with respect to, e.g., its investment lineup would become "individualized" advice within the meaning of the proposed multi-factor test; and

- If a platform provider is a fiduciary by reason of the multi-factor test (rather by reason of acting as an acknowledged fiduciary or investment adviser), it cannot take advantage of the "platform provider" exception in Prop. Reg. §2510.3-21(c)(2)(ii)(B); as drafted, the multi-factor test (which applies only if individualized advice if provided) and the platform provider exception (which is unavailable if individualized advice is provided) are mutually exclusive.

If the platform provider at some point in its relationship with the plan becomes an investment advice fiduciary, it is barred from taking its own business considerations into account in the support it provides to the plan on its investment lineup and perhaps other investment matters. This would cause a fundamental change in the retirement marketplace that is neither described nor defended in the preamble to the proposed regulation, and would place platform providers in a position of irreconcilable conflict. The Department should either revise the "platform provider" exception or otherwise make provision in the final regulation for platform providers to continue to offer their services in the ordinary course other than as fiduciaries, where that status is neither intended nor justified.

III. Solicitors for investment advisers are not ERISA fiduciaries.

As noted above, many of our member firms are dually registered as broker-dealers and investment advisers, or are affiliated with and act through registered investment advisers. It is common practice for investment advisers to rely on referrals to attract clients. These referrals may come from registered representatives of broker-dealer firms, or the representatives of affiliated or unaffiliated investment adviser firms, among others. The party providing the referral, commonly called a "solicitor," is often paid a cash fee by the adviser, or sometimes noncash compensation in the form of directed brokerage if the solicitor is a broker-dealer. These solicitation arrangements are permitted by and regulated under the federal securities laws. For example, Rule 206(4)-3 under the Advisers Act sets out a framework for cash payments to solicitors, including written disclosure to the client. All of this is uncontroversial under the securities laws and in the interest of investors (since investment intermediaries can be provided an incentive to refer clients to another investment adviser better positioned to offer the services needed by the investor), but becomes problematic under ERISA if the solicitor is an ERISA fiduciary.

In Prop. Reg. §2510.3-21(c)(1)(i)(A)(3), the Department takes the position that providing advice or making recommendations as to "the management of securities or other property" is fiduciary investment advice, and in the preamble suggests that a recommendation as to "the selection of persons

to manage plan investments" is such advice. Thus, it appears that solicitation may always be fiduciary activity under the proposal if the solicitor is acting in an investment adviser capacity as defined in Advisers Act §202(c)(11), and may be fiduciary activity if the solicitor is acting in a broker-dealer or other capacity and the solicitation falls within the scope of the proposed multi-factor test.

At the outset, we note that the Department's position that the recommendation of an investment manager is fiduciary investment advice, which may date to 1984[12] or earlier, is not clearly supported by the statute. Under section 3(21), advice is fiduciary activity only if it is "with respect to moneys of other property of the plan." Advice with respect to any other aspect of the management of the plan is not fiduciary activity; discretionary control, authority or responsibility is required for fiduciary status in any other circumstance. It is not clear that the Department's position – which essentially conflates the investment manager with the investment property – is a defensible reading of the statute. And for this reason, it may be that the recommendation of an investment *adviser*, as distinguished from a discretionary investment *manager*, is not intended to be within the scope of Prop. Reg. §2510.3-21(c)(1)(i)(A)(3); the preamble to the proposed regulation is not clear on this point.

These sorts of issues and complexities need not burden the final regulation, however. In the regulatory context of ERISA, solicitors inherently are acting in a sales capacity, not as disinterested ERISA fiduciaries. There is nothing in the justifications offered by the Department for its proposal that shows this solicitation practice has harmed the interests of plan participants and beneficiaries; our members' experience is that the practice is in fact beneficial for investors, including ERISA plans. There is no clear means in the proposal to reconcile this sales function with the proposed redefinition of "fiduciary." The "purchase or sale" exception could serve this purpose but, in addition to the difficulties with that exception noted above, that provision is not framed in terms that clearly reach beyond securities or property as such, to sales activity in respect of the "management of securities or other property." In order to prevent unintended consequences detrimental to the interests of plans and their participants, the final regulation should include a mechanism for solicitors acting in a sales capacity to reliably avoid unintended ERISA fiduciary status.

IV. The final regulation should include a specific and more limited fiduciary definition for individual retirement accounts.

The application of the prohibited transaction rules of Code section 4975 to individual retirement accounts (IRA's) has largely been successful in respect of transactions between the IRA and the IRA owner, and has accomplished important tax policy objectives. The application of those rules in respect of IRA service providers, including fiduciaries, has been less functional, for a variety of reasons, including:

- The relationship between the benefited individual and the service provider is very different in the plan and IRA setting. In the plan setting, the plan is organized and operated by the plan sponsor and other intermediaries, service providers are most often selected by persons other than the participant, and the participant is obliged to accept the actions and decisions of those other persons if he or she is to enjoy the benefits of plan participation. This is a classic setting for which fiduciary responsibilities make sense. The IRA setting is the polar opposite; the IRA owner (i) is free to select any IRA from thousands offered in the market, (ii) is in privity with the IRA service providers, with direct legal recourse against them, and (iii) can, at any time he or she

[12] See Advisory Opinions 1984-03A and 1984-04A.

is dissatisfied with that IRA or its providers, transfer the account on a tax-free basis to any other available IRA.

- Moreover, the IRA owner typically deals with his or her IRA in a retail setting. In our industry, independent broker-dealer firms and their representatives routinely deal with IRA's in the context of an investor's overall personal investment activity; they assist with the investor's IRA investment alongside his or her other personal investments. It makes no sense to IRA owners (or, frankly, to our representatives) when otherwise permissible investments are either unavailable in an IRA or subject to different terms and conditions, by reason of section 4975, as compared to other retail investments.

- In this retail setting, IRA owners are able to choose between commission-based products and advisory fee-based accounts. For buy-and-hold investors, a commission-based account will usually be less expensive to the IRA owner over the long term and, as the Department knows, reduced investment expenses can materially affect retirement income. An unintended consequence of the proposal thus is to constrain the choices of IRA owner in a manner that may increase costs and reduce retirement savings.

- In the event an IRA service provider disserves the IRA owner, a variety of legal remedies are available (in part because ERISA preemption is inapplicable) under state statutory or common law, as well under federal securities or other applicable laws. There is of course no private right of action under section 4975, and no evidence that such a remedy is needed.

- This means that the enforcement of section 4975 is left to the prohibited transaction excise tax administered by the Internal Revenue Service. While this is not a matter of public record, our understanding is that, since the enactment of this provision in 1974, there have been very few instances in which the Service determined that the actions of an IRA fiduciary (or even service provider) warranted a section 4975 excise tax.

- And the Department itself, in partnership with the Treasury Department, is increasingly taking the view that regulatory initiatives designed for employee benefit plans under Title I of ERISA are neither necessary nor appropriate for IRA's under section 4975.

The proposed regulation provides the Department, in consultation with the Treasury Department, an opportunity to consider the proper scope of "fiduciary" status for IRA's. There may well be circumstances where service providers to IRA's should be investment advice fiduciaries subject to section 4975(c)(1)(E) and (F), in addition to subsections (A) through (D). (There is of course no counterpart to ERISA section 404(a) in Code section 4975.) Taking into account the policies underlying section 4975, the Department's stated objectives for this project, and the principles of Executive Order 13563 (January 18, 2011), however, we respectfully submit that, in light of the fundamental structural differences between ERISA plans and IRA's, the appropriate scope of fiduciary status is narrower under section 4975 for IRA's than under Title I for ERISA plans. In the context of the proposed regulation, only IRA investment service providers who accept in writing fiduciary status within the meaning of section 4975 or ERISA should be treated as such; such an outcome would make sense to IRA owners in terms of their expectations and objectives, and do no harm to the purposes or enforcement of section 4975.

V. Preparation of account statements or other routine reports reflecting the value of plan investments is not fiduciary activity.

In the proposed regulation, the Department (i) takes the position that advice or an appraisal concerning the value of securities or other plan property is fiduciary "investment advice" and (ii) provides an exception for general reports or statements merely reflecting the value of an investment required by ERISA or the Code, unless that report involves assets for which there is not a "generally recognized market" and serves as a basis for plan distributions. The negative inference we draw from these provisions is that the preparation of "general reports" not mandated by ERISA or the Code would be fiduciary activity if they include asset values.

Independent broker-dealer firms and their representatives routinely prepare investor reports for a variety of reasons. For example:

- They issue confirmations of securities transactions, as required by the SEC.
- They prepare account statements, currently at least quarterly and (pursuant to a pending rulemaking) potentially monthly, as required by FINRA.[13]
- They may update investor account information available on an "evergreen" website continuously on trading days, or at least on a daily basis.
- They may provide annual or more frequent analyses of investment results or trends for the investor.
- They may offer non-individualized, general reports on investment products or providers from time to time, prepared in-house or by others, that include valuation data.

In most cases, the preparation of these materials including any valuation or performance information is activity regulated by the SEC, FINRA or other agencies.

The preparation of these reports is not, however, ERISA fiduciary activity within any fair reading of the statute. These reports are intended to be empirical, not advisory; they are ministerial, not fiduciary, in nature. And the economic consequences of suggesting that broker-dealers must engage in a diligence process sufficiently rigorous to meet ERISA fiduciary standards whenever they prepare a report or update a website account value – even taking into account a measure of latitude for the frequency with which any particular investment is closely re-examined – cannot stand under any fair cost-benefit analysis. There are plainly circumstances when a securities firm otherwise an ERISA fiduciary will provide a report for a purpose that should be accountable under ERISA's fiduciary standards, but that does not mean that (i) every report including valuation information is fiduciary activity or (ii) the preparation of any such report converts an investment professional otherwise not a fiduciary into a fiduciary. Whether through a tightening of Prop. Reg. §2510.3-21(c)(1)(i)(A)(1) or broadening of §2510.3-21(c)(2)(iii) or otherwise, the Department's position on this point in the final regulation should be more nuanced.

[13] In contrast, under ERISA §105, participant statements for defined contribution plans are required quarterly or annually.

On a narrower point, the Department's special treatment in the proposed "report" exception of "assets for which there is not a generally recognized market" requires further attention.

- While there is no elaboration of this formulation in the proposed regulation or its preamble, it seems to us likely that it is at least intended to reference hedge funds and other private placements. If that is so, we have two observations: this rule (i) had it been in effect, would not have prevented the Madoff fraud, but (ii) will curtail the use of private placements, often beneficial as uncorrelated investments or for other investment purposes, in ERISA plans. If the Department intends the latter result, a specific notice-and-comment rulemaking on that issue seems warranted.

- Independent broker-dealers most often offer mutual funds and insurance products to investors, including ERISA plans. There is no secondary market for these investments. Nonetheless, it seems improbable that the Department intended these investments to be treated as "assets for which there is not a generally recognized market," and that should be made clear in the final regulation if that formulation is retained.

VI. Distribution advice is not fiduciary activity, even if the provider is otherwise a fiduciary.

In the preamble to the proposed regulation, the Department specifically requested comment on whether recommendations related to ERISA plan distributions should be treated as fiduciary investment advice.

- We agree with the Department's conclusion in Advisory Opinion 2005-23A that distribution advice, including whether to roll over the distribution, is not investment advice. The decision within the ambit of the plan is fundamentally a distribution decision; there is no explicit investment element in that decision until the participant's funds are distributed and are outside the scope of both the plan and ERISA regulation of that plan. Depending on the choices made by the participant, there may be regulatory requirements for an investment professional assisting with the reinvestment of those funds, but that regulation is extrinsic to the plan and thus to ERISA regulation of that plan.

- We disagree, however, with the Department's contention in Advisory Opinion 2005-23A that distribution advice provided by a person who is otherwise a plan fiduciary becomes fiduciary investment advice. We appreciate the Department's apparent concern that a participant could be confused if a service provider sometimes is acting in a fiduciary capacity and sometimes not; best practice would require service providers to be clear in their dealings with participants when they switch between fiduciary and non-fiduciary services. That having been said, however, section 3(21) assigns fiduciary status only "to the extent that" a service provider is performing a fiduciary function, and we do not see how the Department's argument on this point in the advisory opinion can be squared with the plain meaning of the statute. To conclude otherwise also would create an irreconcilable tension for the service provider – between the interest of the particular participant contemplating a distribution (who may or may not be best served by taking the distribution), and the interests of other plan participants and beneficiaries (who almost always would be better served if the particular participant's interest is not distributed from the plan).

For the foregoing reasons, the Department should provide in the final regulation that distribution advice is not fiduciary investment advice in any circumstance.

Conclusion

We are committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with you on this important regulation.

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