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**U.S. CHAMBER OF COMMERCE**

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July 17, 2015

Office of Regulations and Interpretations  
Office of Exemption Determinations  
Employee Benefits Security Administration  
U.S. Department of Labor  
200 Constitution Ave., NW  
Washington, DC 20210

**Re: Definition of the Term “Fiduciary” (RIN 1210-AB32); Best Interest Contract Exemption (ZRIN 1210-ZA25), Amendment of PTE 84-24 ( ZRIN 1210-ZA25), Amendment of PTE 77-4 ( ZRIN 1210-ZA25)**

To Whom It May Concern:

The U.S. Chamber of Commerce (“Chamber”) is the world’s largest business organization representing the interests of more than 3 million businesses of all sizes, sectors, and regions. We appreciate the opportunity to comment on the U.S. Department of Labor’s (“DOL” or the “Department”) regulatory package published on April 20, 2015 expanding the definition of fiduciary investment advice and proposing new or amended prohibited transaction class exemptions. Specifically, we offer comments on the proposed regulation (the “Proposal”) redefining the term “fiduciary” with respect to the provision of investment advice under ERISA §3(21)(A)(ii),<sup>1</sup> the proposed prohibited transaction class exemption “Best Interest Contract Exemption” (“BICE”),<sup>2</sup> the proposed amendment to prohibited transaction class exemption 84-24 (“PTE 84-24”),<sup>3</sup> and the proposed amendment to prohibited transaction class exemption 77-4 (“PTE 77-4”).<sup>4</sup>

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<sup>1</sup> 80 Fed. Reg. 21,928 (Apr. 20, 2015)

<sup>2</sup> Id at 21,960.

<sup>3</sup> Id at 22,010.

<sup>4</sup> Id at 22,035.

We share the Department’s goal of ensuring ERISA plans, ERISA plan participants and beneficiaries, and Individual Retirement Account (“IRA”) owners receive quality financial advice. Indeed, most of our members are sponsors of retirement plans for their employees, a responsibility our members take very seriously. It is therefore vitally important that our private retirement system, from employer-provided plans to IRAs, protects the interests of our employees and their families, and provides them the means to retire with the dignity that comes with financial security.

Unfortunately, the Department has chosen an approach that is unduly complicated and wrought with serious defects for this regulatory initiative. Indeed, the result is an unworkable rule that ultimately harms American investors and retirees. Given the significant implications that this rulemaking will have, we urge the Department, should it continue with this initiative, to work with everyone involved to correct the numerous defects and unintended consequences. Due to the complexity of this rulemaking and its potential for serious harm to American workers and retirees if done incorrectly, we recommend the Department can best do this by engaging in a negotiated rulemaking process as provided in Federal administrative law exactly for these kinds of situations. Congress didn’t create negotiated rulemaking because it wanted more meetings—it created negotiated rulemaking to ensure complex Federal regulations work as they are intended, and that all affected voices are heard. Here, negotiated rulemaking would ensure that working Americans have more and better retirement advice instead of fewer and more costly choices.

### **Executive Summary**

Our more than 3 million member businesses maintain a long-held commitment to providing voluntary benefits that support the welfare of their workers. Workers, retirees and their families need access to workplace and individual retirement plans, as well as quality, affordable investment advice to help them save for retirement. However, it is much more difficult for smaller businesses to offer retirement plans. As a result, it is vitally important to ensure that the regulations governing retirement plans preserve the choices available to small businesses in structuring plans and services, and do not increase their already significant regulatory burden.

Unfortunately, rather than expanding access to quality advice and encouraging small plan formation, the Department's Proposal will make it more difficult for America's workers and retirees to access retirement plans, to receive quality investment advice, to receive useful educational information about their plans and investments, and to move their retirement assets freely between employer-provided plans and IRAs. Indeed, there is a substantial risk that at least some workers and retirees won't have access to advice at all, and the Proposal's additional restrictions on educational information serve to compound that risk. Accordingly, in our comment letter we address a number of serious fundamental and technical concerns with the Proposal, including the following issues:

- **The Rule is Technically Flawed and Simply Does Not Work as Proposed**—In addition to the many policy concerns and unintended consequences the Chamber finds in the Proposal, it is technically flawed as well. The Best Interest Contract Exemption, one of the central pieces of the regulatory package, simply does not work in practice—it cannot be complied with in its current form.
- **The One-Size-Fits-All Rule Actually Prohibits Advisors from Acting in Your Best Interest in Some Cases**—The Proposal makes it harder for participants and IRA owners to get investment education information, to get assistance in rolling over their previous employer plans into their new employer plans, and to get advice about investments not on the “approved” list of asset types and classes. The Proposal prevents advisors from discussing certain investments and options even when they might be in your best interest.
- **The Proposal Discriminates Against Small Businesses and Individuals**—The Proposal discriminates against small businesses, workers and IRA owners by subjecting them to the full costs and restrictions of the rule, denying them choice in what kind of financial advisors they work with, while giving large business retirement plans the choice to comply with the new rules or not. Small businesses, and low and middle income Americans, need the most help in

saving for retirement, but this rule only allows big businesses to have a full range of choices and options.

- **The Proposal Increases Costs and Reduces Access to Advice for Workers**—By significantly increasing the legal and financial risks facing advisors, the effect of the Proposal will be to make investment advice and education more expensive, less readily available, and more generic, even as workers and retirees need more affordable, more accessible and more specific advice and education.
- **The Department’s Own Estimates Show that Lack of Access to Advice Costs Workers \$100 Billion Every Year, and the Proposal Will Make Things Worse**—Lack of access to advice has a cost. In 2011, the Department wrote that the prohibited transaction rules—the same rules that this Proposal would apply even more broadly—were one of the reasons many participants and IRA owners did not receive investment advice, costing them about \$100 billion in investment losses every year. These losses are far greater than the Department’s dubious estimates of the costs of advisor conflicts. The cure is making the patient sick.
- **The Department Lacks Legal Authority for Elements of the Proposal**—The Proposal seeks indirectly through prohibited transaction exemptions to impose legal liabilities and conduct standards that DOL lacks the authority to impose directly. This jurisdictional land-grab is contrary to the law’s intent.
- **The Labor Department Should Not Be the Primary Regulator for Financial Advice**—The Department should not attempt to supersede the financial regulations developed over decades by Congress, the SEC, FINRA, State securities regulators, the State Insurance Commissioners, and Federal and State banking regulators, and try to replace their decades of experience and long-standing policies with a new, untested, one-size-fits-all Federal regulation that tells people what kind of retirement advisor they may have. The lack of a coordinated approach will leave workers, investors and retirees with diverging

standards that create more confusion. A better approach would be to have all interested regulators work together to avoid these unintended consequences.

- **Impossible to Comply with Changes in Just Eight Months**—The scope of change implemented by the Proposal is so vast, and the requirements it puts in place so onerous, that it is impossible to comply with the new rules in the mere eight months the Department proposes between publication and effective date. We believe it will take several years and hundreds of millions of dollars just in information technology changes to comply.
- **The Comment Period Does Not Allow the Public a Meaningful Opportunity to Respond**—The Department spent nearly four years working behind closed doors to develop the most radical overhaul of financial advice in 40 years—we had only 90 days to try to predict its effects and respond. This denies plan participants and IRA owners a meaningful opportunity to understand and comment on the rule. If the Department is to move forward, it should be through negotiated rulemaking to ensure we help, not hurt, working Americans.

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As the comments below explain in more detail, the Chamber and its members believe that the Proposal and its associated prohibited transaction exemptions not only fail to protect workers, but will actually prevent them from receiving the advice they need. What's more, the Proposal as written simply cannot work—it has technical defects as well as negative policy defects.

### Overview

As the Department correctly notes, there have been significant changes in the retirement industry since the current regulation was promulgated in 1975. At that time, defined benefit pension plans dominated the retirement landscape, and most plans retained professional investment managers to manage retirement assets. Now, defined contribution plans such as 401(k) plans are the most common type of employer-provided retirement savings vehicle, and participants must make decisions

regarding the investment of their retirement savings.<sup>5</sup> The Department is correct that plan participants need more and better investment advice than ever before, and no one disputes that plan participants and IRA owners should be protected from unscrupulous financial intermediaries and advisors.

It is precisely because these issues are so important that we write to express our concern that the Proposal, as currently constituted, undermines these goals. Rather than expanding access to quality advice and encouraging small plan formation, the Proposal will make it more difficult for America's workers and retirees to access retirement plans, to receive quality investment advice, to receive useful educational information about their plans and investments, and to move their retirement assets freely between employer-provided plans and IRAs. Indeed, there is a substantial risk that at least some workers and retirees won't have access to advice at all—the Proposal's additional restrictions on educational information serve to compound that risk.

By making almost all financial intermediaries ERISA fiduciaries (thus significantly increasing their legal and financial risk), the Department's proposal will make investment advice and education:

- More expensive—advisors must obtain new insurance coverage, face new litigation risks in state courts, reform their business operations, and charge fees commensurate with these risks and costs;
- Less readily available—some portion of advisors will not find it commercially feasible to continue to offer services to small plans and IRAs; and

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<sup>5</sup> We are not expressing a negative view of defined contribution plans—the shift to defined contribution plans has resulted in greater access to workplace retirement savings as such plans allow businesses that could not easily offer a defined benefit plan to provide meaningful retirement benefits to their employees.

- More generic—restrictions on educational information and risks of inadvertent fiduciary status will encourage more advisors to provide only basic, written materials in order to control their legal and financial exposure.

Moreover, the scope of the proposed regulatory changes is sure to create uncertainty and significantly increase compliance costs—costs that are ultimately borne by retirement plans and their participants. Therefore, while the Department seeks to help Americans save for retirement,<sup>6</sup> we believe the Proposal will reduce employees' savings and interfere with their ability to receive quality investment advice.

Our comments address both fundamental issues we believe require the Department to reevaluate its approach, as well as specific concerns regarding particular items in the Proposal and the associated proposed exemptions. On behalf of our members, we look forward to working with the Department to address these policy and practical issues to better help Americans save for retirement.

### **About Us**

The Chamber's members range in size from mom-and-pop shops and local chambers to leading industry associations and large corporations. More than 96% of the Chamber's members are small businesses with 100 or fewer employees, and 70% of our small business members have ten or fewer employees. Accordingly, the Chamber is particularly cognizant of the problems facing small businesses, as well as the business community at large.

Besides representing a significant portion of the American business community in terms of employee count, the Chamber also represents a wide spectrum of

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<sup>6</sup> See, e.g., *Maximize Your Retirement Savings: Tips on Using the Fee and Investment Information From Your Retirement Plan*, U.S. Department of Labor, <http://www.dol.gov/ebsa/publications/feedisclosuretips.html> (last visited June 8, 2015); *New Employee Savings Tips: Time is on Your Side*, U.S. Department of Labor, <http://www.dol.gov/ebsa/pdf/NewEntrants.pdf> (last visited June 8, 2015); *Top 10 Ways to Prepare for Retirement*, U.S. Department of Labor, [www.dol.gov/ebsa/publications/10\\_ways\\_to\\_prepare.html](http://www.dol.gov/ebsa/publications/10_ways_to_prepare.html) (last visited June 8, 2015).

businesses in terms of industry types and location. Every major classification of United States business—from manufacturing and retailing to entertainment and finance—is represented by the Chamber. The Chamber’s positions on national issues are developed by a cross-section of members who serve on committees, subcommittees, and task forces. More than 1,000 businesspersons participate in this process. Accordingly, our comments are informed by the real-world experience of our member employers and their employees.

American businesses of every size maintain a long-held commitment to providing voluntary benefits that support the welfare of their workers. However, it is much more difficult for smaller business to offer retirement plans. As a result, it is vitally important to ensure that the regulations governing such plans preserve the choices available to them in structuring plans and services, as well as reducing the cost-burden of such regulation. The private employer-provided retirement system has contributed significantly to the retirement needs of millions of seniors and current workers. The Chamber and its members are committed to continuing the success of the system and ensuring the long-term retirement security of Americans.

### **Overview of Fundamental Concerns**

We address a variety of specific issues and recommended changes to the Proposal below. In addition to these specific issues, the Chamber has several fundamental concerns with the Department’s effort. We are not questioning the Department’s goals—we share your desire to ensure the protection of our employer plans and their employees and retirees. We do, however, question whether the Department is the proper entity to make unilateral changes in this area, and we question the Department’s methods and regulatory process. We are very concerned that the process employed here will not result in outcomes that benefit America’s employers, workers and retirees, but will instead result in unintended consequences making it harder—and in some cases, impossible—for them to get vitally needed education and advice.



- **The Department of Labor Is Not the Proper Agency to Make Unilateral Changes of this Magnitude that Have Far-Reaching Effects Beyond Employee Benefit Plans**

We are concerned that the Proposal makes fundamental changes to the regulation of financial markets that are beyond the scope of the Department of Labor's primary authority, which is the regulation of private sector, employer-provided benefit plans. While the Department seeks to use interpretive authority over the prohibited transaction rules in Internal Revenue Code §4975 (asserted pursuant to Reorganization Plan No. 4 of 1978) to act alone in regulating the conduct of financial advisors to IRAs,<sup>7</sup> we believe these issues properly should be addressed by other Federal agencies and regulatory organizations, such as the Securities and Exchange Commission (the "SEC") and the Financial Industry Regulatory Authority ("FINRA"), or by Congress. By acting alone, the Department seeks to substitute its judgment for those other regulatory entities and Congress, a decision that we strongly believe will lead to many negative consequences for our employer members and their employees. For example, we recently outlined our concerns regarding the Proposal's likely unintended effect on small businesses and small business plans in our report "Locked Out of Retirement: The Threat to Small Business Retirement Savings."<sup>8</sup> We attach that document to this letter and ask that it be included in the record.

In the Proposal, the Department proposes to do nothing less than make itself the primary regulator of how investments are provided to ERISA plans and IRAs that collectively hold approximately \$16 trillion in assets.<sup>9</sup> It is nearly impossible to overstate the significance of these changes. In one fell swoop, the Department would

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<sup>7</sup> The Proposal's scope includes not just IRAs, but other tax vehicles subject to IRC §4975, including Health Savings Accounts (HSAs), Archer Medical Savings Accounts, Coverdell Education Savings Accounts, and Individual Retirement Annuities. Advice regarding investments in these accounts is subject to the same issues as IRAs.

<sup>8</sup> "Locked Out of Retirement: The Threat to Small Business Retirement Savings," U.S. Chamber of Commerce, June 9, 2015, available at <https://www.uschamber.com/report/locked-out-retirement-threat-small-business-retirement-savings>.

<sup>9</sup> See, "The U.S. Retirement Market, First Quarter 2015," the Investment Company Institute, June 24, 2015, available at [https://www.ici.org/research/stats/retirement/ret\\_15\\_q1](https://www.ici.org/research/stats/retirement/ret_15_q1).

supersede<sup>10</sup> numerous regulations and enforcement policies governing the conduct of financial advisors, insurance agents, bank trust officials and consultants developed over decades by the SEC, FINRA, state securities regulators, the State Insurance Commissioners, and Federal and State banking regulators, replacing their decades of experience and long-standing policies with a new, one-size-fits-all Federal regulation dictating what kind of advisors are available to plans and IRA owners, how such advisors should be paid, and in most cases, the process by which such advisors develop their advice. The resulting abrupt change will affect our employer members and their employees by limiting their choices in operating their retirement plans and IRAs, shifting them into fee arrangements they did not bargain for, and reducing their access to vital educational information they need to make informed decisions.

In so doing, the Department acts as if it is filling a void, as if these Federal and State regulations don't exist, and as if there are fundamental flaws in the financial markets that only the Department can address. The Preambles to the Proposal and the associated prohibited transaction exemptions explaining the Department's justification for its actions frequently omit any mention of these extensive Federal and State regulations, giving the impression that workers and retirees simply are unprotected under current Federal and State rules.<sup>11</sup> The reality is that these markets are already highly regulated, and those regulators actively are addressing these concerns. For example, the SEC just launched the "...multi-year Retirement-Targeted Industry Reviews and Examinations (ReTIRE) Initiative" in which SEC staff will examine areas including advisor conflicts of interest, the basis for recommendations, supervision and compliance controls, and marketing and disclosure

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<sup>10</sup> As a legal matter, the Proposal would not replace these other laws and regulations, but would simultaneously apply with them. This would effectively supersede many, but would actually conflict with others.

<sup>11</sup> See, e.g., Comments in the Preamble to the BICE exemption, "In the absence of fiduciary status, the providers of investment advice are neither subject to ERISA's fundamental fiduciary standards, nor accountable for imprudent, disloyal, or tainted advice under ERISA or the Code, no matter how egregious the misconduct or how substantial the losses." By limiting the references to ERISA and the Code, the Department ignores and does not mention applicable SEC regulations and enforcement efforts, FINRA guidance and enforcement efforts, State insurance laws and regulations, and other financial conduct regulations that would not permit advisors to engage in "egregious misconduct." 80 Fed. Reg. 21,960 at 21,962-21,963 (Apr. 20, 2015).

concerns.<sup>12</sup> In another example, FINRA’s 2015 examination priorities includes conflicts of interest and IRA rollover advice,<sup>13</sup> examinations building on FINRA’s detailed guidance addressing advisor conduct in assessing the suitability of rollover recommendations.<sup>14</sup>

As another example, the Proposal’s impact on state insurance regulation raises questions regarding interaction with the McCarran-Ferguson Act,<sup>15</sup> at least to the extent that the Proposal affects IRAs holding insurance products and other investments sold or recommended by insurance agents. Disclosures to insurance customers, the services that can be provided by insurance agents and insurance companies, fee structures for insurance products and compensation paid to insurance agents are all regulated by the States as part of the “business of insurance.” The McCarran-Ferguson Act requires an express Congressional directive for any Federal regulator to regulate the “business of insurance.” Without an express and clear Congressional mandate, State insurance laws, rather than Federal law, govern the business of insurance. In the Proposal, the Department not only ignores the role of state insurance regulators in providing consumer protections, but it also fails to explain what express Congressional directive authorizes the Department to regulate these insurance matters and impose contradictory regulatory requirements.

- **The Department’s Regulatory Process Does Not Offer a Meaningful Opportunity to Understand and Comment on the Vast Scope of the Proposal’s Changes—A Regulation of this Significance Requires Negotiated Rulemaking**

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<sup>12</sup> See, “National Exam Program Risk Alert: Retirement-Targeted Industry Reviews and Examinations Initiative,” Volume IV, Issue 6, June 22, 2015, available at <https://www.sec.gov/about/offices/ocie/retirement-targeted-industry-reviews-and-examinations-initiative.pdf>.

<sup>13</sup> See, “2015 Regulatory and Examination Priorities Letter,” January 6, 2015, available at <http://www.finra.org/industry/2015-exam-priorities-letter>.

<sup>14</sup> See, Regulatory Notice 13-45, “Rollovers to Individual Retirement Accounts: FINRA Reminds Firms of Their Responsibilities Concerning IRA Rollovers” available at <https://www.finra.org/file/regulatory-notice-13-45>.

<sup>15</sup> 15 USC § 1011 et seq.

The Department isn't filling a void—it is attempting to supplant the efforts of Federal and State regulators, and the considered policies they made over decades informed by Congress and the State legislatures. Indeed, Congress has amended ERISA numerous times over the past 40 years, and in so doing implicitly ratifying its original decision to leave financial regulation to financial regulators, rather than the Department. The political processes that created the extensive regulations governing financial markets and financial advisors, agents and other service providers were developed over time with the full involvement of all parties in open and robust political debates. By contrast, the Department has worked behind closed doors for four years to develop an entirely new regulatory regime, and the affected employers, workers and retirees, along with Congress, the States, and the regulated community, have only 90 days in which to evaluate and comment on the magnitude and impact of these changes.

Though the Chamber appreciates the Department's decision to grant a fifteen-day extension to the public comment period initially set to expire on July 5, 2015—a mere seventy-five days after the proposal's release—we consider ninety days to be an inadequate time to allow the public to fully consider the Proposed Rule and associated exemptions and to assess its potential impact on our nation's \$16 trillion voluntary retirement system. Nevertheless, we recognize the importance of responding during the notice-and-comment period, and we write to share the comments that members were able provide during the designated comment period. The Chamber anticipates providing additional comments regarding the proposal as our members deem necessary.

Rather than continuing in this back and forth manner, the Department should enter into negotiated rulemaking with all interested parties.<sup>16</sup> We recognize that as

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<sup>16</sup> Negotiated rulemaking has been used successfully on other retirement issues. For example, the Pension Benefit Guaranty Corporation (PBGC) used negotiated rulemaking to substantially revise regulations pertaining to reportable events. Those regulations were originally adopted on September 17, 1980. 45 Fed. Reg. 61,615 (September 17, 1980). In 1984, minimal changes were made to the regulations. 49 Fed. Reg. 22,472 (May 30, 1984). However, in 1996 substantial revisions were made through a negotiated rulemaking process. The process included a negotiated rulemaking committee consisting of representatives of employers, participants, pension practitioners, and the PBGC. 61 Fed. Reg. 63,988 (Dec. 2, 1996). The negotiated rulemaking was so successful that when the final reportable event

times change, so do the needs and concerns of interested parties. Therefore, it is often necessary to review and change rules accordingly. However, we do not believe that unilateral changes are in the best interest of any party. The agency has not provided a compelling rationale for these radical changes. As such, it is difficult to meaningfully comment on the specific changes without knowing the reasoning or basis for the proposed changes. Through the process of negotiated rulemaking, however, the Department would be able to provide further explanation and all interested parties will be able to provide specific feedback and comment.

One is hard put to imagine a process that is less well-suited towards making fundamental reforms of financial markets that properly ensure considered input from all stakeholders, including assessing economic impact; understanding and mitigating unintended consequences; and providing for robust and open discussion than the path the Department has chosen. We are strongly concerned that this regulatory process does not provide the public a meaningful opportunity to comment. Consequently, we recommend that the Department enter into the negotiated rulemaking process to ensure that the rules are changed in the most beneficial manner possible and without creating unnecessary administrative and financial burdens.

- **The Department Improperly Attempts to Impose Through the Best Interest Contract Exemption Conduct Standards and Legal Liabilities Contrary to the Law**

The Department appears to be exceeding its regulatory authority in very significant ways. As our member employers well understand, the prohibited transaction rules in ERISA apply in arbitrary ways. The value of a transaction, its inherent benefit to a plan or a participant, does not determine whether it is

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rules were issued in December 1996, Vice President Al Gore's National Performance Review awarded a Hammer Award to PBGC for the agency's use of negotiated rulemaking. 1996 PBGC Annual Report [http://www.pbgc.gov/docs/1996\\_annual\\_report.pdf](http://www.pbgc.gov/docs/1996_annual_report.pdf). Through that process, all interested parties were able to weigh in and express their needs and concerns. As a result, the regulations were accepted by all parties.

permitted—the structure of the arrangement does.<sup>17</sup> This is why Congress granted the Department limited authority under ERISA §408(a) to promulgate exemptions to the prohibited transaction rules that allow useful and necessary transactions to proceed under certain specified conditions despite being otherwise prohibited by the general rules.

A common example of this problem for our member employers' plans is rehiring service providers who provide excellent services. A service provider to a plan becomes a "party in interest," and the general prohibited transaction rule does not permit the plan fiduciary to hire a service provider who is a party in interest to the plan. Consequently, the general rule prohibits rehiring a service provider. This result obviously doesn't make sense, so Congress passed an exemption, which the Department further modified by regulation, permitting a service provider to be rehired as long as the arrangement is "reasonable" and certain disclosures are provided.

We provide this common example to illustrate what will happen under the Proposal to many advisors. As will be discussed in more detail below, the Proposal would result in advisors who act in the best interests of their participants or IRA owners when giving advice, yet would still be subject to prohibited transaction rules that would make such advice illegal. In other words, advisors may be prevented from providing advice even though the advice is in the best interest of the plan, participant or IRA owner. To permit such advice, which the Proposal would otherwise make illegal, the Department proposes using its exemptive authority to permit certain arrangements through BICE. The problem is that the conditions in BICE exceed the Department's authority.

BICE would impose on IRA advisors a standard of care that Congress expressly did not choose to require of IRAs when it created them. Further, BICE would supplant

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<sup>17</sup> The Chamber issued a white paper on this issue on February 20, 2015 entitled "Using PTEs to Define a Fiduciary Under ERISA: Threading the Needle with a Piece of Rope" available at <https://www.uschamber.com/report/using-ptes-define-fiduciary-under-erisa-threading-needle-piece-rope>. We attach that document to this letter and ask that it be included in the record.

the legal remedies Congress carefully crafted to protect ERISA participants by introducing new legal liabilities for breach of contract and violation of warranties in BICE.

There is no question that the Department has no statutory authority to impose a standard of care on IRA advisors directly.<sup>18</sup> Similarly, there is no question that the Department has no direct authority to replace ERISA’s statutory remedies.<sup>19</sup> Instead, the Department seeks to do so indirectly, through conditions in BICE, presumably on the grounds that utilizing BICE is a “voluntary” decision by an advisor not directly mandated by the Department. We do not believe that the Department can impose conditions in an exemption that directly conflict with the structure of the law, and we do not believe that adoption of those limitations by advisors is “voluntary” as their alternative is being pushed out of their businesses by the effects of the Proposal. This is not a minor concern. Because the Proposal makes nearly all advisors fiduciaries for purposes of the prohibited transaction rules, and thus unable to receive fees that vary from one investment to another, a functioning exemption is critical to the structure of the regulatory package. Without an exemption with the proper legal foundation, many rollovers and other valuable transactions are effectively prohibited by the broad scope of the Proposal, ultimately preventing participants and IRA owners from getting needed services. The Chamber will be offering extensive comments on these and other legal issues in a separate joint letter with the Chamber’s Institute for Legal Reform.

- **The Proposal’s Overly Broad Scope Will Make it Harder for Plans and Individuals to Access Education and Advice by Reducing Choices Available to Them, Increasing the Roughly \$100 Billion Per Year in**

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<sup>18</sup> Reorganization Plan No. 4 of 1978 also does not transfer to the Department the Secretary of the Treasury’s statutory authority to enforce the prohibited transaction rules in §4975—such authority is expressly reserved to the Treasury Department in §102 and §105 of the Reorganization Plan.

<sup>19</sup> See, *Aetna Health Inc. v. Davila*, 542 U.S. 200 (2004) (quoting *Pilot Life Ins. Co. v. Dedeaux*, 481 U.S. 41 (1987) and *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134 (1985)) (“...the six carefully integrated civil enforcement provisions found in § 502(a) of the statute as finally enacted ... provide strong evidence that Congress did not intend to authorize other remedies that it simply forgot to incorporate expressly.”)

### **Losses the Department Previously Estimated Workers and Retirees Suffer Due to Lack of Access to Advice**

The Chamber is very concerned that rather than ensuring greater availability of quality advice, the Proposal will reduce the availability of vitally needed educational services and personalized investment assistance to low and middle-income individuals and small businesses.

Lack of access to investment information and advice has a real cost to workers and retirees. In 2011, the Department itself calculated that plan participants and IRA owners suffered roughly \$100 billion in investment losses each year, due at least in part to ERISA's prohibited transaction rules preventing access to professional investment advice.<sup>20</sup> We note that this 2011 estimate of the cost of no advice by the Department is greater than the Proposal's estimate of the cost of "conflicted" advice the Department seeks to address. (The Chamber is separately submitting comments on the economic analysis associated with the Proposal that raise significant questions about the validity of the "conflicted" advice estimates). As the Department's 2011 estimate attributed these losses from lack of advice at least in part to the very rules the Department seeks to expand in the Proposal, we are very concerned that an unintended consequence of the Proposal would be further increases in losses due to lack of access to advice and education.

Further, by increasing regulatory pressure to adopt fee-based rather than transaction-based accounts, the Department may inadvertently increase costs for many IRAs and small business plans that benefit from transaction-based pricing. The SEC has targeted enforcement efforts on so-called "reverse churning" in which fee-

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<sup>20</sup> See, The Preamble to the final regulation implementing the Pension Protection Act investment advice provisions, 76 FR 66,151-66,153 (October 25, 2011) (...the retirement income security of America's workers increasingly depends on their investment decisions. Unfortunately, there is evidence that many participants of these retirement accounts often make costly investment errors due to flawed information or reasoning...Financial losses (including foregone earnings) from such mistakes likely amounted to more than \$114 billion in 2010...Such mistakes and consequent losses historically can be attributed at least in part to provisions of the Employee Retirement Income Security Act of 1974 that effectively preclude a variety of arrangements whereby financial professionals might otherwise provide retirement plan participants with expert investment advice.) [Emphasis added].



based accounts are used to make investors pay more for services than they would have paid in transaction-based accounts—indeed, such inappropriate use of fee-based accounts is an SEC examination priority for 2015.<sup>21</sup>

While the Department has noted that the Proposal technically does not prohibit transaction-based accounts, or technically eliminate commissions and other forms of payment often associated with these accounts, the administrative difficulty presented in trying to achieve level fees in such accounts may be tantamount to a prohibition for many small business plans and individual accounts.<sup>22</sup> Our diverse members understand that there is no “one-size-fits-all” solution that is right for every plan, participant or IRA—our members, and their workers, retirees and their families, want choices that allow retirement plans and individuals to select the financial service providers that are correct for their individual situations.

### **Specific Comments Regarding the Proposed Expanded Definition of Fiduciary Advice**

In addition to our broad concerns expressed above, we are offering comments on specific issues presented by the Proposal. In the event the Department proceeds to a final rule on a substantially similar basis as the Proposal, we urge the Department to consider these issues to address the existing problems and ambiguities in the Proposal.

- **The Seller’s Carve-Out Should Not Discriminate Against Small Plans, Participants and IRAs—It Should Be Broadened to Permit All Plans and IRAs the Same Choices as Large Plans, Just as the Department Originally Recognized in 2010**

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<sup>21</sup> See, “Examination Priorities for 2015--National Exam Program, Office of Compliance Inspections and Examinations,” available at <http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf>

<sup>22</sup> As discussed in more detail below, it does not appear that the proposed Best Interest Contract Exemption provides realistic alternatives to level fees in most cases, resulting in a general level-fee requirement for most advisors.

As an organization representing millions of small business, we understand the hurdles facing them in offering employee benefits to their workers. In our voluntary system, Federal regulators should be reducing the impediments to forming plans. Unfortunately, the Proposal does the opposite—not only would it reduce the choices relating to retirement plan advisors for small businesses and place the full regulatory burden of the Proposal on small plans, but it specifically discriminates against small plans by allowing large plans to retain the ability to choose their advisors and payment structures as they wish. This is especially inappropriate given that small plan fiduciaries and large plan fiduciaries share the same legal obligations to their plans. The exclusion of plan participants and IRA owners is similarly discriminatory—as discussed above, smaller accounts may be better served with transactional fees than asset-based fees, and would benefit from choosing the advisors with whom they wish to work on the terms of their choice.

The Department properly recognized and preserved this important distinction in the 2010 version of the proposed regulation by providing an exclusion from fiduciary status for those selling products in which there was no reasonable expectation of a fiduciary relationship, making that option available to all retirement plans, plan participants and IRA owners.<sup>23</sup>

There is a fundamental difference in actions, expectations and obligations regarding the sellers of products and the providers of ERISA fiduciary advice. Where circumstances, viewed objectively, create expectations that the person providing an investment recommendation will act in accordance with the ERISA fiduciary standard of “an eye single” to participants, it is appropriate to include those circumstances in the functional definition of conduct giving rise to ERISA fiduciary status.<sup>24</sup> Unfortunately, the Proposal goes too far and encompasses circumstances where there is no reasonable expectation of fiduciary trust and confidence. A specific example is in the sale of proprietary products, where many of our members are concerned the Proposal seeks to create a fiduciary relationship that is simply

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<sup>23</sup> See, 75 Fed. Reg. 65,263 (Oct. 22, 2010)

<sup>24</sup> *Donovan v. Bierworth*, 680 F.2d 263, 271 (2d Cir.), cert. denied, 459 U.S. 1069 (1982).

inapposite. Our members offer a wide range of proprietary products such as insurance, mutual funds, annuities and bank products. These products have been developed to meet the needs of a wide range of customers, many of whom are middle to lower income investors who might not be served by more expensive investment advisors. The companies who offer proprietary products and their representatives do not hold themselves out as independent advisors on the entire universe of potential investment products. By refusing to recognize the difference between sales and advice, the Proposal ignores the history of financial services regulation, and the fundamental purpose of different legal obligations, licenses and training for insurance agents, broker dealers, registered representatives, registered investment advisors, bank trust officials and other financial professionals.

We also take issue with incorporating into the definition of ERISA investment advice recommendation principles developed by the Financial Industry Regulatory Authority (“FINRA”) for purposes of imposing a supervisory structure over sales practices. FINRA’s threshold for conduct requiring supervisory oversight was designed to establish governance over sales practices. But selling is not an investment advice function, and does not create an objectively reasonable expectation of fiduciary-level trust and confidence. Individuals as well as plan fiduciaries—no matter their level of investment sophistication—understand sales. Those who sell products, especially firms who sell proprietary products and management services, should not be held to a fiduciary standard that potentially requires them to either remain silent or sell a competitor’s product.

The Department’s rationale for changing its 2010 position appear to be its belief that small plans and individuals do not understand sales activity, while large plans are sophisticated purchasers of financial services who do. We disagree on both points—first, that small plans and individuals don’t understand the difference between sales and advice, and second, that status as a large plan fiduciary is a valid proxy for financial sophistication. The validity of this rationale is demonstrably false, and does not justify discriminatory treatment.

There is simply no basis to assume that a plan fiduciary to a plan with 110 participants is financially sophisticated simply because the plan is a “large” plan. More importantly, plan size is immaterial to the legal duties and obligations of the plan fiduciary—all plan fiduciaries have the same legal standard of care, and have a duty to the participants and beneficiaries to properly administer the plan. Regardless of plan size, they need choice and flexibility to select the kind of advisors that best serve their needs. If the Department’s assumptions regarding size and sophistication were true, then the Department should have extended the same logic to participants and IRA owners. A participant or an IRA owner with a large balance should, by the Department’s logic, be allowed choice while a small balance account should not. There is no rational basis for eliminating choice for all participants and all IRA owners while retaining it for large plans.

Finally, and most importantly, it does not require a high level of financial sophistication to understand that a discussion is a sales discussion if it follows a basic disclosure that an advisor is selling a proprietary financial product, that the advisor is paid to sell the product, and the advisor is not providing fiduciary advice. This disclosure, similar to that the Department requires in the large plan carve out, is readily understandable to any recipient. The assumption that small plans, participants and IRA owners cannot understand the difference between sales and advice does not match the real world experience of our members and their employees. The Department can protect participants, IRA owners and small plans with the same kind of disclosures that it requires of large plans under the large plan carve out, but without eliminating their right to choose the services and products that best fit their needs.

The Department should retain the seller’s exemption from its 2010 proposal, but couple that exclusion with simple, clear disclosure. This would preserve choice while providing the information necessary for plans, participants and IRA owners to make informed decisions.

- **Plans and Participants Must Know When a Fiduciary Relationship is Established in Order to Properly Evaluate the Information They Receive—the Proposal’s New and Vague Terms Will Result in Greater Confusion for Plans and Participants, Not Less.**

It is essential that the establishment of a fiduciary relationship be clear and unambiguous. The expectations of plans, participants and IRA owners regarding the advice they receive cannot be met if it is not clear to everyone involved that fiduciary advice is being provided. Indeed, this was one of the reasons the Department originally proposed the rule in 2010—the Department determined that the current regulation did not provide sufficient clarity for its investigators to prove when an advisor was a fiduciary.<sup>25</sup>

Unfortunately, other aspects of the Proposal introduce new ambiguity by removing important terms and introducing new and vague terms that remove certainty in the relationship.

For example, the Proposal removes the requirement of the current regulation that fiduciary advice is provided pursuant to a “mutual understanding.” The retention of this concept is critical. A mutual intent to enter into an arrangement is a basic element that must be present in any relationship as significant as fiduciary advice. A participant needs to know whether he or she is receiving fiduciary advice in order to properly assess the recommendation received. The advisor needs to know that his or her actions establish an advice relationship in order to properly advise the participants, and to comply with regulatory requirements affecting everything from how a recommendation is developed, to how the advisor is paid, to what insurance the advisor needs to have, to whether a prohibited transaction exists for which an exemption is needed. To protect the interests of plans, participants and IRA owners, there must be a mutual understanding that fiduciary advice is being provided.

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<sup>25</sup> See, the Preamble to the 2010 Proposal, 75 Fed. Reg. 65,263 at 65,272 (Oct. 22, 2010).

Another significant concern is the Proposal’s alternative to “individualized” advice—advice “specifically directed to” the recipient. A new and undefined term in the Proposal, it is not clear from the regulatory text when something is “specifically directed to” a participant. This is not a minor ambiguity, but a major source of potential confusion. Is a letter addressed to a participant or IRA owner offering a financial product for sale “specifically directed to” that person because it was addressed to that person by name? Should the named recipient of that offering have a reasonable expectation that this is a fiduciary recommendation being made because there is an “understanding” that the recommendation for that financial product was “specifically directed to” the person? Should that reasonable expectation be different if the letter was addressed to the person by name from an existing non-fiduciary service provider to his or her plan rather than by an entity or person with whom the participant had no prior dealings? Participants and IRA owners need to know when they are receiving fiduciary advice and when they are not—no one’s best interests are served when neither party is certain whether fiduciary advice is being given.

Fiduciary status cannot turn on such casual notions as how a letter is addressed—the Department should retain the requirement of a mutual understanding, and should retain the “individualized” standard. The new term “specifically directed to” should be removed from any final regulation in order to prevent confusion by plans, participants and IRA owners.

**Fiduciary Advice Regarding Rollovers and Distributions Must Be Clarified to Resolve Ambiguities about How and When Advice is Given and To Address Unintended Consequences, Such as Inhibiting Efforts to Combat “Leakage”**

By reversing the Department’s previous position that rollover advice is not fiduciary advice, the Proposal creates a series of new questions and concerns for plan sponsors, participants and IRA owners.

First, the broad language would appear to make all rollover and distribution advice fiduciary in nature, including not just plan to IRA rollovers, but IRA to IRA, IRA to plan, and plan to plan transfers. This will significantly inhibit the enrollment activities of plans and plan service providers. For example, many plan enrollment processes for new employees recommend the consolidation of various retirement accounts in the new employer's plan to prevent so-called "leakage" from qualified plan accounts. Because such advice would now be fiduciary advice, an advisor or company employee could no longer recommend consolidating an account from an IRA or prior plan into the new employer's plan without conducting a prudent fiduciary analysis of the prior employer's plan. Given the time, expense and risk associated with such a review, new employees likely will no longer be encouraged to consolidate their accounts, an outcome that appears to be counter to the Department's goals.

A significant amount of leakage is the direct result of workers "cashing out" of their retirement accounts when changing jobs. A 2011 study by AON Hewitt found that 42% of workers who terminated from employment in 2010 "took a cash distribution...29% left assets in the plan and 29% rolled assets over to a qualified plan. The cashout behavior of terminated employees was greatly influenced by their plan balance, age, and gender."<sup>26</sup> Another study estimated that reducing access to financial service providers upon job termination could "increase annual cash outs of retirement savings by an additional \$20 – 32 billion...these withdrawals could reduce the ultimate retirement savings of affected individuals by 20 to 40 percent."<sup>27</sup> Second, the Proposal offers no additional clarity on whether and under what circumstances a recommendation for a rollover may also be a prohibited transaction. Prior guidance from the Department indicated only that a rollover from the plan recommended by an advisor who is a fiduciary to the plan "may" constitute a prohibited transaction.<sup>28</sup>

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<sup>26</sup> "Leakage of Participants' DC Assets: How Loans, Withdrawals, and Cashouts Are Eroding Retirement Income," AON Hewitt, 2011 at 10.

<sup>27</sup> "Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings," Quantria Strategies, April 9, 2014, at 4.

<sup>28</sup> See, Advisory Opinion 2005-23A.

It is also not clear from the proposal whether a prohibited transaction would arise if an advisor recommended a rollover to a participant with whom the advisor had no other connection. The Department should clarify whether and why a prohibited transaction would arise in connection with rollover advice. The prohibited transaction concern is very real due to the structural cost differences between plans and IRAs unrelated to any conflict of interest. Most IRAs are likely to be more expensive than most plans for a simple reason—an IRA offering individualized advice and specialized products and services is fundamentally different than a typical plan serving as an institutional accumulation vehicle with no individual advice and a limited investment menu. The increased IRA cost may be prudent and in the best interest of the participant, but may still present a prohibited transaction to the advisor depending on the circumstances.

Even where there is not necessarily any increased cost, such as a rollover on an equal cost basis, it is not clear whether there is a prohibited transaction under the Proposal. It is also not clear whether a plan to plan rollover gives rise to a prohibited transaction, because the advisor receives no compensation from the prior plan, but does in connection with the current plan. Without clear answers to these issues, we cannot evaluate the full impact of the Proposal, as we do not know when an exemption is needed, or which exemption to apply.

The Proposal should also clarify that following participant direction to set up and operate an IRA is not fiduciary advice—responding to participant inquiries about the availability of rollover services and costs likewise should not be fiduciary advice. We are also very concerned that it is not clear how the broad scope of the Proposal would apply in a participant call center, where discussing a participant’s distribution options, including the provider’s ability to provide rollover services, could be considered advice rather than education under the Proposal. Any fiduciary obligation in connection with a rollover retained in the final rule must have a clearly defined beginning and end point in order to allow service providers to discuss information with participants.



- **The Education Carve Out Replacing IB 96-1 Will Prevent Plan Education Efforts from Continuing to Successfully Help Participants by Redefining Asset Allocation Models Referencing the Plan’s Investment Options as Fiduciary Advice**

Interpretive Bulletin 96-1 (“IB 96-1”)<sup>29</sup> has been an essential tool for plans to help participants make informed investment decisions. We note the Proposal builds on this success by expressly permitting education to be provided to plans and IRAs as well as participants. We also believe the expansion of IB 96-1 to include education about retirement income needs, risks and strategies is an important step forward.

However, we are very concerned that the Proposal’s redefinition of asset allocation models that reference the plan’s investment options as fiduciary advice will significantly disrupt plan sponsor efforts to educate their employees and retirees about their investment options. Many plan sponsors encourage their employees to maximize their retirement savings by taking advantage of written and computerized investment education materials customized to their plan, often made available by plan service providers. In almost all cases, these materials provide information about the specific investment options in which plan participants may invest their savings.

Many Chamber members, for example, offer computerized investment models that help participants decide which of the offered funds or vehicles they will invest in by using historic data to demonstrate how their assets might have performed over time in specific funds. Other Chamber members offer plan participants the opportunity to have their investment elections tailored to their investment needs, based on factors such as their current age, target retirement age, and risk tolerance. In other cases, intermediaries help plan participants by reviewing their investment elections to help ensure that participants have selected investments that are appropriately diverse and that match their retirement goals. While plan fiduciaries prepare educational materials for their participants in some cases, many Chamber members outsource investment education to trusted third parties.

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<sup>29</sup> 29 CFR §2509.96-1

The Proposal would upend these attempts to provide investment education, because any party who provides participants with information about specific investment options available in a plan, or information about how they might choose to invest in those options would likely be deemed an investment advisor—and thus an ERISA fiduciary. This represents a sea change from plan sponsors’ current understanding of the “education vs. advice” rules, which allow plans and their service providers to make available such information on a non-fiduciary basis. Under the Proposal, in order to avoid ERISA fiduciary status, plan fiduciaries and investment educators would likely limit their discussions to generic information about asset classes, types of investments, investment expenses, and the like. Not only is this information only minimally helpful, it represents a disservice to retirement plan investors who may not fully understand how the available investments fit into each asset class, and is bound to result in decreased returns in employer-sponsored plan accounts.

The Department provided no evidence that model portfolios have been abused by advisors or have otherwise caused harm to participants during the nearly 20 years IB 96-1 has been available for use. The Preamble merely states that the Department agreed with certain comments to the 2010 proposal that model asset allocations “can be indistinguishable to the average retirement investor from individualized recommendations, regardless of caveats.”<sup>30</sup>

Removing a proven tool to help participants make better investment decisions should require more than a general concern that the disclosures in IB 96-1 may not be clear enough. We recommend that the Department expand the education “carve-out” in any final rule by retaining the provisions of IB 96-1, but adding to them the application of the guidance to plans and IRAs, and discussions of retirement income needs. Forcing participants to “connect the dots” and determine which plan investments match model portfolio asset classes does nothing but decrease the utility of education by making it more difficult for participants to make informed decisions.

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<sup>30</sup> 80 Fed. Reg. 21,928 at 21,945 (Apr. 20, 2015).

We also believe that there are technical drafting errors in the education provision. In Section (b)(6)(ii) of the Proposal, the Department provides that, if certain requirements are met, a person does not become an ERISA fiduciary, but is providing non-fiduciary education, if that person provides or makes available certain information.<sup>31</sup> Unfortunately, that subsection is stated in the conjunctive, such that a person providing investment education has actually provided fiduciary investment advice unless the curriculum constitutes “Information *and* materials on financial, investment *and* retirement matters that do not address [certain specific investments and alternatives] *and* informs [the individual] about (A) general financial concepts . . . ; (B) historic differences in rates of return between asset classes . . . ; (C) effects of inflation; (D) estimating future retirement income needs; (E) determining investment time horizons; (F) assessing risk tolerance; (G) retirement-related risks . . . ; *and* (H) general methods and strategies for managing assets in retirement . . . *including* those offered outside the plan or IRA. [Emphasis added]”<sup>32</sup>

By writing this subsection in the conjunctive, all of the listed material must be provided in all investment education materials. Thus, under a strict reading of the Proposal, an individual *would* be providing fiduciary investment advice, not education, if such individual, for example, omitted information on general methods and strategies for managing retirement assets offered outside the plan. Similarly, an individual would also be an ERISA fiduciary if he or she omitted information about determining investment time horizons from educational materials.

While we do not believe this was the Department’s intent, the language creates confusion for plan sponsors who oversee the delivery of investment education and retirement plan investment advisers offering such education. To confirm that investment education is not required to be an “all-or-nothing” affair, the Department should reframe this subsection to clarify that any or all of the information or materials may be offered as part of a plan sponsor’s investment education curriculum.

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<sup>31</sup> See, 80 Fed. Reg. 21,958.

<sup>32</sup> Id.

- **The Platform Carve Out Should Be Revised to Permit Customization of Platforms—A Platform Provider Must, of Necessity, Take Into Account the Individual Needs of the Plan to Respond to Questions and Requests, and Such Responses Are Not and Should Not Be Fiduciary Advice**

Many Chamber members use plan platform providers who offer a selection of investment options to their clients as part of their services. Under the current rule, offering these options does not make platform providers ERISA fiduciaries. Indeed, the Department has argued on several occasions that constructing and offering a platform of investment options available to plans is not a fiduciary act.<sup>33</sup> This is rational, because plan fiduciaries, not the platform providers, are responsible for selecting which (if any) of the available options are available for use by plan participants, and plan fiduciaries are also responsible for ongoing monitoring to ensure the prudence of offering those investment options.

However, the “carve-out” for platform providers in Section (b)(3) of the Proposed Regulation is too narrow, because it would make platform providers ERISA fiduciaries if they individualize investment options based on the needs of a plan, its participants, or beneficiaries.<sup>34</sup> It is virtually impossible for a platform provider to respond to the plan without individualizing the response in some manner, but this individualization should not make these responses fiduciary advice under any reasonable interpretation. Plan fiduciaries often ask extensive questions about the platforms, required funds, discretionary funds, share classes, fees, alternative fee arrangements, investment options and other relevant characteristics of the platforms and the investment options in order to carry out their fiduciary duty to prudently select the service provider and investments.

Because platform providers would be deemed ERISA fiduciaries under the Proposal, providers’ compliance costs would increase, which would, in turn, increase plan administration costs and result in lower investment returns or higher direct

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<sup>33</sup> See, e.g., Brief for Secretary of Labor Elaine L. Chao as Amicus Curiae Supporting Plaintiffs-Appellants, Hecker, et al., April 2, 2008, at 22-23; Brief for Secretary of Labor Hilda Solis as Amicus Curiae in Support of Plaintiff-Appellant, Leimkuehler, June 1, 2012, at 24.

<sup>34</sup> See, 80 Fed. Reg. 21,957.

expenses for participants. The Department should expand the plan platform carve-out to ensure that platform providers are not deemed ERISA fiduciaries merely because they offer investment options that are tailored to the needs of a plan, its participants, or its beneficiaries. The Department should also clarify that an annuity contract is a platform.

- **The Employer Carve Out Should Be Modified to Ensure That Employees Are Not Fiduciaries Regardless of Whether Advice is Provided to a “Plan Fiduciary” or Another Employee**

The Chamber notes that the Department recognized the broad definition of fiduciary in the Proposal could result in employees becoming inadvertent fiduciaries. The “carve-out” in Section (b)(2) of the Proposal would exempt from ERISA fiduciary status plan sponsor employees who provide investment advice to “a plan fiduciary” if the employee receives no more than the normal compensation earned for work performed for the plan sponsor.<sup>35</sup> However, the Proposed Regulation does not address customary practices regarding plan administration, such as:

- When an employee (i.e., a human resources manager) provides investment recommendations (such as rollover information) to another employee;
- When an employee explains to another employee (or retiree) the costs and benefits associated with maintaining his or her savings in an employer’s plan, encourages participation in the plan, and recommends consolidating other accounts into the plan; or
- When an employee provides advice to another employee, who then, in turn, passes that advice to the plan fiduciary (an investment committee, for example).

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<sup>35</sup> 80 Fed. Reg. 21,957.

The conversations between employees regarding the employer's retirement plan should not give rise to fiduciary status for those employees. A literal reading of the Proposal would result in the first employee being an ERISA fiduciary in each instance, because the employee provided the investment "advice" directly to another employee or through an intermediary employee, not directly to the plan fiduciary. We do not believe this was the Department's intent, and urge that any final rule clarify that no plan sponsor employee becomes an ERISA fiduciary merely because he or she provides advice directly to another employee or indirectly to a plan fiduciary concerning the investment or management of plan assets.

- **Recommendations of Investment Advisors and Managers Should Only Be Fiduciary Advice if Provided as a Specific Service for a Direct Fee**

The Proposal clarifies that a recommendation of a fiduciary providing investment recommendations, rollover recommendations or valuations is itself potentially fiduciary advice. Under Section (a)(1) of the Proposal, such advice would have to be provided for "a fee or other compensation, whether direct or indirect."

Our members are concerned that a literal reading of the Proposal could result in a service provider receiving its regular fee for existing services becoming an inadvertent fiduciary by offering its opinion about other service providers. For example, a third party administrator ("TPA") might be asked by the plan fiduciary if the TPA "knows any good advisors." The TPA is not charging a fee for responding to this question, and its ordinary fees for regular services should not be considered indirect compensation in connection with answering the plan fiduciary's question. This is a fundamentally different situation than a plan fiduciary specifically engaging a consultant to recommend investment managers for a sleeve of assets in a defined benefit plan.

We are also concerned that a broad reading of the Proposal might treat the offering of investment advice services by the advisor as the advisor recommending itself. This outcome would result in a prohibited transaction for merely offering a fiduciary service. We urge the Department to clarify that offering fiduciary services to

plans, participants or IRA owners is not itself a fiduciary recommendation or, therefore, a prohibited transaction.

We urge the Department to limit fiduciary status to recommendations regarding fiduciary advisors, managers or valuation entities provided as a specific fiduciary service for a direct fee.

- **The Proposal’s Exclusion for Certain Valuations Is Too Narrow, and May Make Fiduciaries of Service Providers Performing Ordinary Functions for the Plan or IRA, Increasing Costs Ultimately Borne by Participants and IRA Owners**

While the Proposal excludes from fiduciary advice ESOP share valuations, valuations provided to collective investment vehicles utilized by multiple unrelated plans, and valuations made solely for certain legally-mandated reporting and disclosure purposes, it does not clearly exclude many common valuations that platform providers and other financial intermediaries must engage in on a daily basis in the ordinary course of providing services to their clients. These administrative valuations are necessary for the regular operation of plans and IRAs, are well outside the scope of those activities generally considered to involve an exercise of discretion, and thus should not be considered fiduciary in nature.

The Proposal’s treatment of valuations implicates (at least) two separate but highly interrelated concerns. The first is the ambiguity of the Proposal’s language, which provides that the furnishing of a statement “similar” to an appraisal or fairness opinion constitutes fiduciary advice. This is a highly subjective reference, and depending on context, could possibly be interpreted as including any number of verbal or written communications as to the value of securities or other property. For purposes of investment transactions, as well as facilitating ordinary plan/IRA transactions such as plan loans and distributions, platform providers, trustees and other financial vendors provide a myriad of communications that, at least in part, must reference the value of plan and IRA assets.

With this in view, the second concern is that these vendors must routinely rely on market quotations and similar calculations made by unrelated third parties, over which they have no control. Of course, while reliance on an investment fund's published NAV, market valuations as to the securities in an investment account, and similar figures is both consistent with industry practice and generally reliable, these types of calculations are nonetheless subject to occasional human errors. Where a fiduciary relies upon third party information in carrying out its duties, current guidance from the Department imposes upon the fiduciary duties of prudent selection and monitoring of the third party. But to the extent that providing administrative and similar "valuations" could be deemed a fiduciary activity, the platform provider or other vendor has no practical ability to select the source of its information or ensure its veracity in many cases. For example, while the Proposal carves out securities valuations provided to an investment fund, it does not clearly exempt communications to a plan sponsor or IRA owner regarding the value of shares or units of the fund itself. A platform provider or similar vendor cannot be expected to act as a *de facto* auditor or guarantor of, for example, an unaffiliated investment provider's valuation practices.

We suspect that this is not, in fact, the Department's intent. However, the Chamber regards the Proposal's treatment of valuations as a microcosm of the problems with the Department's approach in a more general sense – that is, its broad scope creates potential liabilities and landmines for financial intermediaries, but carves out relief only for a few intricately-tailored situations it has identified. With regard to valuations, there are innumerable scenarios in which a platform provider or other financial vendor may make written or verbal communications or representations as to the value of securities and other property in the ordinary course of its business, and where there traditionally has been no expectation that the fiduciary rules are implicated.

Rather than simply excluding certain narrow valuations from fiduciary coverage, we recommend the Department take the inverse approach and instead include as fiduciary valuations only specifically identified valuation activities the Department has found to be problematic or at risk of abuse in its enforcement



efforts, and which involve situations where the provider has been engaged to furnish an appraisal or fairness opinion as a distinct matter, rather than merely as an activity ancillary to general transactions.

- **The Department Should Not Attempt to Exclude from Fiduciary Advice Recommendations for “Low-Fee” Investments**

The Proposal requests comment regarding whether a simplified exemption should be available for an advisor recommending the “low-fee” option within an asset class. We object to this concept. While cost is a relevant factor in evaluating the prudence of an investment, it should not be the primary or sole consideration regarding whether a recommendation is fiduciary advice.

This request is not well-grounded: First, simply because an investment has low fees does not mean it is a “good” investment, suitable for the participant, prudent for the participant, or in the participant’s best interest. Most sensible investors would not favor a cheap investment over a more expensive one that yields a better “net of fees” return, and that is just to isolate two variables among many. When viewed from even this narrow standpoint, a “low-fee” exemption is no more logical than a “highest net returns” exemption, which the Department ostensibly has no interest in considering. As the Department has noted in other contexts, fees are simply one factor in a prudent investment decision process, not the determinative factor. For example, in its educational publication for plan fiduciaries, “Meeting Your Fiduciary Responsibilities,” the Department directly instructs fiduciaries that, “Fees are just one of several factors fiduciaries need to consider in deciding on service providers and plan investments.”<sup>36</sup> More critically, the Department’s regulation regarding fiduciary investment duties demands that all facts and circumstances the fiduciary “knows or should know” are relevant must be given appropriate consideration.<sup>37</sup> A myopic

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<sup>36</sup> “Meeting Your Fiduciary Responsibilities,” U.S. Department of Labor Employee Benefits Security Administration, February 2012, at 5, available at <http://www.dol.gov/ebsa/pdf/meetingyourfiduciaryresponsibilities.pdf>

<sup>37</sup> A fiduciary making investment decisions must give “...appropriate consideration to those facts and circumstances that, given the scope of such fiduciary's investment duties, the fiduciary knows or should know are relevant to the particular investment or investment course of action involved...” 29 CFR §2550.404a-1(b)(1)(i).

focus on fees turns decades of guidance and painstakingly-evolved fiduciary practice on its head.

A separate simplified exemption predicated on nothing more than the fees associated with an offering would incent plan fiduciaries to act contrary to their fiduciary duties by disregarding all facts and circumstances other than fees, including all service and quality considerations, and the role that the investment is intended to play in the overall plan or IRA portfolio. That is, it would likely simply replace one potential conflict of interest with another. And, it would inevitably trespass on the enforcement interests of the SEC and FINRA by providing a clear financial incentive (avoiding fiduciary liability, compliance with the conditions of other exemptions, etc.) to recommend the use of cheap investments regardless of whether such recommendations would be consistent with their fiduciary duties under the Investment Advisers Act (for RIAs) or suitability requirements (for broker-dealers).

Moreover, while we recognize that the Department has only requested comments on this concept, actually putting such an exemption into practice would be unworkable in the real world. For example, how does one define a “high quality” low-fee investment, in light of innumerable differences in services, liquidity, stability of the offering organization, etc.? How does one define “low-fee”? What if an investment vehicle has a multi-tier fee structure such that the total fee may be influenced by gains or subsequent additions? How would investment fees within a group variable annuity structure be compared to other products? The practical issues are endless.

Likely having recognized the futility (and danger) of such an approach, other regulators with far more expertise as to the financial markets, including the SEC and FINRA, have not attempted to recognize any class of investments that are purportedly such “safe and well-performing bargain buys” such that recommending them does not require the ordinary standard of care to be observed. Granting an exemption for “low-fee” investments would be a significant departure from the

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Department's traditional role of promoting sound fiduciary processes and ensuring that fiduciaries and plan participants are provided with the information they need to make informed decisions for their own individual circumstances. The Department has neither the expertise nor the authority to make such policy decisions. The Chamber recognizes that there is no "one-size-fits-all" answer to the investment question for ERISA plans, participants and IRA owners, and we urge the Department to recognize the same and act accordingly.

- **Responding to an RFP Should Not Be Fiduciary Advice**

Often in response to a Request for Proposal (RFP) or similar request, plans will ask service providers to discuss the investments available to the plan or to otherwise describe their services in ways that could be construed under a broad reading of the Proposal to provide fiduciary advice. The Department should clarify that a recommendation made in the context of responding to an RFP issued by, or on behalf of, the plan sponsor should not be considered fiduciary in nature.

While, as discussed above, the Proposal does recognize a carve-out for platform providers, it is limited to the marketing of platforms "without regard to the individualized needs of the plan..." This suggests that no meaningful discussion of individualized services or investments may take place without becoming a fiduciary. However, when marketing its services to the plan, the platform provider quite likely must discuss how its services would meet the individual needs of the plan outlined in the RFP. The seller's carve-out provides relief, but it is not available for small plans. A broad reading of the rule suggests that providers would probably be able to respond to large plan RFPs and speak freely as to how their abilities would satisfy the plan's needs, but most providers would not be able to recommend their services to small plans in the same way without the risk of becoming fiduciaries.

We will not repeat our concerns about the discriminatory effect on small plans of the limited seller's carve out. However, we will point out that, despite the Department's stated goal of balancing investor protections with preserving ordinary business norms, the Proposal offers no avenue whatsoever for a party

“recommending” many services to a small plan to escape fiduciary status, regardless of how clearly or fervently that party might disclose that he or she is acting in sales capacity.

If service providers, particularly in the small plan space, are unable to have meaningful discussions with plan fiduciaries about individualized services and investment issues in response to an RFP, they can be expected to respond to RFPs with only the most boilerplate documents. This will frustrate the Department’s intention by making it much more difficult for small plan sponsors to make prudent choices as to providers.

Many of our member employers are small plan sponsors who take their fiduciary obligations very seriously, and are certainly qualified to distinguish between fiduciary advice and sales interactions. And there is hardly a more clear case of a “sales interaction” than a candidate’s response to an RFP, where it has been specifically requested to “pitch” its business. We would point out that, even under the seller’s carve-out, the precise contours of relief where a vendor “sells itself” via an RFP response are not well-defined. Accordingly, the Chamber requests that the Department consider adding a clear, objective exclusion from fiduciary advice for any provider responding to an RFP or similar request.

- **The Proposal Should Not Apply To Insurance Contract Sales to Welfare Benefit Plans.**

The Proposed Regulation should not apply to insurance contract sales to welfare benefit plans such as dental, disability and group life insurance plans. While the Proposal is clearly directed at, and applicable to ERISA retirement plans, plan participants, and IRAs, the Proposal does not appear to analyze or even consider sales to welfare benefit plans. This is evidenced by the Department’s economic impact study which was exclusively devoted to retirement plans and IRAs, but did not consider or even mention welfare benefit plans. In light of the fact that the practical need or application of this proposed rule to welfare benefit plans and their fiduciaries was never analyzed or considered, the Chamber asks the Department to clarify that

insurance contract sales to or through welfare benefit plans are outside the scope of the Proposal.

It should also be noted that the fee arrangements, marketing practices, sales and distribution, and types of products used by financial companies for sales to welfare plans are fundamentally different from those used in the pension plan market and therefore warrant different treatment and requirements. To readily apply the Proposal to sales to welfare benefit plans without any type of study or analysis, and without considering welfare benefit plans in the Department's economic impact study, could result in unintended negative consequences to welfare benefit plans, and to participants and beneficiaries. This could include limiting the types and availability of insurance products sold to welfare benefit plans, as well as increased administrative and insurance product costs passed on to those plans and participants. Any proposed regulation should not even be considered without a comprehensive analysis and a thorough economic impact study by the Department. Many of these plans and arrangements are fairly complex, and it would require a significant amount of time and resources for the Department to appropriately consider the impact on these plans, products and arrangements.

We appreciate statements by Department officials in meetings with various groups, including the Chamber, that the Department did not intend to cover these contracts issued to welfare benefit plans in the scope of the Proposal. However, to ensure there is no confusion, and to prevent potential future litigation on what may be perceived as an ambiguity, we request that any final rule expressly exclude such contracts.

- **The Proposal Should Apply the New Fiduciary Standard Prospectively—Current Advice Relationships Should Be Converted Upon Renewal, Not in Mid-Term**

Plans, participants and IRA owners have entered into millions of agreements with advisors. The Proposal would drastically affect every one of those contracts, denying plans, participants and IRA owners the benefits of the agreements they made.

We question the legality of retroactively invalidating the terms of such existing contracts, all of which were legally negotiated and executed in a manner fully consistent with Federal and State laws. On the effective date of any final rule, the new fiduciary definition should be applicable only to new arrangements entered into on or after that date. It should not apply to existing arrangements until they are renewed.

BICE currently provides in Section VII(b)(3) that eligible existing arrangements are exempted from a prohibited transaction only so long as no additional advice is provided after the effective date. This provision does a disservice to participants and IRA owners. First, in many cases, customers have paid an initial sales charge for which they purchased advice to be provided over the term of the agreement. The BICE provision deprives these IRA owners or participants of advice for which they have already paid—if they require additional advice after the effective date of any final rule, they will be forced to adopt a new agreement. Second, it creates an incentive for advisors to refrain from offering advice to existing arrangements—in other words, it creates a new potential conflict of interest. Clearly, this is not in the best interest of the participant or IRA owner.

Further, it makes no sense to address existing relationships through BICE. The limited definition of “asset” in BICE would result in the application of the transition rule based on an asset-by-asset basis, rather than on an account-by-account basis. The same existing account could hold assets covered by BICE and assets not covered—how would the transition rule apply to that account? Further, existing arrangements are not prohibited transactions requiring a retroactive exemption—they are legal and valid contracts appropriately providing investment services under existing law. If the Department changes the regulations in a final rule, it should address the transition between the current legal standard and the new legal standard in the language establishing the effective date of the new standard. Specifically, any final rule should state that the new standard is effective for all arrangements entered into or renewed after the effective date.

### **Specific Comments Regarding the Proposed Best Interest Contract Exemption**

The Chamber is very concerned that the Proposal creates new prohibited transactions for which the BICE proposed class exemption appears to be the only available exemption. As we discussed above, we are concerned about the negative impact of the Proposal on services and investments available to small plans, and the exclusion of advice to plans under BICE is another aspect of that concern. While BICE does apply to IRA owners, it is not clear how BICE applies to SEP and SIMPLE IRA plans offered by an employer. Further, as discussed above, we believe some of the conditions proposed in BICE exceed the Department's regulatory authority. Most significantly, we are concerned that BICE simply does not work as proposed, as the conditions are impractical and expose advisors to significant legal liabilities despite good faith efforts to comply. The Department may intend BICE to be a flexible exemption to ERISA's prohibited transaction rules that preserves a wide range of business practices, and it rhetorically supports a "best interest" standard which protects retirement investors while accommodating the business objectives of firms providing investment advice.<sup>38</sup> As proposed, however, the exemption is flawed in concept and unworkable in practice. If the Department seeks to implement a standards-based exemption, it should eliminate the many conditions and instead articulate a broad "best interest" principle and safe harbor.

In addition to these major concerns, there are many additional reasons that BICE is not a practical solution serving the needs of participants and IRA owners. If a BICE agreement must be signed before any meaningful discussions can occur with a participant or IRA owner, the process of getting and signing necessary paperwork will be cumbersome and will disincent some participants to get needed advice. There should be no need for any paperwork until a transaction involving the advice will take place, and BICE should provide retroactive relief regarding the discussions leading up to the transaction. The BICE agreement also does not take into account that some

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<sup>38</sup> In this regard, we believe the Department should clarify that putting the clients' interests first satisfies the requirement to act "without regard" to an adviser's or firm's compensation. Such a change would avoid any potential confusion as to the ability of a for-profit firm to meet the standard.

IRA providers directly contract with the IRA owner—the advisor doesn't have an agreement with the IRA owner.

- **The Required Warranties and Representations are Subjective and Will Unnecessarily Expose Advisors and Financial Institutions to Litigation Risk—Resulting in Higher Costs and Fewer Advisor Choices for Participants and IRA Owners—Unless Safe Harbors or Objective Standards Are Provided.**

The Chamber is extremely concerned about the contractual and warranty provisions in BICE, and the chilling effect they are likely to have on the availability of advice to participants and IRA owners, due to concerns over potential liability. A principles-based approach results in ambiguity as to whether the conditions of the exemption are met, and would result in class action lawsuits in state courts over these ambiguities. Our objections encompass both the Department's general approach as to the exemption, as well as certain particulars.

As noted previously, Congress excluded IRAs from ERISA entirely. For ERISA plan participants, Congress established a specific set of remedies within ERISA to address grievances, which have been held in many contexts (and by courts in all Federal circuits) to preempt state law causes of action. In short, there was no intent by Congress that the Department impose conduct standards with respect to IRAs, or that it supplant ERISA remedies in the plan context, and in fact, the Department would be prohibited from doing either one directly.

The Chamber is alarmed that the Department's approach to these jurisdictional limitations appears to one of be simple circumvention through sleight of hand. In particular, having abruptly decreed through the Proposal that long-standing industry practices as to IRA advisor compensation would become illegal in a convoluted and roundabout fashion (that is, through interpreting the prohibited transaction rules in the Code), the Department then purports to offer "relief" through BICE that would be conditioned upon forced liability exposure under state laws. We will not repeat our



earlier concerns about regulatory overreach – rather, our intention is to provide background as to specific objections regarding the Department’s approach.

Specifically, the contractual and warranty provisions of BICE make juries in all fifty states the Department’s *de facto* “policemen” to enforce a fiduciary-like conduct standard for IRAs—a standard for which the Department has no authority in the first place. This is not to impugn the state courts in any way, but merely to point out that advisors would become subject to new and untold theories of liability under State laws, separate and apart from the well-established and considered rules and conduct standards issued by regulators and Federal agencies having expertise and traditional involvement with the regulation of advisors, such as the SEC and FINRA. Advisors could be haled into any State court in which an IRA owner resides to respond to an individual or class action claim, irrespective of whether their conduct satisfied their obligations under SEC and FINRA rules.

While the Chamber is concerned that the Department’s course of action effectively would strip away much of the enforcement authority from the agencies most qualified to provide it, the problem is further exacerbated by the lack of objective guidelines in the exemption. While the Chamber understands the Department’s motivation in applying a principles-based approach, BICE represents a radical departure from the objective, common-sense framework observed with respect to all other class exemptions. At a high level, the principles-based approach of BICE simply does not work where a good faith effort to make a representation or warranty is inherently subjective and exposes the advisor and financial institution to a State-law based class action over its interpretation of the subjective requirement. Accordingly, the Department should either provide objective standards for compliance, or establish clear safe harbors for a range of conduct permitted under BICE.

For example, while BICE permits variable compensation related to the “neutral factor” of the amount of time involved in recommending one type of investment over another, this determination is inherently subjective. The financial institution and advisor could be exposed to a class action lawsuit disputing the amount of time they determined was an appropriate for the fee differential, absent a safe harbor in BICE.

This type of subjective consideration is simply unworkable in practical terms. And this is only one example – other highly subjective requirements under BICE, upon which State court interpretations could differ enormously (and regardless of SEC and FINRA standards), include the financial institution’s warranty as to its policies and procedures to mitigate conflicts of interest, and contractual representations that compensation will not exceed a “reasonable” level. If the market for financial assistance to small plans, participants and IRA holders is to be protected (as to both availability and reasonable cost), compliance with BICE needs to be predicated on objective factors, not guesswork.

- **The Limitations on Eligible Assets are Unnecessary Given the General Level Fee Requirement and Serve Only to Restrict Choices for IRA holders.**

BICE relief is not available for advice regarding asset classes and investments not listed under the definition of “asset,” or for discretionary advice. The Chamber believes that asset class limitations are inappropriate for several reasons.

To begin with, and for reasons previously stated, the Chamber does not believe it is within the Department’s proper scope of authority to actively exclude plans, participants and IRA holders from access to advice about certain investment products, while permitting access to others, based upon the Department’s own preferences. Due to the breadth of the proposal, BICE is likely the only avenue available for many transactions, and it should therefore offer adequate flexibility to permit plan participants and IRA owners to invest in whatever products they deem desirable for their own personal needs and goals. We recognize, of course, that many granted exemptions are limited to certain types of investment vehicles – for example, there are several exemptions available only to mutual funds, or to insurance products. But these exemptions are intended to address specific and narrow issues to ensure these products are available to plans and participants, not to prevent access to them. BICE’s limitations exclude entire asset classes and types of investment vehicles even where they are offered by unaffiliated third parties, and thus are in no way different than the investments on the “approved list.”

Given the structure of BICE, the advisor can have no incentive with regard to any particular asset class and thus there is no rationale for restricting investments in any asset classes otherwise open to plans and IRAs. And again, there is no legal basis or rationale for the Department to seek to limit the available investments in plans and IRAs beyond those permitted by law. In fact, the narrow application of the asset definition in BICE is exactly contrary to the Department's stated intentions in crafting the exemption. In the Preamble to BICE, the Department writes, "Rather than create a set of highly prescriptive transaction-specific exemptions...the proposed exemption would flexibly accommodate a wide range of current business practices...The Department has [taken] a standards-based approach..."<sup>39</sup> The asset definition, by contrast, applies rigidly with no flexibility—an asset is either on the list, or not.

This list-based approach also undermines the Department's consistent position of nearly 40 years that it rejected the old-fashioned trust law standard of "legal lists" to embrace modern portfolio theory. In adopting its regulations governing the prudent investment process, the Department wrote that it, "...does not consider it appropriate to include in the regulation any list of investments, classes of investments, or investment techniques...no such list could be complete; moreover, the Department does not intend to create or suggest a 'legal list' of investments for plan fiduciaries."<sup>40</sup> In effect, through the asset definition in BICE, the Department is substituting its own judgment—on a one-size-fits-all basis—for the professional, impartial, and individualized decisions of financial advisors.

Likewise, by excluding discretionary asset management altogether, the BICE agreement may make it impossible for rollovers to managed accounts to take place, where such rollovers are prohibited transactions despite being prudent and in the best interest of the participants and IRA owners. Thousands of investors prefer professionally managed accounts to non-discretionary advice arrangements, and the need to preserve their availability to select these services is of paramount importance.

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<sup>39</sup> 80 Fed. Reg. at 21,961

<sup>40</sup> 44 Fed. Reg. 31,639 (June 1, 1979).

We are frankly perplexed by the Department’s position on this issue—an advisor utilizing BICE could not discuss an asset not on the list no matter how much doing so might be in the best interest of his or her clients. Does the Department see the inherent contradiction in a rule that purports to prevent conflicts that could cause an advisor to act against your best interest while simultaneously prohibiting the advisor from acting in your best interest? For these reasons, we recommend that any final exemption should apply without regard to asset class limitations, and that reasonable exemptive relief for discretionary account management be included.

However, if the Department retains this narrow view of permissible assets, it must include on the list a number of important investments. In the Preamble to BICE, the Department indicates that it selected assets that are “commonly purchased”<sup>41</sup> by retirement plans and IRAs, and suggested the listed assets should contribute to a “basic diversified portfolio” with investments that are “relatively transparent and liquid,” though it did not require a “ready market price” for inclusion.<sup>42</sup> Among the assets types that should be considered for inclusion on this basis (this is not a complete list) are publicly registered, non-listed real estate investment trusts (“NL REITs”), publicly registered, non-listed business development companies (“NL BDCs”), other direct placement products and discretionary managed accounts. These currently hold billions in retirement assets, contribute to a diversified portfolio, and are relatively transparent and liquid.<sup>43</sup>

- **BICE Disclosures Are Too Expensive and Difficult to Achieve for Many Service Arrangements, and Likely Conflict with Securities Laws**

The prospective and retrospective disclosures in BICE require data to be collected, provided and manipulated in ways that, in a number of instances, simply will not be possible depending on the arrangements between plans and service

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<sup>41</sup> 80 Fed. Reg. 21,968

<sup>42</sup> Id.

<sup>43</sup> See, Comment letters from the Investment Program Association (“IPA”) and the PNL Council of the National Association of Real Estate Investment Trusts (“NAREIT”) for additional data and investment information about NL REITs and their role in IRAs.

providers. We are also concerned that the disclosures would require the projection of future investment performance to calculate future investment costs for fee-based advisors in ways that are not permitted under securities laws and regulations.

Specifically, while we do not intend to summarize all of the data collection, manipulation, disclosure and recordkeeping responsibilities that would be imposed under BICE, the astonishing and unprecedented scale of these disclosures will certainly result in massive information technology and compliance costs that will ultimately be passed through to plan participants and IRA owners. Whatever value may be provided through enhanced disclosures can be achieved through far less expensive means—rather than the most efficient approach, the Department here has proposed what may be the least efficient approach. Moreover, the Chamber is deeply concerned that this level of administrative complication and expense will invariably discriminate against smaller and “Main Street” advisors that simply cannot comply with the requirements as they do not control the data involved. The Chamber counts among its membership many advisors of all different sizes, and we support a level playing field. Further, these Main Street advisors serve many of our small business members’ plans, and increases in cost or reductions in services do not serve the interests of these plans and participants.

Demonstrating our concern that the Department has not sufficiently coordinated its efforts with the SEC and other regulations, we believe that the requirement to project future costs on the basis of reasonable return expectations likely conflicts with certain securities laws. The practice of projecting investment returns is not permitted in many other contexts precisely because it can be misleading and unreliable. Projecting investment returns, particularly over the long-term, is speculative, and lends itself to potential abuse. Further, the cost projections based upon the return projections, particularly those made ten years into the future, will likewise be speculative and inaccurate, calling into question what value they provide.

For all these reasons, instead of numerous, complex and expensive individualized disclosures, we recommend that the final exemption allow for more generalized disclosures regarding provider fees and costs, such as meaningful

information about the impact of fees on retirement accounts. For example, a sample illustration of the effect of fees over time would provide the same value for most participants and IRA owners as prospective disclosures without imposing inaccurate projection risks and significant costs ultimately borne by these participants and IRA owners. On balance, we do not believe that those participants and IRA owners who evaluate the fees and costs associated with their retirement accounts (who, of course, are the only individuals who will benefit from any disclosure) will derive materially more value from lengthy and complicated disclosure documents, website reports, etc. than they would from simple, example-based disclosures. It seems even more likely that they would not derive enough additional value to justify the costs of the proposed exemption.

- **BICE Unreasonably Restricts Limited Investment Menus and Proprietary Products**

While BICE recognizes that some IRA providers utilize exclusive arrangements with agents or employees to distribute only proprietary products and limited investment options, it may not be possible for some of these providers to safely make the findings necessary to permit these arrangements under the current terms of the proposed exemption. For example, if a bank offered only IRAs investing in CDs and Money Market accounts, BICE may effectively prevent that bank from offering rollovers at all if it needs relief from the prohibited transaction rules. The ambiguity is whether, despite its ability to adhere to BICE otherwise, and despite the IRA owner's desire to use the bank for the rollover, the sole fact that the bank only offers such a limited menu (while other institutions offer more choices) means that it could not conclude that its recommendations would satisfy the "best interest" and "sole interest" requirements. We do not believe this is a logical or sensible result, as presumably almost all institutions will have some such limitations to a greater or lesser degree.

The exemption should be clarified to ensure that, subject to the institution's obligations to disclose the nature of limitations on the range of products and/or services offered, the IRA owner could still select the institution, and the institution

would not lose its eligibility to rely on BICE where the remaining requirements can be satisfied, solely on the basis of limited and/or proprietary products.

- **Compensation Limitations and Benefits for Insurance Agent Statutory Employees**

Many of our member insurers have long employed agents who are statutory employees. Such employees typically earn health and other employee benefits based on certain minimum production thresholds. However, the broad compensation limits in BICE could arguably affect the employee benefits of statutory employees.

The Department must specifically amend BICE to permit statutory employees to receive employee benefits by excluding those benefits from the compensation limits. The employee benefits earned by statutory employees do not incent agents with respect to any particular transaction. Retirement benefits are unrealized until many years in the future, and the value of welfare benefits are uncertain, depending on unpredictable future events. These plan benefits are simply different in kind and should be treated as such.

One of the Department's fundamental responsibilities is to expand the availability of employee benefits to workers. We do not believe the Department intended to deprive these employees of their benefits, and we do not believe these common and long-standing employment relationships are the kind of conflicts the Department intended to address in the Proposal and in BICE.

### **Specific Comments Regarding the Proposed Amendment to PTE 84-24**

The Chamber is concerned that the Department's proposed amendment to PTE 84-24 will unnecessarily disrupt efforts to provide annuity products to IRA owners and plans. Though the Department seeks to distinguish individual variable annuities as securitized products to be made available under BICE from other annuity products made available under PTE 84-24, this separation makes no sense, given that all of these products provide guaranteed income. An IRA owner needs to be able to

compare guaranteed income options on an “apples to apples” basis, but the effect of the amendment to PTE 84-24 is the he or she will get different disclosures that are not readily comparable for what appear to him or her to be similar products. Rather than making advisors operate under two very different exemptive regimes with two very different compliance processes that will serve only to confuse individuals, the Department should allow all products to be provided under PTE 84-24.

- **The Amendments to PTE 84-24 Are Unwarranted and Will Unnecessarily Complicate the Provision of Annuity Products to the Detriment of Plans and IRA Owners**

PTCE 84-24 currently provides an exemption for certain prohibited transactions that occur when plans or IRAs purchase an annuity product. The exemption permits a company that is a party in interest to a plan or IRA to sell annuity products to those retirement plans, and for salespeople, brokers, and consultants that are parties in interest or fiduciaries with respect to plans or IRAs to receive a commission. The exemption requires disclosure to the plan or IRA of the relationship of the salesperson, broker, or consultant to the company, and the sales commission to be paid pursuant to the sale. The exemption also requires disclosure and a description of any charges, fees, discounts, penalties or adjustments which may be imposed under the annuity contract in connection with the purchase, holding, exchange, termination or sale of the contract. The exemption prohibits the company, salesperson, broker and consultant from holding certain fiduciary positions regarding the plan or IRA, such as being authorized in writing to have discretionary authority and control over plan or IRA assets. Prior to the execution of the sale of an annuity product, and after all the required disclosures have been made, a fiduciary independent of the company, salesperson, broker, or consultant must acknowledge in writing receipt of the disclosed information, and approve the transaction on behalf of the plan or IRA.



The exemption, and the predecessor exemption it expanded and replaced, has been in effect since 1977, and has been effectively utilized since then by sellers and purchasers of annuity products.<sup>44</sup> PTE 84-24 provides a significant amount of protection, information and disclosures to purchasers of annuity products, and is one of the most comprehensive and effectively utilized PTEs. The Chamber is not aware of any annuity customer complaints or concerns regarding the utilization and application of PTE 84-24, or of any inquiries or investigations into PTE 84-24 abuses. Despite this, the Department is proposing significant, unwarranted changes to PTE 84-24.

Specifically, the Chamber objects to the proposal to remove purchase of IRAs or variable annuities within IRAs from PTE 84-24, and to have these annuity sales covered exclusively under BICE. All annuities have been covered under PTE 84-24 since 1977. The changes brought about by the proposed amendment will create a significant amount of confusion and uncertainty in the annuity sales marketplace for plan sponsors, plan fiduciaries, IRA holders as well as salespeople, brokers and consultants who have always relied on one exemption to cover all annuity product sales.

The Chamber sees no rationale or justification for the Department to require that annuity products use two separate and distinct exemptions. Thus, the Chamber requests removal of Section I(b) of the exemption which states that PTE 84-24 should not apply to the purchase by an IRA of a variable annuity contract or another annuity contract that is a security under the securities law. There is no justification or rationale for treating annuity products differently, whether or not the annuity is deemed a security. For example, there are annuity products that contain both fixed and variable annuity features,<sup>45</sup> and it makes no sense for this product to have to rely on two separate exemptions with different conditions and requirements.

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<sup>44</sup> PTE 84-24 amended and superseded PTE 77-9, expanding its scope.

<sup>45</sup> See, IRS PLRs 201519001 and 201515001.

The Department is well aware of the importance of annuity products for the attainment of retirement security by plan participants and IRA holders, and the importance of annuity products offering a lifetime income option. Therefore, any proposal that could hinder annuity purchases and cause confusion by requiring annuity products to use different exemptions, with different requirements and conditions, is unwarranted.

The Department is also proposing to amend PTE 84-24 by adding Section II, the “Impartial Conduct Standard.” Again, it’s our position that PTE 84-24 has been utilized effectively since 1977 and has provided significant and sufficient protections to annuity product purchasers, and does not need to be changed. The “Impartial Conduct Standard” standard is, in essence, the ERISA prudent man standard. There is no reason to apply a slightly different formulation of the ERISA standard in PTE 84-24 because the fiduciaries to these plans must already comply with the ERISA prudence standard. Adding the Impartial Conduct Standard both confuses the applicable standard of care by using slightly different words and creates a prohibited transaction for a fiduciary breach. This is not what Congress intended—a fiduciary breach does not automatically trigger a prohibited transaction in most other ERISA contexts. We believe the approach best protective of the interests of annuity consumers is to remove the Impartial Conduct Standard in light of the ERISA fiduciary standard already applicable. Alternatively, we request that the Department explicitly and exclusively reference the prudent man standard in ERISA §404(a)(1)(B) in lieu of the alternative formulation.

- **The Department Should Clarify Certain Ambiguities in PTE 84-24**

The Chamber believes the new terms in the proposed amendment raise questions about how the exemption would apply in practice. For example, the proposal would replace the term “sales commission” with “Insurance Commission,” which is the sales commission paid by the insurer or an affiliate to the agent, broker or consultant for effecting the sale of an annuity contract, including renewal fees and

trailers, but not revenue sharing payments, administrative fees or marketing payments, or payments from parties other than the insurer and affiliates.

The current PTE 84-24 “sales commission” disclosure definition has been in effect since 1977, and was drafted to take into account common commission and compensation payment practices. The Chamber requests further guidance and clarification on the definition of “Insurance Commission”.

For example, some commissions are paid as overrides or gross dealer concessions to someone that oversees the agent working directly with the customer. These are often not referred to as “commissions” and are management payments for overseeing the purchase or sale of the annuity—are they addressed by the definition change? Further, as discussed above, some insurers have salespeople that are statutory law employees who receive employee benefits and other compensation separate from the “commission” received. The Chamber seeks clarification that these payment practices can continue and do not require disclosure as “insurance commissions.” Also regarding Insurance Commissions, PTE 84-24 permits the purchase with plan assets of an annuity contract from the insurer, even if the insurer is a party in interest to the plan. The Chamber seeks confirmation that 84-24 continues to cover the sale of the insurer’s proprietary products.

#### **Specific Comments Regarding the Proposed Amendment to PTE 77-4**

The Department’s proposed amendment of PTE 77-4 would, among other things, clarify that the exemption applies to non-discretionary advice. However, the proposed amendment did not adopt a provision modifying the affirmative consent requirement when fees in the recommended investments change. The Department has commonly waived this affirmative consent requirement in subsequent individual exemptions addressing fees and other matters in favor of “negative consent” where notice of a change is provided but the plan is deemed to have consented by not

responding to the notice.<sup>46</sup> We ask that the Department acknowledge this change made in individual exemptions, and use the opportunity to modify the class exemption accordingly. The affirmative consent requirement is unreasonable, and negative consent has been increasingly used by the Department in circumstances where affirmative consent is not practical.

**The Eight Month Implementation Period Is Unreasonable and Impossible—It Must Be Significantly Extended**

As the Department notes in the Proposal, making applicable the requirements of any final rule eight months after publication of a final rule would be challenging. It would not simply be challenging—the reality is that it would be impossible. In particular, the significant information technology systems changes that will be required to meet the many conditions – if modified in workable way – of BICE and other parts of any final rule would require significantly more than eight months. As the Department is well aware, modifying or implementing new IT systems is a long and tenuous process. Not only is there a bidding process, but once a contractor is identified, several other phases are required to seamlessly integrate the new requirements, including systems design, implementation, testing and finalization. The Department’s own implementation of the EFAST2 system required roughly three years for the existing system to be modified and fully functional to accept electronic filings. Therefore, given the magnitude of changes of the Proposal, we respectfully request that DOL extend the implementation timeframe for the entire rule, including all exemptions, to three years. Providing any less time, would force service providers to rush through implementation and risk failing to comply with new requirements.

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<sup>46</sup> *See, e.g.*, Signet Trust Company, 57 Fed. Reg. 29901 (July 7, 1992); Chicago Trust Company, 61 Fed. Reg. 51464 (Oct. 2, 1996); Wells Fargo Bank, N.A., 64 Fed. Reg. 16493 (Apr. 5, 1999); Massachusetts Mutual Insurance Company, 67 Fed. Reg. 39064 (June 6, 2002); and more than 15 others. *See also*, Advisory Opinion 97-16A.

**Conclusion**

As 90 days is not enough time to fully understand and address the ramifications of a regulatory package of this magnitude, we hope to work with the Department to determine how best to protect workers and retirees going forward. We ask that the record remain open for additional comments following the expiration of the formal comment period, and that the Department agrees to consider such additional comments as it receives.

For all of the reasons stated above, we are very concerned that the Proposal will not achieve the Department's goals of better protecting workers and retirees, but will instead make it harder for our members and their employees to access financial advice. Changes are essential if a final rule and any final exemptions are to be promulgated.

The Chamber would appreciate the opportunity to discuss these comments in more detail at the Department's convenience, and we thank you for the opportunity to comment on this very significant rulemaking.

Sincerely,



David Hirschmann  
President  
Center for Capital Markets  
Competitiveness



Randal Johnson  
Senior Vice President  
Labor Immigration and  
Employee Benefits



# Locked Out of Retirement

*The Threat to Small Business Retirement Savings*



**U.S. CHAMBER OF COMMERCE**



**U.S. CHAMBER OF COMMERCE**

The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

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# **Locked Out of Retirement:**

## The Threat to Small Business Retirement Savings

Bradford P. Campbell, Counsel  
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# Locked Out of Retirement

*The Threat to Small Business Retirement Savings*



U.S. CHAMBER OF COMMERCE

## SUMMARY

- Small business owners, through SEP and SIMPLE-type IRA plans, provide roughly \$472 billion in retirement savings for over 9 million U.S. households.
- Ninety-nine percent of U.S. employers are small businesses, and they produce 63% of new private-sector jobs. These small business owners and employees need retirement plans at work.
- The DOL is proposing broad new regulations that would impose significant new compliance costs and legal liabilities on advisors to SEP and SIMPLE IRAs, costs that will be passed on to these small business plans and employees.
- Many small businesses cannot offer 401(k) or similar “traditional” retirement plans because of administrative complexity, costs, or eligibility requirements, and instead offer simplified, basic retirement plans built around IRAs.
- SEP IRAs and SIMPLE IRAs are popular choices that are easy and inexpensive to set up and operate. Studies estimate that more than 9 million households own IRAs as a result of these small employer-provided retirement plans.



# Locked Out of Retirement

*The Threat to Small Business Retirement Savings*



U.S. CHAMBER OF COMMERCE

## Executive Summary

Stretching its current regulatory authority over employer-provided retirement plans, the U.S. Department of Labor (DOL) proposed in April a new regulatory package that would put DOL in charge of financial advice provided to all Individual Retirement Accounts (IRAs) as well as to all private-sector, employer-provided retirement plans. This regulatory expansion would change the rules governing how financial advice is provided to roughly \$15 trillion in retirement savings, putting DOL in charge. Unsurprisingly, this kind of sweeping change would result in a lot of unintended consequences.

The DOL is expanding the definition of fiduciary investment advice under a federal law known as the Employee Retirement Income Security Act (ERISA). The result would be that many traditional forms of compensation, such as commissions that vary from one investment to another, for financial advisors could become illegal under special provisions in that law called “prohibited transactions.” A number of aspects of the proposal appear unworkable in actual practice, and would negatively impact how advisors assist small businesses in providing retirement benefits for their employees. In particular, the change would impact two of the most popular retirement savings vehicles for small businesses: Simplified Employee Pension IRAs (SEP IRAs) and Savings Incentive Match Plan for Employees IRAs (SIMPLE IRAs).

The proposal would adopt a broad definition of fiduciary “investment advice” encompassing “sales” communications, certain educational materials, and other situations where no intention to provide individualized fiduciary advice traditionally has been expected. Under the DOL’s new proposal, even providing a small business with marketing materials containing sample investment lineups for SEP IRAs or SIMPLE IRAs could constitute investment advice, as could providing an individual account holder with certain educational materials that reference the specific investment funds that are available to him or her. Consequently, small businesses may find it even harder to offer retirement plans than they do today.

Small businesses make up 99% of all U.S. employers, and account for 63% of new private-sector jobs, as well as almost half of all private-sector employment and output.<sup>1</sup> Like their large employer counterparts, small business entrepreneurs and the millions of workers they employ need retirement savings opportunities. But unlike large employers, many small businesses may not be able to offer a 401(k) or similar “traditional” retirement plan due to cost, administrative complexity, or eligibility rules. Instead, many of these small businesses rely on simplified retirement plans to cover their owners and employees.

Two of the most attractive and popular retirement savings solutions used by small businesses are SEP IRAs and SIMPLE IRAs. SEP IRAs and SIMPLE IRAs are easy and inexpensive to set up, and do not impose ongoing administrative or reporting requirements on employers, allowing

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<sup>1</sup> See U.S. Small Business Administration, Office of Advocacy, “Frequently Asked Questions,” March 2014, available at [https://www.sba.gov/sites/default/files/FAQ\\_March\\_2014\\_0.pdf](https://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf).



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their focus to remain on growing their businesses. These special IRAs have been very successful in helping small business workers save for retirement—nearly 10% of all current IRAs come from SEP/SIMPLE-type plans.<sup>2</sup> As of the end of 2014, there were approximately \$472 billion of retirement savings in these types of IRA plans.<sup>3</sup> Another study of IRA data concluded that more than 9 million U.S. households owned employer-sponsored IRAs like SEP and SIMPLE IRAs.<sup>4</sup>

More complex regulations mean more hurdles and compliance costs, and a greater likelihood of lawsuits. Main Street advisors will have to review how they do business, and likely will decrease services, increase costs, or both. Small business SEP IRA and SIMPLE IRA arrangements that currently depend on these advisors for affordable assistance are likely to disproportionately bear the costs of excessive regulation—their small scale means they are more expensive to serve. The U.S. Chamber believes that DOL’s proposed regulations risk hurting the very small businesses and workers they are intended to protect.

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<sup>2</sup> “Individual Retirement Account Balances, Contributions, and Rollovers, 2013; With Longitudinal Results 2010–2013: The EBRI IRA Database,” Craig Copeland, EBRI Issue Brief #414, May 2015.

<sup>3</sup> See Investment Company Institute, “The U.S. Retirement Market, Fourth Quarter 2014,” March 2015, *available at* [www.ici.org/info/ret\\_14\\_q4\\_data.xls](http://www.ici.org/info/ret_14_q4_data.xls).

<sup>4</sup> See Investment Company Institute, “How Many Households Own IRAs,” based on year-end 2012 data, *available at* [http://www.ici.org/faqs/faq/faqs\\_iras](http://www.ici.org/faqs/faq/faqs_iras).



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## Introduction

This DOL regulatory expansion would change the rules governing how financial advice is provided to roughly \$15 trillion in retirement savings. Unsurprisingly, this kind of sweeping change would result in significant unintended consequences. One such unintended consequence is that small businesses may find it even harder to offer retirement plans than they do today, and some may stop offering employer-sponsored IRA plans to employees. SEP and SIMPLE IRAs are basic retirement plans that allow small businesses to offer retirement savings opportunities to their employees, and are set up with the help of financial professionals that they trust. DOL, however, thinks these Main Street financial advisors need a new set of complex rules and regulations to prevent potential conflicts of interest.

The DOL proposal would adopt a broad definition of fiduciary “investment advice” encompassing “sales” communications, certain educational materials, and other situations where no intention to provide individualized fiduciary advice traditionally has been expected. Under the DOL’s new proposal, even providing a small business with marketing materials containing sample investment lineups for SEP IRAs or SIMPLE IRAs could constitute investment advice, as could providing an individual account holder with certain educational materials that reference the specific investment funds that are available to him or her.

The proposed standards for defining what would or would not be fiduciary investment advice are highly subjective and would be difficult to observe in practice. Even well-meaning advisors who do not intend to provide specific, individualized investment advice may inadvertently “step in” to fiduciary status, triggering potential prohibited transactions and greater legal liability. To compensate for the significant liability they could face, these advisors, and the financial institutions they work for, would likely have to include an additional risk premium in the fees they charge to clients.

This expanded fiduciary definition can also make it hard for advisors to recommend SEP and SIMPLE IRA investments that use certain proprietary investment products. For example, an insurance agent advising a SEP or SIMPLE might not be able to discuss some of the investments offered by the insurance company for which the agent works, regardless of their performance or suitability for the individual.

In order to comply with the proposed regulatory package, many advisors and their related financial institutions would have to change how their products and services are structured, and how the retirement plans and IRA accounts are charged fees. If finalized in its current form, the proposed rule would very likely increase the costs associated with SEP IRAs and SIMPLE IRAs, and would make it more difficult for retirement savers to receive meaningful assistance, such as choosing appropriate asset allocations, within their accounts. Some Main Street advisors may choose to exit the SEP and SIMPLE IRA marketplace in light of the costs and risks of compliance with the new rule.



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## Benefits of SEP and SIMPLE IRAs

SEP and SIMPLE IRAs provide benefits for more than 9 million households because they are simpler for employers to offer than 401(k)s, but give employees more generous benefits than traditional IRAs not offered through employers. Though SEP and SIMPLE IRAs are built around IRAs, they are plans provided by the employer, and the tax laws permit more tax-preferred contributions than are allowed in a non-employer provided IRA, which limits contributions to \$5,500 in 2015 (\$6,500 for individuals 50 and older). SEP and SIMPLE IRAs are different from one another, however, and one may be better for a particular small business over another.

SEPs and SIMPLE IRAs are simplified plans presenting less administrative burden than 401(k) and other plans. For example, unlike many other plans, the assets and investments in SEP and SIMPLE IRAs are held within each participating employee's IRA account rather than in a common trust account. This reduces the record keeping at the plan level. Likewise, unlike other plans, there is no annual Form 5500 filing requirement for a SEP IRA or SIMPLE IRA, a significant cost savings in and of itself. Perhaps the most significant differences relate to investments. Under a traditional 401(k) or other defined contribution plan, the employer (or its plan committee, etc.) must evaluate, select, and monitor each of the core investment options offered to participants. There has been a significant uptick in lawsuits against 401(k) plan sponsors in recent years, often alleging excessive fees and expenses associated with selected investments.

For a SEP IRA or SIMPLE IRA, the investment funds offered are not individually selected by the employer—rather, they generally constitute a broad range of alternatives offered by the vendor through its IRA platform. The employer does not generally have involvement with monitoring the options or instructing the IRA vendor to add, replace, or discontinue the alternatives made available. Employers considering a SEP IRA or SIMPLE IRA that select the IRA vendor should review potential providers and make a prudent determination that the vendor selected offers a suitable product at a commercially reasonable price. Likewise, DOL guidance indicates that employers should periodically monitor the vendors (that is, the IRA trustees) to ensure they are doing their jobs and not charging unreasonable fees.<sup>5</sup> But, in comparison with a traditional qualified plan, the employer's fiduciary obligations as to a SEP IRA or SIMPLE IRA are very limited in scope. Not only does this limit the fiduciary liability of small business owners, but it also allows them to focus more of their time in managing and growing their business while increasing jobs.

Of course, the significant reductions in cost and administrative burdens also mean that SEP IRAs and SIMPLE IRAs are less flexible than traditional retirement plans. Employers have less ability to limit eligibility for participation, to vary contribution amounts for different employee groups,

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<sup>5</sup> See DOL, SEP Retirement Plan for Small Businesses, "Monitoring the Trustee," available at <http://www.dol.gov/ebsa/publications/SEPPlans.html>; and SIMPLE IRA Plans for Small Businesses, "Monitoring the Trustee," available at <http://www.dol.gov/ebsa/publications/simple.html>.



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and to offer certain other features than they would under a traditional qualified plan. However, this loss of flexibility is often a blessing in disguise for small businesses—with the flexibility of a traditional qualified plan comes complex nondiscrimination testing, numerous participant disclosures, government reporting, vendor oversight, and day-to-day administrative tasks.

## ***SEP IRAs***

SEP IRAs provide benefits similar to qualified profit sharing plans, in that contributions are funded by the employer. Contributions are limited to 25% of each eligible employee's compensation, and the same percentage must be applied for each eligible employee. Annual contributions are also capped at \$53,000 (for 2015) and cannot be based on compensation exceeding \$265,000 (also for 2015), which are the same limits that apply to qualified defined contribution plans. Employees are not allowed to contribute to a SEP IRA, but they benefit from the employer contributions, which are not taxed to the employee until the funds are withdrawn at retirement. As such, SEP IRAs are mostly utilized by sole practitioners or employers with a very small number of employees.

A SEP IRA can be established by executing Form 5305-SEP, issued by the Internal Revenue Service (IRS), or another prototype or individually designed plan document. All contributions are immediately 100% vested, and can generally be withdrawn or rolled over according to the same rules governing traditional IRAs.

Once a SEP IRA is established, the employer may, but is not required to, make contributions each year. Each eligible employee must be provided with certain information about the SEP IRA, and must have an IRA account established for his or her benefit. Eligible employees, subject to a few exceptions, generally include all employees who (i) receive \$600 or more in compensation during the year (for 2015), (ii) are at least 21 years of age, and (iii) have worked for the employer during three of the previous five years. The employer can always be more generous in terms of eligibility, but cannot exclude employees who meet these eligibility criteria.

## ***SIMPLE IRAs***

SIMPLE IRAs are an option for employers that do not maintain other retirement plans, and have 100 or fewer employees. If the business grows, a two-year grace period is allowed in most cases after the 100-employee threshold is exceeded to transition to a 401(k) plan or some other retirement plan. SIMPLE IRAs are more similar to 401(k)s—eligible employees can make elective deferral contributions from their own pay, subject to a \$12,500 annual limit (for 2015, plus up to \$3,000 in catch-up deferrals for employees aged 50 and over), and employers make either (i) a dollar-for-dollar matching contribution on elective deferrals up to 3%, or (ii) a flat (nonmatching) contribution for all eligible employees equal to 2% of compensation. Again, contributions cannot be based on compensation exceeding \$265,000.





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A SIMPLE IRA can be established by executing IRS Form 5304-SIMPLE or 5305-SIMPLE (depending on whether each employee can select his or her own IRA institution, or if there is a designated financial institution for the entire arrangement), or another prototype or individually designed plan document. Again, all contributions are immediately 100% vested, and can generally be withdrawn or rolled over according to the same rules governing traditional IRAs. Once a SIMPLE IRA is established, each eligible employee must be provided with certain information about the SIMPLE IRA, and must have an IRA account established for his or her benefit. Eligible employees, subject to a few exceptions, generally include all employees who are expected to earn at least \$5,000 in compensation during the year, and have earned \$5,000 or more during any previous two years. Again, the employer can always be more generous in terms of eligibility, but cannot exclude employees who meet these eligibility criteria.

## **Small Businesses Are Most Harmed by the DOL Proposal**

The DOL proposal expands the universe of financial advisors considered to be fiduciaries. The effect of being a fiduciary is that many traditional compensation arrangements, such as commissions that vary from investment to investment, utilized by advisors to SEP and SIMPLE IRAs would no longer be permitted. Unfortunately, the proposal puts small business retirement plans at a further disadvantage relative to large employer plans because they are not treated the same.

### ***Small Business Advisors Unfairly Excluded From the Seller's Carve Out***

The DOL proposal "carves out" large plan advisors from fiduciary status. If a plan has 100 or more participants, or \$100 million or more in plan assets, the advisor to that large plan does not have to be a fiduciary, while an advisor to a small plan does. Because an advisor to a small plan is not carved out of the rule, the advisor who is trying to market retirement saving vehicles to a small plan is considered to be providing investment advice and must determine how to comply

### **Realizing the Impact**

**Consider Kathleen's Wedding Kakes**, a hypothetical small business in Tucson, Arizona, that employs about eight people in its shop, bakery, and delivery service. Like most small business owners, the founder, Kathleen Carver, wanted to help her employees save for their retirements, but because her business was so small, she could not afford to offer a traditional 401(k).

Instead, she established SEP IRAs for each of her employees, and contributes matching funds each month. When these new rules go into effect, the cost of offering these plans could significantly increase. Her financial advisor says he may have to change his whole business model, and that he may not be able to afford to spend the time it takes to help her and her employees with their small account balances unless he charges higher, up-front fees. If this happens, Kathleen will have to reassess her ability to offer this important benefit to her employees.



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with the rule. This advisor must either now provide advice for a level fee or, if the advisor has variable compensation, he or she must comply with the many conditions of an applicable prohibited transaction exemption (an exemption that may still limit fee variation). Advisors to large plans are not burdened with these additional hurdles under the carve out. Due to these additional burdens, advisors to small plans are likely to incur additional costs, which will be passed on to the plan. Further, some advisors to small plans may determine that the small-scale of such plans means the expense and risk of changing business models and fee structures is not justified, and may no longer offer their services to small plans.

It does not make sense that small business plans should have to absorb costs that large plans do not simply because of regulatory fiat. While DOL may intend this as “extra protection” for small plans, it really represents “extra cost.” SEP IRAs and SIMPLE IRAs are popular among small businesses because they are cheaper and easier to offer and operate than 401(k) plans; therefore, imposing additional costs would make SEP and SIMPLE IRAs less attractive to small business owners, making it harder to offer plans to their employees.

## ***The Proposal Will Increase the Cost of Providing Services to Small Businesses***

Because advisors to small businesses are not carved out of the fiduciary definition, they must change their fee arrangements, or qualify for a special rule called an “exemption” in order to provide services on the same terms as before. However, the new exemption proposed by the DOL may not apply to small business plans. It does apply to individual owners of IRAs, but it is not clear whether this exemption is available for SEP and SIMPLE IRAs while they are being offered by the employer. Further, even if it does apply, the new exemption—called the “Best Interest Contract Exemption”—would itself substantially increase costs for advisors due to its many conditions and requirements.

The reason the DOL regulatory package causes such significant change is that a fiduciary investment advisor under ERISA generally has engaged in a prohibited transaction if the advisor recommends investments that either pay the advisor a different amount than other investments, or that are offered by affiliates (for example, the advisor is connected with the insurance company that offers the investment). There are certain exceptions to these rules, called “prohibited transaction exemptions,” but as the DOL has proposed the new rules, the exemptions generally won’t help Main Street financial advisors who are working with small businesses to set up plans. Therefore, it may be illegal for those advisors to get commissions or to recommend certain investments.

For example, it may not be possible for a bank official to recommend that an IRA invest in the bank’s own certificates of deposit under some circumstances. Or if a financial institution provided SEP IRA or SIMPLE IRA marketing materials to a prospective small business client, and those materials described a sample allocation that included some of the institution’s own investment products, the marketing materials could be viewed as prohibited advice.





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One way advisors might try to comply is by charging a flat fee for their SEP or SIMPLE IRA services. However, many IRA vendors prefer not to charge a direct fee to account holders, and many account holders prefer not to pay flat fees, especially in small accounts where a flat fee may be a significant portion of the assets. Logically, a vendor must generate a certain amount of revenue from servicing a SEP IRA or SIMPLE IRA account to generate some profit from it, or it will not provide the service. If advisors and vendors change to a flat fee model, they may actually charge more than before to account for the risk and expense associated with changing their method of doing business. This potential loss of low-cost investment assistance was one of the reasons why the DOL's previous proposal to redefine fiduciary investment advice several years ago—a proposal that was ultimately withdrawn—raised objections from many within Congress.<sup>6</sup> It is important to note, however, that some advisors may already be compensated in a manner consistent with the proposed DOL requirements, though this is less common in IRAs and small 401(k) plans.

## How to Make a Difference

The public comment period for this proposal is open until July 20, 2015. After the comment period, there will also be public hearings at DOL. After all of the comments and hearings are concluded, DOL will have to review the comments and take them into account in writing a final rule. In all likelihood, this process will not be complete until sometime in 2016, and DOL proposed an eight-month transition period before the final rule would take effect.

To be most effective, the DOL proposal needs to strike a proper balance between protecting the interests of retirement investors and ensuring they have access to reasonably priced investment services. To accomplish this, advisors and financial institutions need to be provided with practical and clearly defined boundaries as to what is or is not fiduciary investment advice, as well as with commercially realistic and reliable standards.

Under the current proposal, Main Street advisors are very concerned that there may be no reasonable avenue to communicate meaningfully with individual and small plan investors (including SEP IRAs and SIMPLE IRAs) about matters related to investments without incurring potentially significant new costs and legal risks.

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<sup>6</sup> See, e.g. Letter from members of the Congressional Black Caucus serving on the House Financial Services Committee to then-Acting Labor Secretary Seth Harris dated March 15, 2013, warning that the “if the re-proposal reflects the Department’s initial fiduciary proposal it could disparately impact retirement savers and investment representatives in the African American community... We are particularly concerned about the effects these regulations will have on savers in [IRAs]. If brokers who serve these accounts are subject to ERISA’s strict prohibitions on third-party compensation, they may choose to exit the market...[i]f that occurs, it could cause IRA services to be unattainable by many retirement savers in the African American community.”



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# USING PTEs TO DEFINE A FIDUCIARY UNDER ERISA

**Threading the Needle with a Piece of Rope**



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## Using PTEs to Define a Fiduciary Under ERISA: Threading the Needle with Rope

### Summary

The Department of Labor (DOL) has indicated that it intends to address concerns with its proposal to broaden the definition of fiduciary “investment advice” by utilizing prohibited transaction exemptions (PTEs) to carve back the rule so that it is appropriate in scope. However, the history of the use of the exemptive process to narrow overly broad rules demonstrates the many problems of using PTEs in this context.

The goal in this regulatory initiative should be to enhance the ability of individuals to adequately save for retirement. We are very concerned that the DOL—in the name of investor protection—is actually taking an approach that will harm the very people it is trying to protect. By definition, a regulatory regime that prohibits every transaction unless it is specifically allowed through a PTE may unnecessarily eliminate choices and make it difficult to find new ways to better serve investors. Despite best efforts by the DOL, we remain concerned that no matter how well-crafted the PTEs are, they will prove to be insufficiently narrow and inflexible to accommodate the many beneficial ways that financial professionals serve the needs of investors today and in the future.

Unfortunately, the prohibited transaction regime has proven to be (1) lengthy and protracted; (2) burdened with conditions, limitations, and requirements; and (3) generally ineffective in addressing the needs of the employee benefits community. By utilizing a series of PTEs to narrow an overly broad regulation, the DOL is looking backwards rather than forward and unintentionally creating barriers to finding better ways to improve the system and protect investors. This paper provides several examples where the exemptive process has failed to appropriately limit expansive rules. As such, to the extent the DOL can demonstrate that changes are necessary, it should explore a narrowly-tailored approach that balances the need for protection of plan participants and also affords them the education and investment choices they need for a secure retirement.

### Background

In 2010, the DOL issued a proposed regulation on the definition of the term fiduciary under the Employee Retirement Income Security Act of 1974 (ERISA). According to the DOL, the intent of the proposed rule was to define more broadly the circumstances under which a person or entity is considered to be a fiduciary when giving investment advice to an employee benefit plan or a plan’s participants. Under ERISA, an investment adviser is a fiduciary if he or she provides investment advice for a fee. Under current DOL regulations, which interpret the statutory provision, there is a five-part test for determining whether fiduciary status exists by reason of

providing investment advice. Under the five part test, a person is deemed to provide investment advice if he or she:

- (1) renders advice on the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property,
- (2) on a regular basis,
- (3) pursuant to a mutual agreement, arrangement or understanding between the person and the plan or a plan fiduciary that,
- (4) this advice will serve as a primary basis for investment decisions with respect to plan assets, and that
- (5) this advice will be individualized based on the particular needs of the plan.

To be deemed a fiduciary by reason of providing investment advice, a person must meet each part of this test. In the proposed regulation, the DOL did away with the five-part test and instead based fiduciary status on whether the information provided by a person would reasonably be considered in making an investment decision.

The DOL's 2010 proposal was broadly criticized from many quarters, including from both Democrats and Republicans in Congress, as well as from various stakeholders that warned against its impact upon the ability of low and moderate income Americans to save for retirement. Specifically, commentators pointed out concerns about the rule's effect on individual retirement accounts (IRAs) and the ability of plan participants to receive valuable investment advice. Additionally, the proposal failed to include prohibited transaction exemptions that the DOL said would address some of the concerns raised by commenters.

Due to these significant concerns, in September 2011, the DOL withdrew its proposal and announced that it would re-propose the rule at a later date. The DOL has also indicated that it intends to propose certain PTEs in connection with the re-proposal of the regulation. While there may be merit in revisiting the definition of fiduciary under ERISA given the evolution in the retirement savings market over the last four decades, the U.S. Chamber of Commerce believes that any expansion of the definition of investment advice must be carefully crafted to ensure that it reaches only conduct that warrants imposition of ERISA fiduciary status and, more significantly, the sanctions of ERISA's prohibited transaction rules.

### **The PTE Problem**

The DOL intends to address concerns with its proposal to broaden the definition of fiduciary "investment advice" by utilizing PTEs to carve back the rule so that it is appropriate in scope. In some ways, this reflects the approach originally taken by Congress to the prohibited transaction

rules when it enacted ERISA in 1974. Congress was fully aware that the prohibited transaction rules in ERISA Section 406 and Code Section 4975 were significantly overbroad and, while it included in the statute a handful of specific statutory exemptions, it granted broad authority to the DOL to grant administrative exemptions where appropriate.

Forty years of history has demonstrated that Congress' expectations about the ability of the administrative exemption process to remedy an overly broad prohibited transaction regime were seriously misguided. The prohibited transaction regime as administered by the DOL has proven to be (1) lengthy and protracted; (2) burdened with conditions, limitations, and requirements; and (3) generally ineffective in addressing the needs of the employee benefits community.

While the DOL's commitment to issue proposed class exemptions along with the proposed investment advice regulation ostensibly eliminates the "slow and unresponsive" issue, the likelihood that those exemptions will effectively address the concerns raised by an overly broad rule are remote. More importantly, even if the class exemptions effectively address concerns today, the market for financial products and services is continually evolving. Exemptive relief that is sufficient today may well become obsolete, constraining innovation in the marketplace.

This document outlines several concrete examples from among many to demonstrate the difficulties of using PTEs to solve the problems with an overly broad application of the fiduciary standard under ERISA.

### *The PTE process is lengthy and protracted*

The single most telling fact about the way in which the prohibited transaction program is administered is to consider how infrequently the DOL grants exemptive relief, particularly in recent years. In the program's 40 year history, only 55 class PTEs have been created and currently remain in effect. Of those 55 PTEs:

- Thirty-nine were granted during the 20 years following enactment of ERISA—less than two per year.
- Sixteen were granted in the last 20 years—less than one per year.
- Two were granted in the last decade, with the most recent class exemption granted in 2006. That exemption was an amendment and restatement of two prior class exemptions dealing with securities lending.<sup>1</sup>
- The most recent class exemption activity was to *withdraw* a PTE that had been proposed by the DOL under the prior administration.<sup>2</sup>

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<sup>1</sup> PTE 2006-16 (an amendment and restatement of PTE 81-6 and PTE 82-63)





This dearth of class exemptive relief is paralleled in the granting of individual exemptive relief. In 2014, the DOL granted 11 individual exemptions and 6 exemptions under its EXPRO<sup>3</sup> procedure, which permits expedited consideration of transactions substantially similar to other exemptions for which individual exemptions have already been granted. This is down from a combined peak of 51 in 2009.<sup>4</sup> The process can take upward of two years and involves significant legal costs. There is no way to determine the number of exemption requests actually filed, or the number of requests that were never submitted because of the DOL's unwillingness to indicate whether the relief would be granted if requested. But the extremely limited use of the exemption process indicates how unworkable it would be in addressing the needs of the retirement community.

The failure of exemptive relief to remedy an overly broad rule was demonstrated with the statutory provisions in ERISA Section 406(a) dealing with party-in-interest transactions. These are highly technical rules that are overly broad and prohibit many otherwise desirable transactions for plans.<sup>5</sup> The DOL did not issue any exemption broadly addressing this over-breadth problem until 1984 (10 years after ERISA was enacted) when the qualified professional asset manager (QPAM) exemption<sup>6</sup> was issued. Even then, the over-breadth problem was not fully addressed because the availability of the QPAM exemption was limited to three classes of regulated entities (banks, insurance companies, and registered investment advisors) and was subject to a number of additional conditions and limitations. Twelve years later, in 1996, the DOL expanded the scope of generic 406(a) relief slightly when it issued the in-house asset manager (INHAM) exemption,<sup>7</sup> which provided comparably broad 406(a) relief with respect to a small number of large plans whose assets were managed by in-house registered investment advisors.

These exemptions still left a material number of situations where exemptive relief for nonabusive 406(a) transactions was still not available. Concerns over this issue were not addressed until 2006 (32 years after ERISA was enacted) when Congress, frustrated by the fact that its initial intent had not been fulfilled, enacted a statutory exemption<sup>8</sup> designed to provide broad generic exemptive relief from nonabusive Section 406(a) prohibited transactions.

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<sup>2</sup> 74 Fed. Reg. 60,156 (November 20, 2009)

<sup>3</sup> PTE 1996-62. The mere fact that the EXPRO procedure was needed is evidence of the unwillingness of the DOL to use the class exemption process to address routine transactions where exemptive relief is appropriate.

<sup>4</sup> See Sutherland, Asbill & Brennan LLP, *Legal Alert: 2015 in Review: ERISA Individual Prohibited Transaction Exemptions and Advisory Opinions* (January 8, 2015) at <http://www.sutherland.com/NewsCommentary/Legal-Alerts/169426/Legal-Alert-2014-in-Review-ERISA-Individual-Prohibited-Transaction-Exemptions-and-Advisory-Opinions>

<sup>5</sup> ERISA Section 406(a) broadly prohibits many ordinary transactions that do not necessarily involve plan fiduciaries and that are essential and beneficial for the functioning of a plan, such as providing services to the plan, leasing property to the plan, or engaging in many common investment transactions for the plan.

<sup>6</sup> PTE 1984-14

<sup>7</sup> PTE 1996-23

<sup>8</sup> ERISA Section 408(b)(17)

Because of the inability to address the over-breadth of Section 406(a) of ERISA through the use of PTEs, it is undoubtedly the case that plans were either precluded from engaging in otherwise beneficial transactions or forced to engage a QPAM or an INHAM, when they otherwise would not have done so.

Another example of the impracticality of relying on PTEs relates to foreign exchange transactions. Until the mid-1980s, no one focused on the fact that foreign exchange (FX) transactions are principal transactions that, when entered into with a counterparty that is a party-in-interest (as would typically be the case), give rise to a Section 406(a) prohibited transaction, absent an exemption. There was no exemption available at the time; nevertheless, it is clear that billions of dollars of FX transactions were entered into during this period without an exemption.

Once the issue was brought to the DOL's attention in the mid-1980s, it considered the issue for years until it eventually granted a class exemption<sup>9</sup> in 1994, nearly 20 years after the issue first arose and approximately 10 years after the issue was first raised with the DOL. As a result, for nearly two decades many FX transactions engaged in by ERISA plans constituted nonexempt prohibited transactions. When the exemption was ultimately issued in 1994, the DOL recognized the potentially disastrous consequences of its failure to address this issue sooner and granted broad retroactive relief for virtually all nonabusive FX transactions occurring prior to the issuance of the exemption.<sup>10</sup>

The DOL has said that it intends to issue proposed PTEs in connection with its proposed investment advice regulation. The proposed regulation and exemptions have already taken many years to develop, with numerous delays along the way. Only when the DOL finally releases its proposal will the regulated community be in a position to consider and analyze the regulation and any PTEs and the balance of complex policy choices they represent. They will be the subject of intense and widespread comment and debate. If the 40 year history of the exemption process is any guide, there is no reason to think that the DOL will ultimately be able to resolve these policy choices through PTEs expeditiously.

### ***Exemptions granted by the DOL are burdened by conditions, limitations, and requirements***

The DOL typically imposes numerous conditions, limitations, and requirements on the availability of its exemptions. At a minimum, these conditions, limitations, and requirements (1) often create a significant amount of confusion and misunderstanding;<sup>11</sup> (2) impose significant administrative burdens and costs on the parties attempting to utilize the exemptions (3) fail to anticipate future developments and, as a result, become obsolete over time; and (4) represent a trap for the unwary in that a failure to comply completely with the relevant conditions,

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<sup>9</sup> PTE 94-20

<sup>10</sup> *Id*

<sup>11</sup> In this regard, the DOL is loath to provide interpretive guidance regarding the many ambiguities to be found in its exemptions and certainly does not do so in an expeditious manner.





limitations, and requirements results in loss of the exemption, thereby creating a nonexempt prohibited transaction with all of the negative consequences that flow therefrom.

For example, the FX exemption referred to here, and a companion exemption issued in 1998<sup>12</sup> addressing standing instructions with respect to FX, both contain a number of requirements and limitations that make them inadequate in scope as well as difficult to use. This deficiency ultimately led Congress, when it considered these prohibited transaction issues in 2006, to enact a statutory exemption<sup>13</sup> that was intended to be more comprehensive and less complicated and thereby to address the deficiency of the class exemptions that had been issued by the DOL.

As time has passed, the DOL's class exemptions have become even more complicated, incorporating more and more restrictions and conditions. For example, the most recent class exemption dealing with securities lending<sup>14</sup> contains many conditions, limitations, and other special rules, some of which apply to all securities loans and others which apply only to loans to certain eligible non-U.S. borrowers. As a practical matter, for parties to securities lending transactions involving ERISA plans to engage in such transactions, it is necessary for both the lending fiduciary and the borrower to work with their respective ERISA counsel to ensure that the securities loans in which they engage will satisfy all these conditions, restrictions, and other special rules. Compliance with such complicated exemptions creates significant administrative burdens for both the plan fiduciaries and their counterparties. It also increases costs, which increases ultimately will be passed on to the plans in the form of higher fees.

In connection with its legislative effort to break the logjam that had arisen over the 30 years following ERISA's effective date by enacting a number of statutory exemptions as part of the Pension Protection Act of 2006, Congress also attempted to provide relief from the prohibited transaction rules in the context of the provision of investment advice to plan participants.<sup>15</sup> However, the DOL has subsequently issued regulations relating to this provision that are complicated, difficult to work with, and inconsistent with how most organizations desire to operate in this context. As a result, the issuance of the DOL regulations relating to this statutory exemption has not facilitated the use of the exemption, rather it has limited its use to a degree that is inconsistent with the legislative intent to promote the delivery of investment advice to participants.

Another example of the excessive conditions and complexity in class exemptions is demonstrated by the class exemption for transactions in REIT shares involving plans sponsored by the REIT.<sup>16</sup> Because many REITs are organized as trusts rather than as corporations, it is unclear whether their shares are "qualifying employer securities," which they must be in order to

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<sup>12</sup> PTE 98-54

<sup>13</sup> ERISA section 408(b)(18)

<sup>14</sup> PTE 2006-16

<sup>15</sup> ERISA section 408(b)(14).

<sup>16</sup> PTE 2004-07

be eligible for the general statutory exemption relating to transactions in employer securities.<sup>17</sup> Even though the statutory exemption and the administrative PTE address virtually identical situations and risks, the PTE incorporates numerous conditions and restrictions into the administrative exemption over and above the conditions and restrictions that Congress thought were appropriate in the more general context addressed by Section 408(e).

The exemption process has also resulted in gaps and inconsistencies in scope and application of exemptions to similar transactions. For example, the QPAM exemption referred to earlier provides very broad relief from ERISA Section 406(a) if its relatively generic conditions are satisfied. It generally applies to all types of transactions that a plan may engage in with a “remote” party-in-interest (i.e., a party-in-interest that is neither related to the QPAM nor affiliated with the fiduciary who appointed the QPAM).

However, the exemption specifically excludes from relief securities lending transactions. This exclusion appears to have been based solely on the fact that the DOL had previously issued a substantive exemption with a host of specific, substantive conditions, designed to address securities lending transactions. There was no apparent policy reason for singling out securities lending and imposing numerous specific, substantive conditions and requirements on securities lending compared with other types of transactions.<sup>18</sup> Rather, the dichotomy of treatment seems to have been driven solely by the fact that the DOL just happened to have addressed securities lending prior to issuing the QPAM exemption. Thus, this dichotomy demonstrates the difficulty of using the PTE process to narrow an overly broad rule in a consistent and effective manner.

### ***The exemptive process is generally ineffective in addressing the needs of the employee benefits community***

Another problem with the exemptive process is that the DOL does not have the experience or the expertise to recognize all the business realities of the context in which it is granting exemptive relief. As such, the exemptive process requires significant input and discussion with the business community or it risks the issuance of unworkable exemptions. A good example of this is the exemption that allows for investments in affiliated mutual funds if certain conditions are satisfied.<sup>19</sup>

This exemption includes one condition that completely fails to recognize the practical realities of the context in which the exemption will often be utilized. In particular, one of the conditions requires that, if any of the fees that must be approved affirmatively in writing by an independent fiduciary before any plan investments can be made in the affiliated mutual fund are subsequently modified, then a new affirmative written authorization must be obtained from the independent

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<sup>17</sup> ERISA section 408(e)

<sup>18</sup> Securities lending is not inherently more risky or subject to abuse than other transactions (e.g., derivatives) as to which the QPAM exemption is available.

<sup>19</sup> TEC- 77-4



fiduciary. This requirement, when considered from the perspective of an isolated single plan, seems reasonable enough. However, many of the financial services firms that employ the exemption have in many cases thousands (particularly when IRAs and Keogh plans are taken into account) of plan clients whose fiduciaries provide the initial written authorization to invest in their affiliated mutual funds. To require these financial services companies to go back to the independent fiduciary of each one of these plans every time there is any modification<sup>20</sup> of the previously authorized fees to obtain affirmative written reauthorization is extraordinarily burdensome (indeed, completely, unrealistic). Even the DOL has recognized the difficulty created by this requirement by issuing a number of individual exemptions allowing utilization of a “notice and deemed consent” approach for subsequent fee increases over the past 20 years.

In addition, the DOL exemptions are issued at a single point in time based largely upon a fact record presented to the DOL. As a result, they are frequently drafted in a way that, even if they address the existing fact situation adequately, fail to anticipate future developments, and as a result, become obsolete and/or unworkable as time goes on.

As previously mentioned, the DOL issued its initial securities lending exemption in 1981 authorizing plans to lend securities to U.S. banks and U.S. broker-dealers and to take cash and U.S. Government Securities as collateral. At that time, securities lending by ERISA plans was in its infancy and was largely limited to transactions involving regulated U.S. borrowers and the provision of cash and U.S. government securities as collateral.

However, market practice evolved significantly. Increasingly, foreign borrowers became involved and alternative forms of collateral were used. Because their securities lending transactions were subject to the straightjacket imposed by the conditions and limitations set forth in the exemption, ERISA plans were not able to take advantage of these evolving circumstances. It was not until 25 years later, in 2006, that the DOL addressed this deficiency by issuing revised exemptive relief, which expanded the range of permissible borrowers to include certain eligible foreign banks and foreign broker-dealers and permitted alternative forms of collateral to be utilized albeit, as noted, subject to a host of new and complicated conditions.<sup>21</sup>

The DOL has issued exemptions that are under-inclusive in that they are drafted address the more extreme contexts of the type of transaction that is intended to be covered by PTE. Therefore they fail to address contexts that are actually less subject to any potential for abuse. For example, Section 406(b)(1) of ERISA would typically preclude an investment manager of ERISA plan assets from utilizing its affiliated broker-dealer to perform agency trading services and receive commissions with respect to the plan assets it is managing.

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<sup>20</sup> The DOL has provided subsequent guidance to the effect that this requirement only applies to fee modifications that result in an increase in fees. This interpretation provides some relief but does not eliminate the problem.

<sup>21</sup> PTE 2006-16



In 1986, the DOL issued an exemption that allows an investment manager to utilize an affiliated broker-dealer, subject to the satisfaction of a number of complex conditions.<sup>22</sup> However, to utilize this exemption, the broker-dealer must be affiliated with the investment manager as that term is defined in the exemption. While this definition picks up situations involving the most significant potential for self-dealing concerns, it fails to pick up more attenuated situations where the investment manager is not “affiliated” with the broker-dealer, but nevertheless may have an interest in the broker-dealer that is sufficient to create a self-dealing concern. For example, the investment manager may own 25% or 30% of the broker-dealer entity but, given all the relevant facts and circumstances, the broker-dealer may not be affiliated with the investment manager within the meaning of the exemption. Hence, this context is left without an exemption due to the particular wording utilized by the DOL in issuing the exemption. The DOL has long been aware of this deficiency and has issued several individual exemptions to address specific cases but has never proactively addressed the problem on a class basis. The result is an inconsistent regime that treats similar situations differently.

Finally, it should be noted that, in the majority of contexts and based on a majority of the relevant court decisions, the availability of an exemption to provide relief from a claim of prohibited transaction is considered to be an affirmative defense and, as a result, cannot be utilized by a defendant at the motion to dismiss stage. As a practical matter, this means that parties who enter into transactions involving ERISA plans in reliance on exemptions are potentially exposed to the threat of meritless claims that cannot be avoided at the motion to dismiss stage but that are likely to proceed through later stages of litigation (including discovery) at significant cost and administrative burden to such parties. Again, over the long term, these additional costs and administrative burdens will ultimately be passed on to, and borne by, the ERISA plan—participants who are intended to be protected by all of these rules. Alternatively, they may result in service providers deciding not to offer beneficial services or products to ERISA plans.

### Conclusion

When dealing with exemptions from the prohibited transaction rules of ERISA (and the Code), the DOL has historically provided incomplete relief and created complexity, administrative burdens and incremental costs that are unwarranted and excessive. Consequently, the DOL exemptions are an extremely poor means to cure an overly broad definition of fiduciary investment advice. To the extent that the DOL believes the current definition of fiduciary investment advice is deficient, the DOL should explore a narrowly tailored approach for addressing such deficiencies that balances the need for protection of plan participants and also affords them the education and investment choices they need for a secure retirement.

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<sup>22</sup> PTE 86-128



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