EXECUTIVE SUMMARY

By U.S. Mail and Email: e-ORI@dol.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule, Room N-5655
U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

Re: RIN 1210-AB32

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to provide comments regarding the Department of Labor's ("Department") proposed regulation under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") that would redefine the term "fiduciary" under section 3(21) of ERISA and section 4975(e) of the Internal Revenue Code of 1986, as amended (the "Code"). SIFMA appreciates the opportunity to comment and hopes that our comments are helpful to the Department as it assesses the dramatic impact of the proposal on the millions of American investors benefitting today through participation in retirement plans, Individual Retirement Accounts ("IRAs") and other retail accounts.[2] We respectfully request an opportunity to testify at the Department's August 10-13, 2015 hearing.

Our comments reflect SIFMA's deep concerns that the Department has proposed a rule that would harm American investors, while completely re-casting the ERISA definition of who is a fiduciary when providing investment advice for a fee. The Department has greatly expanded the scope of service providers subject to the fiduciary requirements of ERISA and the Code, and the significant prohibited transactions that come with such status under ERISA and the Code, while creating very limited, inflexible, and prescriptive exceptions and exemptions that do not work and will not be in the best interest of American retirement investors. The net effect is that this proposal, if enacted, would limit the ability of Americans to continue to receive personalized

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] The rule covers all employer sponsored retirement plans, all employer sponsored welfare plans, IRAs, Individual Retirement Annuities, Coverdell Education Savings Accounts, Archer MSAs and Health Savings Accounts.

investment guidance for retirement plan accounts, which would result in a less secure retirement for many Americans already seeking to save and invest for their financial futures.

Much of the discussion around the Department's recently proposed retirement regulation focuses on the question of a "best interest standard" for financial advisors providing guidance to IRA holders and employees who participate in 401(k) plans. SIFMA and the broader financial services industry have long advocated for such a best interest standard when providing personalized investment advice. However, the Department has added hundreds of pages of extraneous conditions, restrictions, and prescriptions on top of its proposed best interest standard. The clear consequence of the Department's heavy hand with its proposed regulation is the explicit and implicit limitation on the types of investments individuals may choose to utilize with their retirement funds, as well as how they choose to pay for the service they seek.

Expanded Definition under Section 3(21) of ERISA

The Department seeks to turn sales pitches and cold calls into fiduciary conversations. The proposal so narrows "financial education" that only those already educated will understand what they are being told under the Department's new regime. The proposed education exception is expanded to cover IRAs; however, it does not allow for the naming of individual investment options. The provider would only be able to provide guidance that includes broad asset classes. Giving asset classes without allowing examples will not help participants. The Department's proposal would morph all of these educational and common sense conversations that are intended to help people prepare for retirement into "fiduciary" conversations, subject to a whole new restrictive, burdensome and liability-filled regime.

Further, the Department has proposed to expand the definition of providing investment advice so broadly that conversations that are merely designed to sell or pitch one's services would fall within its scope. Therefore, the Department wants to capture in its regulatory "fiduciary" web situations where a provider is merely speaking about the benefits of its services to an individual or small business owner to help them, and their employees, save for retirement.

The Department's proposal would also pull in all distribution and "rollover" conversations. These are conversations that a provider has with an individual about moving their assets out of their old employer's plan and into an IRA, which might help that individual keep better track of the funds, and take a more active role in managing their funds. SIFMA does not believe distribution recommendations are fiduciary advice. We do not believe that it is in the best interest of plan participants to discourage all conversations regarding distributions. By discouraging these conversations, leakage (dropping) out of the retirement system becomes far more likely.

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Narrowed Exceptions

The proposal has many exceptions that were drafted too narrowly. In particular, the education exception and the seller's exception are both too narrowly drawn. The proposed seller's exception only applies to large institutional clients. Small plans and all retail investors are left out. It should apply to IRAs and small plans as well. It is simply not reasonable, and is entirely inconsistent with the views of primary securities regulators, that the Department can not offer an amount or type of disclosure that would be found sufficient to alert a listener to the fact that a conversation involves selling. There simply is no legal difference when one is selling in the retail context versus a large plan context.

Another major failing of this carve-out is that it does not currently cover services, such as brokerage services, futures execution and clearing services, prime brokerage services, custody services, and other appropriate and necessary services provided to plans. There is no reason for the Department to have such a limitation.

Unworkable Exemptions

In addition, SIFMA has filed today several comment letters on the Department's exemptive proposals that are part of this package, but it should be clear from the outset that virtually all of the exemption amendments, as well as the new exemptions, are not administrable, as required under ERISA, nor do they meet the requirements that govern the Department's exemption granting authority under ERISA and the Code. The Best Interest Contract Exemption raises significant and insurmountable obstacles for broker-dealers, along with disclosure requirements that will not only overwhelm the customer with more information than they can possibly digest, but also impedes customer transactions and create losses for certain retirement accounts.

In addition, many of the requirements of the exemptions are so broad, subjective, and ambiguous in certain areas that it would be impossible to build systems and processes to ensure compliance. Compliance with the terms and conditions of any, or all, of these exemptions, would impose significant additional costs and liability on brokers-dealers which could likely cause them to change their business models in an effort to avoid unnecessary risk and punitive excise taxes that the Department is seeking to broadly expand. This change would lead to decreased access to one-on-one financial guidance for smaller retirement accounts, as well as potentially increased costs.

We believe the Department's proposal, if enacted, would result in fewer Americans having access to the help and guidance they need to save for retirement. The Department, in its own analysis of the 2011 final rule implementing the investment advice provision of the Pension Protection Act, found that financial losses from investing mistakes due to lack of advice likely amounted to more than $114 billion in 2010. The Department's new, and more complicated, proposal risks reducing many investors' access to meaningful guidance and education while unnecessarily increasing their costs. This is particularly troublesome for low to middle-income savers who rely heavily on the brokerage model. Currently, 98 percent of IRA investors with less than $25,000 are in brokerage relationships.

Regulatory Impact Analysis

Not only does the regulatory impact analysis fail to show how this proposal would benefit the public quantitatively, but it also underestimates greatly the harm that this would cause American investors. The Department has no study data to compare the performance of accounts with a financial advisor who is a fiduciary to the performance of accounts with a broker or other financial advisor who is not a fiduciary. The Department cannot reasonably conclude that investors would be better off under an expanded fiduciary standard on the basis of the studies cited. In fact, NERA's analysis of actual account level data demonstrates that commission-based accounts do not underperform relative to fee-based fiduciary accounts. In addition, in its analysis of the "benefits" of the proposal associated with curtailing purportedly conflicted advice, the Department misapplied academic research that is key to its conclusions. The range of estimates of benefits is so wide as to raise serious questions about its applicability and credibility.

To help provide a relevant data set, SIFMA is including in its analysis of the Department's proposal a review, conducted by NERA Economic Consulting, of data from tens of thousands of IRA and 401(k) accounts provided by SIFMA member firms. It is highly likely that most firms that offer retirement account services will be unable to offer commission-based accounts to retirement savings customers under the proposal, even under the Best Interest Contract exemption. Based on that premise, we can draw several key conclusions:

- Some commission-based accounts would become significantly more expensive when converted to a fee-based account under the Department's proposal;
- A large number of accounts do not meet the minimum account balance to qualify for an advisory account;
- There is no evidence that commission-based accounts underperform fee-based accounts; and
- The Department's own economic analysis is so broad as to undermine its validity and further it misinterprets the referenced academic literature.

In addition, a key finding of the NERA study is that customers do choose the fee model that best suits their needs and trading behavior. In 2014, the median trade frequency in commission-based accounts was just six trades. By comparison, in fee-based accounts the median trade frequency was 57 trades, with larger accounts generally trading more frequently than smaller ones. Thus, the data are consistent with the idea that investors who expect to trade often rationally choose fee-based accounts whereas those that do not trade often are likely to choose commission-based account.

SIFMA also questions the Department's cost estimates for complying with its proposal. The Department's cost estimates rely primarily on data submitted by SIFMA to the SEC in regard to a request for information related to Dodd-Frank Section 913 in 2013 (the "SIFMA Data").[3] Such reliance is inappropriate. The SIFMA Data was collected and submitted by SIFMA to the SEC for the sole purpose of estimating the costs of complying with a prospective SEC fiduciary rule established under Dodd-Frank Section 913, under specific assumptions that were applied to such a contemplated SEC approach.[4] Although the Department concedes that "*there will be substantive differences between the [DOL]'s new proposal and exemptions and any future SEC regulation that would establish a uniform fiduciary standard…* ", the Department nevertheless elects to rely on the SIFMA Data as the basis for its cost estimates.[5] The Department's stated reason for doing so is that there are *"some similarities between the cost components"* in the SIFMA Data and the costs that would be required to comply with the Department's proposal.[6]

The SIFMA Data was custom-generated for a wholly different prospective rule by the SEC, and is specific and exclusive to that purpose. The Department's proposal, on the other hand, introduces an entirely new and different set of requirements, obligations, liabilities and costs, which were not known or even contemplated at the time the SIFMA Data was generated nearly two years earlier. It is not possible and would be improper to use the SIFMA Data to estimate the cost of a separate and distinct Department regime. Because the Department did so, they started with a false premise, followed a flawed methodology, and generated costs estimates that are unfounded, inaccurate, and otherwise fatally flawed.

To help more appropriately understand the costs of compliance related to the Department's proposal, SIFMA conducted a survey of start up and ongoing compliance costs as documented in the Deloitte Report.[7] SIFMA's survey found that the estimated cost to comply with the Department's proposal is considerably greater than the estimates for the broker-dealer industry provided by the Department in its Regulatory Impact Analysis. The results of the survey estimate that, for large and medium firms in the broker-dealer industry, total start-up costs alone would be

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[3] Regulatory Impact Analysis, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf, at pp. 160 – 65.

[4] SIFMA Comment to SEC dated July 5, 2013, http://www.sifma.org/issues/item.aspx?id=8589944317.

[5] Regulatory Impact Analysis at p. 161.

[6] *Id.*

[7] Report on the Anticipated Operational Impacts to Broker-Dealers of the Department of Labor's Proposed Conflicts of Interest Rule dated July 17, 2015

$4.7 billion and on-going costs would be $1.1 billion. This is nearly double the estimated cost provided by the Department in its analysis. This is not surprising, given that the Department's estimate was based on a narrow dataset that was never intended to measure costs for compliance with this proposal.

Impact on Asset Managers

The impact of the Department's proposed retirement regulation raises concerns for asset managers who are already fiduciaries under ERISA when they act as discretionary investment managers or provide investment advice for clients that are retirement plans and IRAs. Asset managers are concerned that the expanded definition of investment advice definition will hamper their ability to act in the best interest of these clients. Asset managers will be less able to provide information and education than they are able to do currently. They may also be restricted in making available services and/or products or may only be able to do so at greater expense. In addition, because the proposal broadly imposes fiduciary obligations on market participants with whom asset managers transact on behalf of plans, those market participants will be less willing to engage in activities and services that assist in carrying out one's fiduciary duties, and will restrict information where providing it may transform their role into a fiduciary one. Moreover, asset managers and investors, already deemed sophisticated, will be burdened by standards designed for retail retirement savers.

Further, asset managers, separate and apart from their role as fiduciaries to plans, create and manage registered mutual funds, exchange traded funds, real estate investment trusts and hedge funds and other private funds that are purchased as investments for plans. Because different plans will have different investment objectives, different products and strategies will be best suited to help investors achieve their objectives. As drafted, the proposed rule and Best Interest Contract Exemption will result in substituting the variety of products currently available with a *de jure* or *de facto* "legal list," and make the burdens of offering many funds and products effectively prohibitive. The asset managers are concerned that both the proposed rule and the Best Interest Contract Exemption will have the effect of limiting or restricting asset managers' products that are available to plans and promoting certain types of products (*e.g.*, low-cost index products) over others.

Conclusion

SIFMA reiterates its long and much-documented support for a best interests of the customer standard, and in many ways, through the highly regulated securities industry overseen by the SEC and FINRA, the industry is already headed in that direction. Those regulatory bodies should remain in the lead on the issue, and best interests standard should apply across the entire retail market, not just the tax deferred retirement market. The proposal's voluminous and overreaching terms, prescriptions and conditions - separate and apart from the best interests standard – would create a myriad of new requirements and systems that would make the process of helping American savers prepare for retirement far too complex to implement without causing undue harm. In the end, the very same investors the Department seeks to protect would likely inadvertently be harmed with limited choices, less access to retirement advice, and higher costs.

Sincerely,

Kenneth E. Bentsen, Jr.
President and CEO

July 20, 2015

By U.S. Mail and Email: e-OED@dol.gov

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

Re: RIN1210-AB32

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SIFMA shares the Department's concern that American workers are not saving enough for retirement. SIFMA members know that financial professionals are already subject to a suitability standard that requires that they put the interests of their clients first and SIFMA

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welcomes a best interest standard, implemented by the appropriate regulatory authorities, when financial professionals are providing investment recommendations. While SIFMA may differ with the Department on the appropriate means to remedy the lack of adequate retirement savings on the part of American workers, we look forward to working with the Department to increase and improve retirement security and to preserve the current investment choices available to retirement investors, as well as their choice of the type of professional services they want and need. SIFMA respectfully requests an opportunity to testify at the Department's August 10-13, 2015 hearing.

Attached hereto are SIFMA's submissions for the related rulemakings being undertaken by the Department. These attachments are an integral part of this submission.[3]

Overview

While SIFMA believes that the provision of individualized advice should be covered by a best interest standard when both the financial professional and the client agree that a fiduciary account is what they both expect, this proposed rule goes too far and will have significant adverse consequences for Americans trying to save for retirement. The following is a list of only some of the consequences of the Department's proposed rule.

- The proposed rule will curtail access to many beneficial services and products available to retail retirement investors.
- The proposed rule will significantly limit retail retirement investors' ability to tailor the kind of services they want in light of their individual circumstances and instead will be forced into a "one size fits all" solution.

[3] See Appendices numbered 1-8.

- Fiduciary liability will attach, with either no exemptive relief or limited and operationally difficult relief, without any reliance by the client and without a mutual understanding of the services for which the client is contracting.
- A person could become a fiduciary merely by marketing his or her own services, advertising one-on-one counseling and the business generally, and urging a potential client to hire the financial professional.
- Fiduciary liability could attach to generally available, non-individualized materials from a financial institution, including research, product brochures, and lists of investments that a financial institution "follows".
- The newly created best interest contract exemption proposed a best interest standard with conditions and elements that are, for all practical purposes, impossible to meet: providing advice without regard to what one might earn requires that the financial professional not know what he could be paid. Retail retirement investors overwhelmingly will be offered only wrap programs or fee based advisory accounts to avoid the logistical issues of complying with the BIC exemption's numerous and onerous conditions. Where an advisory account is not suitable or where the account holds less than $50,000, the account will likely be terminated and the IRA often will have no one-on-one professional assistance available to them.
- Bond quotes, account statements, and periodic reporting of pooled fund values could make the dealer, the custodian or the pooled fund sponsor fiduciaries.
- The Department's reversal of its long held view that distribution advice is not investment advice translates all distribution conversations into a fiduciary breach with no exemptive relief at all for the rollover or for any fees charged in the IRA.
- The education carve-out will be virtually useless to a participant who is not financially literate and can't translate generalities into some realistic choices.
- The effective date for the proposed rule is unrealistically short.

- There are more cost effective ways to achieve the Department's goal of ensuring that a best interest standard applies to IRAs.

SIFMA understands that the Department wants to ensure financial services providers are looking out for their customer's best interest. The industry and its many regulators shares that goal. But this proposal will not achieve that goal without significant revisions. In addition, SIFMA has filed comments on the exemptive proposals that are part of this package, but it should be clear from the outset that virtually all of the exemption amendments, as well as the new exemptions, are not administrable, and thus fail to meet ERISA's statutory requirement that the Secretary may not promulgate an exemption unless it is administrable.[4]

It should also be clear that SIFMA does not share the Department's assessment of current practices and purported costs in the financial services industry, nor does it agree with the Department's assessment of the benefits and costs that would result from implementation of these proposals. SIFMA is submitting separate reports on those topics today, prepared by NERA[5] and Deloitte Consulting[6].

SIFMA shares the Department's interest in ensuring that investors receive appropriate, informed assistance with decisions concerning retirement. However, SIFMA respectfully believes that this proposed exemption, and the package of proposals accompanying it, are not the proper way of proceeding. SIFMA also does not believe that the Department may use a new definition of "fiduciary," in combination with its exemptive authority, as a means of establishing a new regulatory and enforcement program for financial professionals, ERISA plans, and non-ERISA

[4] ERISA Section 408(a).
[5] Appendix 1
[6] Appendix 2

plans such as IRAs. SIFMA expresses this objection with regard to the BIC Exemption, and the other, related exemptive rules that have been proposed.

Finally, SIFMA believes that the Department's proposals exceed its statutory authority, the SEC and FINRA are that the appropriate authorities to develop and implement a best interest standard for financial professionals, and that the Department should defer to those regulatory authorities rather than adopt this new definition of "fiduciary" and the related exemptive rules. Nothing in these comments should be understood to mean that SIFMA concurs with the construction of ERISA and the Code underlying the Department's proposals. Rather, SIFMA offers these comments to assist the Department in improving its proposals in the event it decides to move forward with this package of regulatory changes despite the serious concerns they present.

Comments on specific provisions can be found on the pages indicated below:

Background and Current Law

The statutory definition of "fiduciary" (ERISA § 3(21), paralleled almost verbatim in Code § 4975(e)(3)) has three parts, two of which pertain to plan investments. First, persons who exercise discretionary authority or control over the investment of plan assets are fiduciaries. Second, a person who does not have that degree of control but who "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan" is also a fiduciary (ERISA §3(21)(A)(ii)).

Very soon after the enactment of ERISA, the DOL issued a regulation[7] defining the circumstances under which a person would be treated as providing investment advice under ERISA § 3(21)(A)(ii). That regulation remains in effect today. It provides that a person will be deemed to be providing "investment advice" within the meaning of Section 3(21)(A)(ii) only if:

> (i) Such person *renders advice to the plan as to the value of securities or other property, or makes recommendation as to the advisability of investing in, purchasing, or selling securities or other property*; and
>
> (ii) Such person either directly or indirectly (*e.g.*, through or together with any affiliate)—
>
> > …
> >
> > (B) Renders any advice described in paragraph (c)(1)(i) of this section *on a regular basis* to the plan *pursuant to a mutual agreement, arrangement or understanding*, written or otherwise, between such person and the plan or a fiduciary with respect to the plan, *that such services will serve as a primary basis for investment decisions* with respect to plan assets, *and that such person will render individualized investment advice* to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments.

[7] 29 C.F.R. § 2510.3-21(c) (filed with the Federal Register on October 28, 1975) ("1975 regulation").

The italicized language establishes a five-part test with respect to advice regarding securities or their value: to provide "investment advice," a person must (1) render advice as to the value of securities or other property or make 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 that (4) the advice will serve as a primary basis for investment decisions, and that (5) the advice will be individualized based on the particular needs of the plan.

The April 2015 Proposal

The Definition of Advice

In a marked departure from current law, the Department has proposed a rule that re-imagines Section 3(21) of ERISA and goes well beyond what was contemplated by the statute.[8] The proposed rule adds two significant categories to the kind of advice that would make one a fiduciary, and significantly revises the test for the provision of such advice to eliminate any

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[8] See the remarks of Georgetown University Law Professor Roy Schotland on the careful balancing that the Department now attempts to reverse:

> "While flat prohibitions [of all conflicts of interest] would be more 'pure,' such a course would not only disrupt arrangements that seems unwarranted absent a far plainer direction to do so; in addition, such a course would result in serious long-range harm to plan beneficiaries. . . . Congress [just] concluded an intensive look at the securities markets and industry and dealt quite explicitly . . . with the relationship between the broker-dealer function and the investment management function. Absent very clear direction, it would be questionable to treat the same problem, in the same industry more sweepingly than Congress deemed appropriate . . . . [I]n the name of protection against abuse, flat prohibitions would inflict greater injury than is likely to occur from abuse of conflicts of interest . . . . [I]t does seem necessary, in considering broker-dealers' conflicts, to keep in mind the anomaly which would occur if flat, sweeping prohibitions were imposed in this area, while the conflicts problems in . . . non-pension accounts were not subjected to appropriate safeguards. All these areas present conflicts, and by the nature of the problems and the reasons causing them to arise in the first place, intricate balancing to preserve potential benefits, and protect against potential dangers, is a difficult course but simply the only reasonable one."

reliance or even mutual understanding on the part of the advice recipient with respect to the role that the advice will play in his or her decision-making.

The proposed rule specifies four types of advice that may – when provided *directly* to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner in exchange for a fee or other compensation – make a person a fiduciary if the person represents or acknowledges that it is acting as a fiduciary within the meaning of ERISA, or if the person "[r]enders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA."

The four types of advice are:

> (i) A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property, including a recommendation to take a distribution of benefits or a recommendation as to the investment of securities or other property to be rolled over or otherwise distributed from the plan or IRA;
>
> (ii) A recommendation as to the management of securities or other property, including recommendations as to the management of securities or other property to be rolled over or otherwise distributed from the plan or IRA;
>
> (iii) An appraisal, fairness opinion, or similar statement whether verbal or written concerning the value of securities or other property if provided in connection with a specific transaction or transactions involving the acquisition, disposition, or exchange, of such securities or other property by the plan or IRA;
>
> (iv) A recommendation of a person who is also going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (i) through (iii).

SIFMA believes that it is sensible to define advice with respect to individualized recommendations provided directly to a person regarding investments and managers (subparts (i) and (iv)) although the recommendation and any action taken based on that recommendation should be close in time.[9] However, we have three concerns about this definition:

(i) the second prong of the definition is too vague and the language used – recommendation as to the management of securities or other properties -- needs to be revised to reflect the quite different purpose that is described in the preamble to avoid confusion and misunderstanding;

(ii) the third prong of the definition on valuation should be reserved until it can be fully and appropriately addressed by the Department; and

(iii) based on language in the preamble, it appears that the fourth prong of the definition should cover not only recommendations of investment advice fiduciaries but also other referrals.

Each of these concerns is described in more detail below. But as an overarching point, SIFMA strongly disagrees that distribution recommendations are fiduciary advice within the meaning of ERISA. They are not investment advice. Nothing in the statutory language or the legislative history is consistent with the Department's interpretation, and the Department's "new" view is flatly inconsistent with its own legal interpretation in 2005.

1. The Prong Dealing with "Management"

The proposed regulation provides that fiduciary advice includes a recommendation as to the management of securities or other property, including recommendations as to the management of

[9] We think that the rule needs a time proximity test. If a financial professional unsuccessfully attempts to sell an IRA to a plan participant, but months or years later, the participant on his or her own, opens an IRA at the financial institution (not through that same financial professional) and that financial institution receives a fee, the future looking receipt of compensation definition is drafted to make the financial institution a fiduciary without any exceptions or carve-outs. SIFMA urges the Department to add a time proximity standard to the definition.

securities or other property to be rolled over or otherwise distributed from the plan or IRA. "Management of securities" is a broad and vague formulation, and would appear to duplicate the first prong of the definition. The preamble, however, provides helpful clarification on the Department's meaning with respect to "management". It suggests that the second prong of the advice definition was intended to cover advice regarding the rights appurtenant to securities and other properties held by a plan.[10] We respectfully request that the Department use this very clear language instead of the over-inclusive term "management". SIFMA members are concerned that this vague language at best appears duplicative of the first prong, and at worst, hides a variety of issues that could be a trap for the unwary. If the Department's intention is as described in the preamble, the language should be more narrowly drafted to reference these duties. If the Department has other issues in mind, SIFMA would welcome a discussion of those issues. We suggest that this prong be rewritten to provide as follows:

> (ii) A recommendation as to the exercise of rights appurtenant to assets of the plan;

Such a revision would clearly indicate the meaning of "management" in this context and distinguish it from prongs (i) and (iv) of the definition.

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[10] "(2) Recommendations as to the Management of Plan Investments

The preamble to the 2010 Proposal stated that the ``management of securities or other property" would include advice and recommendations as to the exercise of rights appurtenant to shares of stock (e.g., voting proxies). 75 FR 65266 (Oct. 22, 2010). The Department has long viewed the exercise of ownership rights as a fiduciary responsibility because of its material effect on plan investment goals. 29 CFR 2509.08-2 (2008). Consequently, individualized or specifically directed advice and recommendations on the exercise of proxy or other ownership rights are appropriately treated as fiduciary in nature. Accordingly, the proposed regulation's provision on advice regarding the management of securities or other property would continue to cover individualized advice or recommendations as to proxy voting and the management of retirement assets in paragraph (a)(1)(ii).

We received comments on the 2010 proposal seeking some clarification regarding its application to certain practices. In this regard, it is the Department's view that guidelines or other information on voting policies for proxies that are provided to a broad class of investors without regard to a client's individual interests or investment policy, and which are not directed or presented as a recommended policy for the plan or IRA to adopt, would not rise to the level of fiduciary investment advice under the proposal. Additionally, a recommendation addressed to all shareholders in a proxy statement would not result in fiduciary status on the part of the issuer of the statement or the person who distributes the proxy statement. These positions are clarified in the proposed regulation." 80 FR 21939 (Apr. 20, 2015)

2. Valuation as Part of the Advice Definition

SIFMA also urges the Department to apply the same reasoning it applied to ESOP valuations and reserve the valuation section of the proposed regulation entirely. First, valuation information is not a recommendation and should not be investment advice. The point of the regulation is to capture the person recommending the investment, not the person providing the values from market sources. Nothing in the statutory language of ERISA or the Code, nor their legislative history, would support the Department's view that a value placed on an asset is investment advice. Values placed on assets are neither a call to action, nor an explicit endorsement. The Department has no authority to expand the concept of investment advice to include valuation information.

As drafted, however, apparently all statements of value are fiduciary advice, regardless of whether they are part of investment recommendations. SIFMA agrees that valuations should be accurate and complete and made in good faith, but those standards do not transform pricing information and administrative functions into fiduciary advice.

In determining not to include ESOP valuations in this rulemaking, the Department has apparently correctly concluded that it is not appropriate to expand the definition of investment advice to remedy every theoretical or potential abuse and uncertainty. In describing why the valuation provisions were included in the 2010 proposal, the Department noted:

> First, the proposal specifically includes the provision of appraisals and fairness opinions. As discussed above, the Department concluded in AO 76-65A that a valuation of closely held employer securities that would be relied on in the purchase of the securities by an ESOP would not constitute investment advice under the current regulation. However, a common problem identified in the Department's recent ESOP national enforcement

> project involves the incorrect valuation of employer securities. Among these are cases where plan fiduciaries have reasonably relied on faulty valuations prepared by professional appraisers. The Department believes that application of the proposal to appraisals and fairness opinions rendered in connection with plan transactions may directly or indirectly address these issues, and align the duties of persons who provide these opinions with those of fiduciaries who rely on them. Accordingly, paragraph (c)(1)(i)(A)(1) of the proposal specifically includes the provision of appraisals and fairness opinions concerning the value of securities or other property. This paragraph is intended to supersede the Department's conclusion in AO 76-65A, but is not limited to employer securities. Therefore, if a person is retained by a plan fiduciary to appraise real estate being offered to the plan for purchase, then the provision of the appraisal would fall within paragraph (c)(1)(i)(A)(1) of the proposal, and may result in fiduciary status under ERISA section 3(21)(A)(ii). The Department would expect a fiduciary appraiser's determination of value to be unbiased, fair, and objective, and to be made in good faith and based on a prudent investigation under the prevailing circumstances then known to the appraiser.
>
> Fn. 7: The Department's Employee Benefits Security Administration (EBSA) maintains a national enforcement project designed to identify and correct violations of ERISA in connection with Employee Stock Ownership Plans. One of the most common violations found is the incorrect valuation of employer securities. …[11]

The Department has not stated that there is evidence that valuations outside of the context of ESOPs have been unfair, abusive, or otherwise unlawful.[12] There is no justification for causing an investment adviser, custodian bank, broker-dealer or other entity that provides regular reporting of values to participants as required by the account agreement, the constituent documents of the investment vehicle, the securities law or Commodity Futures Trading Commission ("CFTC") requirements regarding marking of collateral to become an ERISA fiduciary without a demonstrated need to remedy or prevent bias or abuse and SIFMA does not

[11] 75 FR 65265, and fn. 7 thereto.

[12] We note that while the Department has alleged ESOP valuation abuses, courts have properly imposed liability on the fiduciary who knew or should have known that the valuation was flawed, not on the appraiser. Simplifying the Department's enforcement burden is not a substitute for statutory authority.

believe that the Department intended this result.[13] This is especially true where the Department affirmatively intends that those firms that provide privately held stock valuation for ESOP purposes may continue to be outside of these rules. The Department has recognized that existing professional standards for appraisals are consistent with the fiduciary duty as proposed, but has not demonstrated a need for the proposed "additional layer of protection for consumers" set forth in the proposal.

If the proposal regarding valuations were part of the final rule, there is a strong risk of uneven treatment of valuation in the marketplace. The potential for additional compliance resources, enforcement actions and liability under ERISA in connection with plan valuation, as opposed to all non-plan valuations, would further complicate contractual arrangements and increase costs.

We note that while the Department believes it has narrowed the rule, it is, in fact, broader than the 2010 proposal. Whether a value given is "in connection with" a transaction is not a clear standard, and encourages looking back in hindsight as to whether a value shown on a regular account statement was "in connection with" a transaction. The carve-out is not helpful: it covers valuations given *to* pooled funds but not valuations given *by* pooled funds to investors on a periodic basis. [14] If a hedge fund or private equity fund could become an ERISA fiduciary simply by providing values to plan investors, their willingness to accept ERISA and IRA

[13] To the extent that the counterparty and swap carve-outs are revised to cover services, including valuation services, this consequence may be avoided for institutional accounts, but it would still remain an issue for all other accounts.

[14] At one point, the preamble notes, in listing the carve-outs: "(6) the provision of an appraisal, fairness opinion or a statement of value to an ESOP regarding employer securities, to a collective investment vehicle holding plan assets, or to a plan for meeting reporting and disclosure requirements; and" which seems to limit the carve-out to plan asset vehicles. Later in the preamble, the explanation reads: "In response to comments, the proposal also contains an entirely new carve-out at paragraph (b)(5)(ii) specifically addressing valuations or appraisals provided to an investment fund (e.g., collective investment fund or pooled separate account) holding assets of various investors in addition to at least one plan or IRA." If the Department means to include all pooled funds, regardless of whether they are subject to the fiduciary requirements of ERISA, we would appreciate that clarification.

investors would be severely impacted. The effect on the capital markets, small and new business, and capital formation would be significant.

The proposed rule is open to the following questions:

- Funds (whether or not plan asset funds) value the fund daily, monthly or quarterly and these values are shown on custody statements for the account in which the fund interests are held, without a legal requirement to do so. Does the proposed rule apply to an unaffiliated fund administrator that calculates NAV for mutual/hedge/private equity funds pursuant to the respective fund's guidelines for calculating the valuation? There does not seem to be a carve-out for providing this information to plans, which potentially could use the information to enter into a transaction.
- Custody, prime brokerage and securities lending also may be impacted because the definition of investment advice is so broad and the valuation carve-out is so narrow. Does providing clients statements of value of assets held in custody or out on loan (normally but not always taken from recognized independent pricing services) constitute investment advice under the proposed rule? We understand from the Department's public statements that it did not mean to cover these kinds of valuations, and even if covered, are intended to be covered by a carve-out for institutional accounts. SIFMA urges the Department to clarify that these types of valuations do not constitute fiduciary investment advice.
- Securities lending also will be impacted. Does the proposed rule apply when the securities lending agent provides a valuation of the value of loaned securities or collateral, or marks collateral to market? The valuation is being provided by the securities lending agent to ensure that there is sufficient collateral as required by the securities lending agreement and if it is an ERISA account, in part to ensure compliance with PTE 2006-16, the securities lending exemption. The Department should clarify that these

types of valuations are excluded from the rule by the carve-outs for counterparties and swaps (modified as discussed below).

- Asset managers seeking to obtain real estate appraisals will be hard pressed to find willing appraisers if they will become fiduciaries by providing an appraisal. The Department fails to assess the impact of the rule on real estate investing for plans and on the acquisition of private equity investments by institutional investors. See, in the connection, the 2010 comments provided by the American Society of Appraisers, National Association of Independent Fee Appraisers, Institute of Business Appraisers, Real Estate Appraisal Coalition, American Society of Appraisers, and the Appraisal Foundation.
- Mergers and acquisitions will be severely impacted if fairness opinions in connection with the transaction will make the investment bank an ERISA fiduciary to the deal if any plans or IRAs are shareholders. Such a result would have massive consequences in the capital markets.
- Does a quote from a dealer in a completely self-directed brokerage account where no recommendations are provided constitute fiduciary advice, if the plan, participant or IRA owner goes ahead and purchases the bond based on the quote? It would be very harmful to the markets if dealers are not assured that they can give price quotes without coming within this prong.
- With respect to a single plan investment pool for which participants are provided a daily NAV, would this function be considered fiduciary advice?

There is no statutory authority to deem private equity funds, other pooled funds, prime brokers, securities lending agents, custodians or fund administrators ERISA fiduciaries in the course of valuing securities, loans, portfolio companies, or collateral. Nor does it make sense at all that a quote from a bond dealer regarding the price at which it would buy or sell a bond from or to an IRA or a plan maintained by a small business suddenly would be considered "investment advice". All of the effort that went into making sure that the bond markets would not be affected by the fiduciary rules of ERISA is simply discarded in this proposal. This effect on bond dealers has broad implications for the bond market and how investors behave when seeking to purchase or sell a bond. Few bonds are shown with firm bids/offers. Most are subject to revision or are indicative bids.[15] In the bond market, investors compare the quoted prices to a comparable yield curve to see if they are getting a good price. These market comparisons, whether through an automated tool or through a financial professional, may be covered by the definition of investment advice and may not be carved out by reason of the valuation or counterparty carve-outs.

If the Department believes that it has identified a problem with respect to valuation of privately held stock for an ESOP, it should bring those cases, as it repeatedly has. Making factual appraisal functions into fiduciary functions will merely cause appraisal firms to turn down assignments for plans, dealers to refuse to quote values for plans, and custodians to refuse to price any asset not valued by a third party public source. The Department has failed to consider the costs of this change to plans and participants. The comments raising precisely these points in 2010 have been ignored by the Department; only ESOPs have been eliminated from the regulation but the flaw in the Department's approach remains.

The proposal will turn routine and required valuations and market quotes into fiduciary acts in a manner that will surely affect normal market practice. SIFMA urges the Department to reserve the valuation prong of the definition of advice. When the Department determines that it is appropriate to tackle the issue of valuations, it should do so in a coordinated manner, and not

[15] Whether bond dealers will provide the bids required in the proposed exemption for principal transactions is questionable, especially if providing the quote could make them a fiduciary, if they know that the request for a quote is for a plan or IRA.

focus first on an area where there has been no abuse, leaving aside the area where it has determined the problem is the most urgent.[16]

3. The prong dealing with advice on managers

The fourth prong defines advice as a recommendation of a person who is also going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (i) through (iii). The preamble suggests that the fourth prong of the advice definition was intended to capture individualized recommendations and advice as to the selection of investment managers and advisers. However, the prong appears to apply to all recommendations or referrals without limitation. We are concerned that this broad definition, especially when coupled with "the specifically directed to" language discussed below, will preclude information and access that is beneficial to retirement investors. [17]

SIFMA suggests that this prong be rewritten to provide as follows:

> (iii) A recommendation as to the advisability of engaging a person who is also going to receive a fee or other compensation for providing any of the types of advice described in ERISA Section 3(21)(A) (i) or (ii).

Such a revision would indicate that fiduciary status extends to those persons that offer advice as to the advisability of an adviser or discretionary asset manager based on the needs of the plan or investor, but not to referrals of such advisers or managers where no recommendation or advice is given as to the advisability of engaging a particular advisor or manager.

[16] For the reasons described more fully below, the valuation carve-out addresses virtually none of the concerns described here.
[17] In addition, the BIC exemption specifically needs to provide relief for the recommendation of discretionary management programs.

Rollovers as Part of the Advice Definition

1. Sales conversations

As stated above, SIFMA believes that the Department's 2005 legal interpretation regarding rollovers is correct and that there is not a basis for the Department to depart from it. Even supposing some extension to rollovers were appropriate, SIFMA members have concerns with respect to the drafting of the rollover language in paragraphs (i) and (ii). The rule should not capture sales pitches that are no more than a "hire us to provide services to your retirement assets" appeal. There is no carve-out for a plan participant to merely listen to and participate in a sales conversation about an IRA rollover. There is no carve-out for a call center conversation, initiated by a participant or eligible employee, to discuss distribution options[18]. Sales conversations need to be clearly carved out of the rule, and that includes sales conversations about rollovers.

2. Education

While the Department's intent to include rollovers in the scope of the rule is quite clear, we strongly believe that there needs to be a clear line: factual education about distribution and rollover options and processes should not be fiduciary advice. This kind of education should not be subject to fiduciary liability. On the other hand, mutually agreed upon, individualized investment advice about distribution investments should be fiduciary advice, if that is what the participant chooses to contract for.[19] Without clear lines, distinctions blur, information becomes unavailable and participants suffer.

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[18] We note that the education bulletin in general should provide for education to eligible employees because it is that education that may encourage the employee to participate in the plan.

[19] Indeed, the education carve-out, described in more detail below, is internally inconsistent and confusing about rollover education, which will surely chill all such discussions for fear of falling outside the carve-out, even as the

SIFMA fundamentally disagrees that every conversation regarding rollovers should be treated as fiduciary advice. SIFMA simply does not agree that participants cannot distinguish a sales call from trusted advice.[20] SIFMA does not agree that it is in the best interest of plan participants to discourage all conversations regarding distributions. Rollover education starts with a conversation urging participants to keep the assets in a retirement account and not liquidate these retirement assets. We agree that premature liquidation could subject participants not only to a less secure financial future but potentially to current tax penalties as well. The fact that financial firms urge participants and IRA owners to keep their assets in retirement accounts and not dissipate them on boats or vacations or other discretionary spending is one of the greatest strengths of the financial professional system. If a policy goal is to avoid “leakage” out of the retirement system so that Americans save sufficiently for retirement, an effective strategy to pursue that goal would be to encourage one- on- one educational conversations with investment professionals about the pitfalls of taking distributions (as opposed to a strategy that relies on the hope that now, than to hope participants will stumble happen across the right information for their needs before they switch jobs and cash out of their former employer’s retirement plan). Although current financial needs are far more real and acute for many people than are financial needs after retirement, real, but often financial professionals often can help participants

Department acknowledges that "[i]n most instances participants will be better off if they preserve all or most of the their account balance in a tax-preferred vehicle, be it a plan or an IRA."[19] As described in more detail below, FINRA Regulatory Notice 13-45 provides a useful example of how to operationalize a conversation about rollovers without veering into investment advice. We urge the Department to consider its use as a safe harbor. As a public policy matter, we should not stifle call centers, which are the last place where a neutral and fact based conversation can take place to inform participants of their options, prevent leakage and provide information on options when leaving assets in the employer’s plan is not possible.

[20] Recent research suggests consumers can distinguish between a sales call and fiduciary advice. People don’t trust sales calls or other unsolicited advice. *See, e.g.*, “Trust and Financial Advice,” J. Burke and A. Hung, RAND Labor and Population Working Paper, WR-1075 (Jan. 2015), at 1. (“...we find that financial trust is correlated with advice usage and likelihood of seeking advisory services. Analysis of the experiment shows that trust is an important predictor of who chooses to receive advice, even after controlling for demographic characteristics and financial literacy. However, providing unsolicited advice has little impact on behavior, even for individuals with high levels of trust.” This finding underscores SIFMA’s view that unsolicited advice – sales conversations – should not be deemed fiduciary advice.

understand the importance of saving early and often for retirement and why they should consider exhausting all other resources before cashing out of the retirement system. If every sales conversation or every educational conversation is fiduciary advice, all participants suffer. SIFMA urges the Department not to drive all discussion of the benefits of retaining some form of tax-favored account into the realm of fiduciary advice.

3. The consequences of an overbroad rule

Leakage from retirement plans is at an epidemic high. In 2010, one in four American workers with a 401(k) or other defined contribution plan tapped their retirement account for current expenses. This "leakage" reached $70 billion in 2010, equal to nearly a quarter of all contributions that year. As Alicia Munnell and Anthony Webb found in a study released earlier this year:

> "The ability of our model to match the SIPP public use data corroborates our leakage estimates; leakages reduce wealth by 22 percent. They are more significant than fees (14 percent) but less significant than the effects of non-participation among eligible employees and the immaturity of the system (30 percent and 27 percent). In total, all these factors reduce retirement wealth by two thirds."[21]

Yet the Department's focus on fees to the exclusion of coverage and leakage is unfortunate. We urge the Department to reconsider its narrow limited carve-out for educational rollover conversations and no carve-out at all for sales. The Department's approach likely will make the problem of retirement security worse, not better.[22] SIFMA believes that the Department has not

[21] "The Impact of Leakages from 401(k)s and IRAs", Alicia Munnell and Anthony Webb, February, 2015, page 17.
[22] In 2005, the Department determined that it is not fiduciary advice when a person makes a recommendation regarding whether to take a distribution from a plan, whether that distribution should be in cash or in kind, and whether it should be rolled over to a plan or an IRA or invested in a non-tax favored account. Just five years later, in the 2010 Proposal, the Department decided that its 2005 determination was a mistake. With this 2015 iteration, the Department has decided that any recommendations about distributions, regardless of how general in nature, should be actionable fiduciary advice, regardless whether that advice relates to the securities involved in the

carefully considered alternatives here.[23] The Department has not provided any analysis as to why the flat, intentionally prohibitive approach is protective of participants or in their interest. Nor has it provided a basis for believing that the new rules will have a positive effect on reducing leakage.[24]

The Department's rule appears to assume that all plan sponsors want their terminated vested participants to remain in the plan. We think this assumption may be incorrect, especially in light of the cost and complexity of administering the accounts of participants who are no longer employees.[25] Some employees have such small balances that they are automatically cashed out. They need options or the tendency to simply take a distribution and spend it will overwhelm the best employer intentions. Moreover, the Department ignores participants' real concerns about their former employers and the chance that their retirement account may not be accessible when they need it. The Department minimizes the very real issue for participants who change jobs frequently, on average more than 11 times over their careers.[26] Leaving small account balances in a dozen or more plans creates a huge amount of work for participants. They need to keep up with menu changes in many plans, keep many plan sponsors apprised of address changes, name changes and beneficiary changes. It will likely be easier for a participant to have all of his or her

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distribution. These provisions should be reconsidered in light of the very serious adverse effect they will have on savings.

[23] FINRA Regulatory Notice 13-45, Rollovers to Individual Retirement Accounts, December 2013.

[24] We note that a recommendation to stay in the plan by a plan sponsor who may benefit from that decision will also be fiduciary advice and a prohibited transaction.

[25] Plan sponsors heavily depend on call centers to discuss distribution options with participants, and these call centers are an important source of one on one educational conversations when participants can describe their circumstances, their goals, and their concerns. But even a single balanced, factual conversation on distributions to individual participants could become fiduciary advice if it were deemed to be a recommendation directed to the participant who called. SIFMA believes that its members, plans and participants are ill-served by call center conversations that must end after the participant asks what specific alternatives exist for his or her plan account balance or IRA. Education is critical in this area, and the proposed rule should accommodate education about rollovers, and about other distribution issues that are confusing to participants, such as inherited IRAs, and required minimum distributions. Plan sponsors depend on call centers to communicate these issues to participants and it is in no one's interest to impede these conversations.

[26] See footnote 26, infra.

retirement assets in one place, allowing the participant to focus on one platform. It may allow the participant to have professional management, generally not available in a 401(k) plan, or a wider array of investment options. Indeed, the Department appears to believe plans should have available fewer investment choices, not more.[27] Participants may be legitimately worried about the stability of their employer, and the future of the plan. The Department concedes that the number of abandoned plans is significant and growing. It cannot be disputed that participants have had real difficulty obtaining their benefits when their former employer abandons the plan.

The effect of the proposal would likely make rollovers very difficult, if not impossible, to discuss with individuals. As currently drafted, discussions with participants regarding distributions and rollovers would be limited in scope. SIFMA urges the Department to adopt the sensible approach taken by FINRA under Regulatory Notice 13-45 to create a safe harbor for financial professionals so that participants can discuss rollovers in a balanced, educational way. We provide further detail on Notice 13-45 below in the context of our discussion of the education carve-out, and note that this FINRA guidance is expressly aimed at addressing the very conflicts with which the Department is concerned. There can be little doubt that the major societal issue that needs to be addressed here is the adequacy and preservation of retirement savings. It will do little good if the result of this proposed rule is that plan participants will be more confused, more concerned about the security of their assets being controlled by an entity with which they no longer are connected, more cut-off from sources of information and education that is readily accessible and more cut off from sources of financial literacy, especially during volatile economic cycles. The ultimate goal should be to create policy that encourages and simplifies the ability of individuals to retain savings in tax favored retirement accounts, regardless of whether they are plans or IRAs.

[27] See the comments of the Joint Trades to Assistant Secretary Borzi regarding Field Assistance Bulletin 2012-02, objecting to the Department's arbitrary requirement that a plan have no more than 25 investment alternatives.

The Department does not appear to have considered or analyzed the benefit to participants and their families of having all retirement assets in one place, where they can discuss their investment needs more holistically with a single person with respect to all of their savings. The Department also has not analyzed the behavioral impact on a young participant with a very low account balance when faced with the choice of electing to take (or being forced to take) a distribution or continuing to save for retirement. Participants in today's mobile workforce change jobs on average more than 11 times before they reach retirement age.[28] Fifty years ago, those job changes were far less frequent. For individuals who are now in their 20s and 30s, those numbers will surely rise. Employees often had little or no account balance in a retirement plan when they left the employer after a couple of years. Now, with automatic payroll deduction, immediate participation, automatic deferral rate increases and mandatory employer matches, participants will have a least a few hundred or a few thousand dollars when they change jobs after a year or two. The Department spends little time looking at how a young participant views that account balance, or the effort it takes to educate that participant effectively enough to cause that participant to continue to save that account balance rather than use it for immediate spending. But in the current employment environment of multiple employers over short periods, participants may be less likely to entrust even their small account balances in the plan to a former

[28] A BLS news release published in March 2015 examined the number of jobs that people born in the years 1957 to 1964 held from age 18 to age 48. The title of the report is "Number of Jobs Held, Labor Market Activity, and Earnings Growth among the Youngest Baby Boomers: Results from a Longitudinal Survey." The report is available on the BLS web site at: www.bls.gov/news.release/pdf/nlsoy.pdf. These younger baby boomers held an average of 11.7 jobs from ages 18 to 48. (In this report, a job is defined as an uninterrupted period of work with a particular employer.) On average, men held 11.8 jobs and women held 11.5 jobs. From ages 18 to 48, some of these younger baby boomers held more jobs than average and others held fewer jobs. Twenty-seven percent held 15 jobs or more, while 10 percent held zero to four jobs. For additional statistics on the number of jobs held, see the tables at: www.bls.gov/nls/nlsy79r25jobsbyedu.xlsx. See also Forbes Magazine, August 14, 2012: "The average worker today stays at each of his or her jobs for 4.4 years, according to the most recent available data from the Bureau of Labor Statistics, but the expected tenure of the workforce's youngest employees is about half that. Ninety-one percent of Millennials (born between 1977-1997) expect to stay in a job for less than three years, according to the Future Workplace "Multiple Generations @ Work" survey of 1,189 employees and 150 managers. That means they would have 15 – 20 jobs over the course of their working lives!"

employer, or tolerate receiving account statements from a dozen different employer plans accumulated over the first 10-15 years of their working lives.[29]

SIFMA's suggestions for changes to the education carve-out are discussed below.

Who is a Fiduciary?

1. Persons Who Acknowledge Fiduciary Status

The proposal defines investment advice fiduciaries in two subparagraphs. The first apparently is intended to deal with the financial professional who claims to be a fiduciary with respect to particular advice in a particular account and then later recants; however, it is written far more broadly. SIFMA supports the intent of this provision but urges the Department to clarify it, especially where it is used to create an absolute bar on the use of a carve-out.

Section (a)(2)(i) of the proposal provides:

> (2) Such person, either directly or indirectly (*e.g.*, through or together with any affiliate),-
>
> (i) Represents or acknowledges that it is acting as a fiduciary within the meaning of the Act with respect to the advice described in paragraph (a)(1) of this section;

This provision needs to be narrowed in two important ways. First, the language "directly or indirectly (*e.g.* through or together with an affiliate)" is too broad. A representation that a person is a fiduciary should be explicit and express and not just an inference. That statement should be made by that person. It is too important a concept, with too much potential liability, to infer such

[29] The Department has also not analyzed the effect on the nonbank custodian rules if all IRAs are treated as nonpassive and the net worth requirement s applicable to all nonbank custodians are significantly increased.

status through loose language or comments made by an affiliate. Nor do we understand what it means to say "through an affiliate". The definition of fiduciary is a functional test and one becomes a fiduciary because of one's recommendations, not because one's affiliate has made a recommendation. See Advisory Opinion 97-16:

> "You have assumed that ALIC, an affiliate under common control with ALIAC, is a fiduciary with respect to the Plans by virtue of exercising authority or control over Plan assets invested in separate accounts maintained by ALIC. There is nothing, however, in your submission to indicate that ALIAC is in a position to (or in fact does) exercise any authority or control over those assets. Accordingly it does not appear that ALIAC would be considered a fiduciary merely as a result of its affiliation with ALIC."

In addition, SIFMA believes the language should be clarified to say "with respect to a particular account and a particular recommendation or series of recommendations". Unless that clarification is made, a representation that one is acting as a fiduciary with respect to particular advice given with respect to one account could automatically render the financial professional a fiduciary with respect to *all* accounts in a self-directed plan, regardless of whether individualized advice is given to more than one participant, or with respect to other plans of the same advice recipient plan sponsor, or several accounts of one individual, such as a person's individual account, his IRA, and his business accounts. The Department makes clear in the preamble to the BIC exemption that one can agree with a client on the scope of its fiduciary obligations – that is, fiduciary status can be transaction based, account based, or limited to a period of time, limited to the recommendation to buy, without any obligation to provide advice regarding how long an asset should be held or when it should be sold and does not require additional contract execution prior to each transaction recommended for an account.[30] This expansive definition should be narrowed in the same fashion.

[30] Dept. of Labor, Proposed Best Interest Contract Exemption, 80 FR 21960, at 21969.

The expansive language in Section (a)(2)(i) of the proposal definition should be narrowed to reflect the Department's intent reflected in the BIC exemption that a fiduciary and a client can agree on the exact contours of the fiduciary's responsibilities.in the same fashion. Accordingly, we ask the Department to revise this language so that the provision reads:

> "(2) Such person –
> (i) Expressly states that it is acting as a fiduciary within the meaning of the Act with respect to advice described in paragraph (a)(1) of this section that is or will be provided with respect to a particular account in connection with a particular recommendation of an investment transaction or a series of recommendations regarding such a transaction or series of transactions, provided that the express acknowledgement of fiduciary status with respect to a particular transaction, account or recommendation will not, by itself, cause the person to become a fiduciary with respect to any other transaction, account or recommendation."

2. Mutual Understanding

The proposal changes current law with respect to whether the parties must have a common understanding of the services being provided. The Department also errs in supposing that a fiduciary relationship within the meaning of ERISA or the Code can be formed by a single transaction, particularly a transaction of a nature customarily performed by broker-dealers. That is inconsistent with the on-going relationship of heightened trust and confidence historically associated with fiduciary status, and with the long-standing recognition—expressly embodied in the Advisors' Act—that a broker-dealer whose advice is merely incidental to a sale is not a fiduciary. The proposal provides:

> (ii) Renders the advice pursuant to a written or verbal agreement, arrangement or understanding that the advice is individualized to, or that such advice is specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to securities or other property of the plan or IRA.

These changes will cause confusion and costly litigation. The second prong of this definition of "investment advice" should relate to situations where the parties *agree* that the recommendations will play a significant role in the participant's decision-making. The Department's proposal, however, abandons the requirement that there be a mutual understanding, agreement or arrangement between the financial professional and the advice recipient about anything at all. Indeed, the preamble specifically notes that no meeting of the minds is required.[31] While we would have thought eliminating the notion that the parties should reach an understanding regarding whether the intent is that the financial professional be an investment advice fiduciary was merely a drafting issue rather than a substantive one, the preamble specifically notes that no meeting of the minds is required. By eliminating any notion that the parties should have a meeting of the minds regarding the financial professional's role, the Department opens the door to nearly indefensible claims by any person who in hindsight is upset with an investment decision, whether or not the person relied at all on the financial professional's related recommendations. SIFMA believes that the Department's elimination of the concept of a meeting of the minds opens the door to potentially false but nearly indefensible claims. This standard would allow a person who has not received fiduciary advice to later claim that he "understood" that it was investment advice, or that the financial professional "understood" that the information was targeted to the person, leaving the financial firm with an impossible task of proving that the claimant could not have so understood the statement. The standard also would place courts and arbitrators in the simple, but utterly one-sided, position of assuming that any arguable "recommendation" by a broker makes the broker a fiduciary with no room to consider the facts and circumstances of the situation. The nature of the advisory relationship should be demonstrably intentional for both parties. Whether one is a fiduciary governs bonding decisions, liability and risk decisions, training and systems management. It governs what the client should

[31] "The parties need not have a meeting of the minds on the extent to which the advice recipient will actually rely on the advice, but they must agree or understand that the advice is individualized or specifically directed to the particular advice recipient for consideration in making investment decisions." 80 CFR at 21940.

be charged, and what the financial professional and his financial institution can receive under the Department's proposed prohibited transaction exemptions. It should be a reasoned decision, by a plan, plan participant or IRA, to seek and agree to pay for investment advice, and both parties should understand the arrangement, the fees and the conflicts. Setting up a legal regime that allows or encourages individuals, with investment hindsight, to recast arrangements as fiduciary in nature and allow a unilateral, after the fact "understandings" regarding the nature of recommendations rather than requiring or encouraging the parties to reach an understanding up front regarding the nature of a financial professional's role and responsibilities simply is unreasonable.

There were scores of comments making this point in 2011 but these comments seem to have been ignored by the Department in this iteration. In causing the most casual recommendations to be deemed fiduciary advice, the Department seems to want to permit advice recipients to look backward and claim an understanding or agreement that did not exist at the time.[32] SIFMA's 2011 comment described the 2010 proposal as follows:

> "The Department's alternative test for defining "fiduciary" eliminates the regular basis test, the mutual understanding requirement, and the test that requires the advice to be a primary basis on which the client will make his or her investment decision. The elimination of these tests will result in a service provider becoming an unwitting fiduciary. No longer must the parties agree that the relationship is a fiduciary relationship. If the client "understands," long after information is provided by a service provider, that the relationship is, in retrospect, a fiduciary relationship, even if the service provider specifically disclaims that status, the client's one sided, opportunistic "understanding" carries the day. This is true, despite the fact that the client's one-sided understanding can be manufactured after the fact when any trade turns out less successfully than he anticipated. The formulation cannot work nor can it be validated. Allowing a plan fiduciary or participant to claim, after the fact, that he "understood" that a broker was offering

[32] The Department's defense of this position essentially acknowledges this point, stating that the new definition "would simplify the determination of fiduciary status *by eliminating difficult factual questions* relating to what constitutes a 'regular basis,' a 'mutual agreement,' a 'primary basis,' or 'individualized' advice." Dept. of Labor, Fiduciary Investment Advice Regulatory Impact Analysis, (Apr. 14, 2015), at 155 (emphasis added).

> tailored fiduciary advice puts too great of a burden on the fiduciary, unless the Department allows brokers and others to have written agreements disclaiming fiduciary status and the Department recognizes that disclaimer. The elimination of the term “mutual” from the current regulation is particularly troubling. Agreements, arrangements and understandings are by definition mutual, suggesting that there are two people party to the agreement or arrangement. The most inchoate and subjective of the three terms - understanding - is made even more subjective and elusive by dropping the modifier “mutual.” Thus, a regulation which should be (and currently is) a bellwether to guide standards of conduct instead becomes subjective, where no service provider will have a clear understanding of the expectations of its client. The deletion of the word “mutual” will cause significant disruption in the markets, changes in trading patterns for asset classes that currently trade on a principal basis and increases in costs to plans and IRAs, just as the Department feared in its economic analysis of the regulatory alternatives it rejected. See 75 FR 65275. Brokers will not take the risk that they will be later deemed to be fiduciaries, and in violation of the prohibited transaction provisions of ERISA and the Code. We urge the Department to retain the requirement that any agreement, arrangement or understanding be mutual to avoid permitting a much more subjective reading of the regulation. Any change in the regulation will be unworkable unless it is based on service provider and client agreement.”

That comment is equally true with respect to the 2015 proposal, despite the Department’s view that it listened to the criticisms and have proposed something that is “nothing like the earlier proposal”. In connection with the 2010 Proposal, the Department staff said in many forums that the term “mutual” was superfluous and its deletion was merely editorial. Nevertheless, this time around, the preamble is more straightforward; it notes that both the primary basis test and the mutual understanding test were deleted to preclude a financial professional from “defeating” fiduciary status.

> “Under the five-part test, fiduciary status can also be defeated by arguing that the parties did not have a mutual agreement, arrangement, or understanding that the advice would serve as a primary basis for investment decisions. Investment professionals in today's marketplace frequently market retirement investment services in ways that clearly suggest the provision of tailored or individualized advice, while at the same time disclaiming in fine print the requisite “mutual”

> understanding that the advice will be used as a primary basis for investment decisions."

SIFMA members believe that a claim that a relationship is a fiduciary relationship *should* be "defeated" if the parties do not mutually understand that they both intended a fiduciary relationship, with the additional liability on the part of the financial professional and the additional cost on the plan, participant or IRA owner. SIFMA does not agree with the Department's view that striking the essential component of "mutual" agreement is justified by the stated goal of easing the burden on Department investigators and "more effective enforcement".[33] Indeed, the Department's formulation requires only that if the financial professional understands that he is "specifically directing" his sales pitch to a person who has not agreed to be his client – and to whom he may never have spoken before – he becomes a fiduciary, even where the person on the other end of the phone neither sees the financial professional as a "trusted adviser" nor evidences any mutual understanding, reliance or trust of any kind.

3. A Reliance Standard

Under current law, a recommendation must be a primary basis on which the advice recipient makes up his or her mind on a course of action. That test is deleted entirely from this new proposal. The Department apparently believes that "a primary basis" is too high a standard. SIFMA disagrees. Nonetheless, we continue to be willing to discuss other standards. But the total elimination of any notion of reliance, or even a standard of importance to the recipient, is simply too one-sided. While the Department's formulation may make it easy for the Department to prove fiduciary status, it makes little sense in trying to define when a conversation legitimately

[33] *Id.*

should be considered "investment advice." In 2010, the Department's formulation was "advice which may be considered". The revised proposal is no better. In 2010, SIFMA noted:

> Similarly, the "may be considered" test is too vague and credits even the most casual conversation as fiduciary advice. Whenever someone talks, the listener "may consider" the speaker's words. The "may be considered" test is really an "I hear you" test. We urge the Department to consider a test which both parties to a conversation understand to be fiduciary advice, such as material reliance, substantial reliance, or a significant part of the plan's decision making process. The "may be considered" test is inconsistent with the level of reliance described by the Department in the preamble to the regulation. We note that this test may well capture every lawyer, accountant, actuary or other consultant that works on an investment policy, reviews asset allocations for purposes of an actuarial valuation, or looks at values for purposes of an audit. The Department's preamble specifically excludes these service providers from the first prong of the regulation's four prong test; it should exclude these service providers from all four prongs. See 75 FR 65266.

Interestingly, the preamble to the 2010 proposal states that the then proposed regulation "is intended to capture persons that significantly influence the decisions of plan fiduciaries and have a considerable impact on plan investment." 75 FR 65265. SIFMA soundly agrees with that formulation. This time around, the Department goes beyond the 2010 formulation and doesn't pretend to require that it is intended to "capture persons that significantly influence the decisions of plan fiduciaries and have a considerable impact on plan investment". SIFMA urges the Department to codify its explanation from its first proposal here in paragraph 2(a)(ii):

> "Renders the advice pursuant to a written or oral agreement, *mutual* arrangement or *mutual* understanding that the advice is individualized to the advice recipient *to significantly influence* investment or management decisions with respect to securities or other property of the plan or IRA."

As SIFMA has repeatedly stated, it concurs with a best interest standard, and concurs with financial professionals being subject to fiduciary liability when they are acting as fiduciaries at the client's request. If the standard now becomes "any consideration, regardless of how insignificant", then the proposal is even less practical and appropriate in its current form than the 2010 proposal.

4. Recommendations that are "Specifically Directed To" a Person

The third area with respect to which SIFMA urges the Department to modify its proposal is in connection with its newly created "specifically directed to" test in section 2(a)(ii). This test extremely troublesome and is inappropriate as a means of determining whether information properly should be considered fiduciary "investment advice, and accordingly should be eliminated. Moreover, the test is so overbroad and ambiguous that it makes the 2015 proposal as unworkable as the 2010 proposal. A test for fiduciary status that arguably identifies advertisements, group meetings, research reports, marketing materials and other clearly non-fiduciary communications as "investment advice" needs to be scrapped.

References to this language in the preamble underscore the Department's apparent intention to make every financial professional a fiduciary if his or her employer advertises on the radio, on television or in the newspaper, or suggests in any marketing material – whether or not that material is intended for plan participants or IRAs – that financial professionals give one-on-one advice. While SIFMA agrees that advice may be fiduciary in nature if it is specifically individualized to a participant pursuant to a mutual agreement to provide advice that will significantly influence investment decisions and is not merely selling, SIFMA believes that the Department is actually trying to capture non-individualized information – and the mere selling of one-on-one services -- with this change, including through broadly disseminated television and newspaper advertisements.[34]

[34] The Department concedes this point by calling out, as the problem it is trying to address, marketing materials rather than the agreement between the parties. Apparently in the Department's view is that where there may be a conflict between a public advertising campaign and an agreement entered into with a client, the advertising campaign, and not the agreement, should characterize the client relationship: "Thus, at the same time that

The Department notes in the preamble to the proposed rule that it "avoids burdening activities that do not implicate relationships of trust and expectations of impartiality".[35] SIFMA agrees with that aim but unfortunately, we do not believe that the text of the proposal accomplishes this objective. Research reports sent to thousands of clients don't implicate relationships of trust. Newspaper and television advertisements to the general public do not implicate relationships of trust. Sales calls, responses to requests for proposals, and product brochures do not implicate relationships of trust.

The preamble notes that this language "addresses concerns that the general circulation of newsletters, television talk show commentary, or remarks in speeches and presentations at financial industry conferences would result in the person being treated as a fiduciary." However, the preamble then draws a direct line between the "specifically directed to" language and *advertising*, stating that advisers could not "continue the practice of advertising advice or counseling that is one-on-one or that a reasonable person would believe would be tailored to their individual needs and then disclaim that the recommendations are fiduciary investment advice in boilerplate language in the advertisement or in the paperwork provided to the client." The rule, as proposed, could be read to capture virtually all general marketing materials that mention specific products and similarly could transform advertising and all selling of advice services into actionable fiduciary advice before there is individualized contact, let alone a mutual agreement, based on the Department's "specifically directed to" formulation.

The language also risks capturing research and market commentaries, even if sent to all or a large group of clients, and even if not geared at all to individualized trading recommendations.

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marketing materials may characterize the financial adviser's relationship with the customer as one-on-one [sic], personalized, and based on the client's best interest, footnotes and legal boilerplate disclaim the requisite mutual agreement, arrangement, or understanding that the advice is individualized or should serve as a primary basis for investment decisions.

[35] 80 FR 21938.

Classifying such materials as fiduciary advice will curtail the availability of key educational and informative resources that help investors in making informed investment decisions.

For all of the foregoing reasons, SIFMA urges the Department to delete "specifically directed to" from the regulation. At best, it is highly confusing. At worst, it makes general research, a sales call, or a television or newspaper advertisement proof of a fiduciary relationship.

The Carve-outs

There are seven specific carve-outs from the proposed rule's "investment advice" definition. SIFMA believes that they need to be broadened. Our concerns are as follows.

1. The Exclusion From Use of the Carve-outs

First, the carve-outs do not appear to be available at all to any service provider who has affirmatively represented or acknowledged that he or she is a plan fiduciary SIFMA agrees that a person should not be able to agree to act as a fiduciary and then seek to avoid the fiduciary status to which he or she agreed,. But, the language in the proposed regulation makes the carve-outs unavailable is a far broader set of circumstances. We urge the Department to clarify the language in the carve-outs to reflect the very basic concept under ERISA's fiduciary rules: that a person is a fiduciary with respect to particular recommendations made with respect to particular assets of a particular account, and not a fiduciary "in general" of an entire plan. The way the Department has written this section, a none of the carve-outs would be available to a directed trustee because the directed trustee will acknowledge in its trust agreement, that it acts as a fiduciary in safekeeping assets.

A client may have several accounts, or several IRAs, and only in certain of these accounts, and perhaps only with respect to certain assets, has he engaged the financial professional to provide investment advice. The exclusion is overbroad and assumes that once a person is a fiduciary for any set of assets in any manner, no matter how limited, you are a fiduciary for all accounts, all assets, all relationships, and all communications. That is simply not the law.

The definition of fiduciary in the statute is quite clear: a person is a fiduciary "to the extent" that the statutory tests are met. This same, statutorily mandated qualification needs to be reflected in the carve-outs..

Section (a)(2)(i) of the proposal provides:

> (2) Such person, either directly or indirectly (*e.g.*, through or together with any affiliate),--
>
> (i) Represents or acknowledges that it is acting as a fiduciary within the meaning of the Act with respect to the advice described in paragraph (a)(1) of this section; or . . . .

As noted above, SIFMA requests that it be revised to provide:

> "(2) Such person –
>
> (i) Represents or acknowledges that it is acting as a fiduciary within the meaning of the Act with respect to advice described in paragraph (a)(1) of this section that is or will be provided with respect to a particular account in connection with a particular recommendation of an investment transaction or a series of recommendations regarding such a transaction or series of transactions."

The carve-out section describes this definition as applying to persons in general, not persons in connection with particular recommendations with respect to particular assets of a particular plan. The proposal provides:

> (b) Carve-outs--investment advice. Except for persons described in paragraph (a)(2)(i) of this section, the rendering of advice or other communications in conformance with a carve-out set forth in paragraph (b)(1) through (6) of this section shall not cause the person who renders the advice to be treated as a fiduciary under paragraph (a) of this

section.

Thus, this language should be revised to read as follows:

> "Except for advice described in paragraph (a)(1) of this section with respect to which the person has represented or acknowledged that it is acting as a fiduciary as described in paragraph (a)(2)(i) of this section with respect to a particular account (or particular assets in an account) and a particular transaction, the rendering of advice or other communications in conformance with a carve-out set forth in paragraph (b)(1) through (6) of this section shall not cause the person who renders the advice to be treated as a fiduciary under paragraph (a) of this section."

2. IRAs and Other Retail Accounts

Only two of the six exceptions – the education and financial reports exceptions – cover communications with participants, beneficiaries, and IRA owners. SIFMA members think this limitation is a mistake that has no analytical basis and goes beyond the Department's authority. Incidental advice as part of selling is a concept Congress adopted in 1940 with the Investment Advisors Act. Congress presumably would have noted such a striking difference when it passed ERISA since it was considering securities law amendments at the same time.[36] Selling is selling, regardless of the setting or recipient. If a financial professional makes clear he is selling, then it is inconsistent with that reality to suggest that selling is a fiduciary activity when the target is a retail account. There simply is no legal difference. When the fee for executing a trade is the same whether one gives "advice" incidental to the sale or not, there is no fee for the advice. Similarly, objectively monitoring data or platform information is just that: factual and objective. It doesn't become less so because it is given to an IRA or a plan participant. SIFMA members

[36] The Conferees intend that this legislation with respect to individual retirement accounts is not to limit in any way the application of the Federal securities laws to individual retirement accounts or the application of them of the laws relating to common trusts or investment funds maintained by an institution. As a result, the Securities and Exchange Commission will have the authority to act on the issues arising with respect to individual retirement accounts independently of this legislation. [CITE}

do not agree with the Department that there is no warning, no cautionary language, no disclosure, that would suffice to warn an individual that the financial professional is selling a service, or that the factual information provided is just that: data. Not every conversation will be misconstrued as a recommendation. SIFMA urges the Department to make all of the carve-outs eligible for retail accounts, including plan participants and IRAs and to create a clear carve-out for sales pitches and other sales activities.

3. Mere Selling

We think the regulation needs to clarify that a person or entity seeking to be hired – as a broker, a custodian, a fiduciary, an advisor, a trustee – initially, for a longer engagement, or a new mandate or new account, and in a one-on-one conversation, a response to an RFP or in a newspaper advertisement, is not a fiduciary regardless of what kind of investment suggestions are contained in that sales context. While selling could be covered by a carve-out, it needs to cover selling to all potential clients, and not just plans with 100 or more participants or asset managers with $100 million in employee benefit plan assets. The clearest expression would be a provision in the rule itself, after the definition of the four kinds of advice in section (a), which would read as follows:

> "Provided however, that no person shall be deemed to be providing investment advice by reason of recommending, urging, responding to requests for proposals regarding or otherwise promoting, its own hiring."

Alternatively, there should be a clear carve-out for selling one's own services.

4. The Counterparty Carve-out

SIFMA seeks several clarifications with respect to this carve-out. The first, as noted above, would make this exception applicable to all retirement accounts, and to all intermediaries who sell products to or act on behalf of those accounts. The lack of opportunity for accounts of any size to decide for themselves whether or not they want to work with a fiduciary advisor is a serious shortcoming. Subject to clear warnings that the financial professional is not providing impartial advice and has no duty to do so, we strongly believe that the Department should not decide for every American that he or she cannot have a non-advisory brokerage account where they nevertheless can speak with a financial professional. Some individuals might not choose to select an advisory account to meet their needs.

The second clarification is that this carve-out should cover services, such as brokerage services, futures execution and clearing services, prime brokerage services, custody services, and other appropriate and necessary services provided to plans where the service provider is acting as agent or representative of the plan. As written, the exception is explicitly available only with respect to a sale, purchase, loan or bilateral contract, and not with respect to services provided to accounts. Thus, any incidental advice from a service provider could be deemed to be fiduciary advice if it is specifically directed to the plan, despite the fact that Congress clearly meant incidental advice which bears no additional fee over and above the fee for execution is not fiduciary advice. Such incidental advice could include:

- information provided by a futures commission merchant executing a futures trade for the biggest, most sophisticated plan client,
- information provided by the institutional agency desk at a broker-dealer, again dealing with the most sophisticated institutions,
- any such information from a plan's prime broker,
- all marketing materials or pitches from trustees, brokers, custodians, investment managers, commodities trading advisers,
- generally available research,

- corporate finance recommendations made to a company's corporate financial staff which may later be communicated to plan fiduciaries,
- any sales pitches by collective trust trustees, brokers, or third party administrators to plan fiduciaries.

For virtually all of these service provider communications, the counterparty exception appears to be inapplicable. Similarly, the current language seems to omit communications from exchanges, alternative trading systems and electronic communication networks used in trading.[37]

While the Department has informally indicated in its meetings with the industry that it will fix this carve-out to include services and that the omission was not intended, the lack of coverage of services, including selling one's own services, by this carve-out is worrisome, especially since in the 2010 proposal, the carve-out also failed to cover services and the Department received scores of comments highlighting this point. The Department has said in every setting from the initial proposal forward that the clarification we seek – the coverage of services and selling -- is what it intends. SIFMA hopes the Department will clarify coverage of service providers and selling one's own services in the carve-out. We also hope that the Department will reconsider its current position regarding the ability of American investors to decide for them what kind of relationship they want to have with their financial professionals and will modify the carve-out to cover transactions with IRAs, participants and small plans. Accordingly, SIFMA respectfully requests that the Department circulate revised language on this point for comment prior to finalizing the proposal because of its importance.

Third, the carve-out should apply to referral programs. Many financial institutions have programs that provide compensation to professionals (*e.g.*, lawyers or accountants) for referrals

[37] SIFMA, and several other commenters, made this very same point in response to the 2010 proposal. See page 15 of SIFMA's February 3, 2011 comment.

(as regulated by SEC Rule 206(4)-3). Under these programs, an estate planning lawyer might refer their client to a financial institution for investment services or advice relating to their IRA and other non-retirement assets. Under the proposal, such referrals would likely be considered fiduciary advice because they could be construed to be a recommendation of an investment adviser or manager. Yet the referral would not be subject to the counterparty carve-out because IRAs are not included. These referral programs are beneficial to consumers. Furthermore, these programs are already regulated by the SEC, which requires extensive conflict disclosures to the consumer, but would not be covered by the counterparty carve-out, as currently contemplated.

Fourth, the carve-out should clearly apply to pooled funds. We assume that this was an inadvertent omission and the carve-out applies to asset managers and trustees who manage pooled funds and to the funds they manage, regardless of whether it is managing the assets of a single plan or a pooled fund. Nonetheless, clarity on that point would be helpful.

Fifth, the $100 million asset test should be based on all assets under management, and not merely employee benefit plan assets. Our members know of no managers who keep track of assets under management based on client type, and no other exemptions where the Department has looked at only employee benefit plan assets to qualify a manager. See, *e.g.*, PTE 84-14, and numerous individual exemptions. This test should be satisfied either by the reasonable belief of the service provider or counterparty or by a representation by the plan sponsor. In addition, the $100 million threshold should be revised to use a standard that is commonly understood in the market place. SIFMA urges the Department not to create new definitions for commonly understood market terms for a sophisticated investor when accepted definitions exist that are well understood by brokers and advisors and counterparties. We suggest in our revision below that the asset level be at $50 million. The condition regarding the level of sophistication at $50 million is taken from the INHAM Exemption (PTE 96-23) and from FINRA Rule 4512(c)(3), which defines aninstitutional account as follows:

(c) For purposes of this Rule, the term "institutional account" shall mean the account of:

(1) a bank, savings and loan association, insurance company or registered investment company;

(2) an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state securities commission (or any agency or office performing like functions); or

(3) any other person (whether a natural person, corporation, partnership, trust or otherwise) with total assets of at least $50 million.

Sixth, as noted above, this carve-out should apply to all accounts with additional disclosure for retail accounts, and a more frequent reminder to retail accounts that any information or suggestions are not impartial investment advice. If the Department is unwilling to take that suggestion, SIFMA members believe that the 100 participant test is a mistake.[38] It is operationally difficult from a compliance perspective. How often would the financial professional need to check on the number of participants in the plan? It would not be possible to check on the current number of participants as of the date of every transaction or every recommendation. If the test is intended to reflect less sophisticated plan sponsors, we think the Department should use an asset-based test that aggregates the assets of all plans sponsored by the same employer and its affiliates. Many large and sophisticated employers sponsor many plans, and some of those plans may be quite small. It does not seem reasonable to suggest that the plan sponsor is not sophisticated, when other plans it sponsors have thousands of participants, and the plans contain billions of dollars in assets. SIFMA urges the Department to use a test that focuses on the value of the assets in all employee benefit plans sponsored by the employer and its affiliates so that this carve-out can apply to large, sophisticated employers, regardless of the size of their plans. Again, this test should be satisfied either by the reasonable belief of the service

[38] We note that the 100 person test is very unwieldy since it does not specify the date as of which this determination is made, or the consequence of fluctuations in this number.

provider or counterparty or by a representation by the plan sponsor.

Seventh, the representations need clarification. The timing of the representations is not specified; they should be provided prior to the first transaction and, as noted above, only for retail accounts should they be repeated periodically. Under no circumstances should the representations be provided on a trade by trade basis. The representations that operationally may be required to make this carve-out work will slow all investment transactions and make plans second class citizens in the market place. As written, it is unclear if they need to be given for each transaction or at the beginning of the relationship. Systems will need to be built to reflect whether a current necessary representation is on file. This kind of infinite prescriptive requirement is unnecessary.[39]

SIFMA is also concerned about the 8 month transition rule in this context. Even if this carve-out only applies to those plans that are covered by the proposal, the task of obtaining mutual representations will likely take a minimum of 24 months, if the recent Dodd-Frank experience is any guide. We urge the Department to be realistic, especially here where the carve-out specifically requires representations from the plan fiduciary.

For retail accounts, the following representations should be sufficient.

- The plan fiduciary will not rely on the person to act in the best interests of the plan, to provide impartial advice or to give fiduciary advice and that the plan fiduciary has sufficient expertise to evaluate the merits of the transaction.
- The financial professional discloses that it has its own financial interests in the arrangement or transaction, or may receive a fee as a result of the transaction.

In sum, SIFMA believes that the carve-out should read as follows:

[39] 17 CFR 23.434.

COUNTERPARTIES AND SERVICE PROVIDERS. In such person's capacity as a counterparty, service provider, including exchanges and other similar trading platforms, to a plan or IRA, or representative of either the plan, the IRA or the counterparty or service provider, the person provides advice to a plan or IRA fiduciary who is independent of such person, with respect to an arm's length service arrangement, sale, purchase, loan or bilateral contract between the plan or IRA and person (or with respect to a proposal to enter into such an arrangement, sale, purchase, loan or bilateral contract), each a "transaction" for purposes of this subclause if, prior to or in connection with entering into a transaction, (A) the plan fiduciary represents that it has the requisite sophistication and experience in investment matters, and such person discloses to the fiduciary, participant or beneficiary, as the case may be, that the person has a financial interest in the matter, and that the person is not undertaking to provide impartial financial advice; provided such person has not acknowledged in writing that it is acting as a fiduciary (within the meaning of the Act) with respect to the transaction and the person does not receive a specific separate advisory fee for such recommendation or (B) such person knows or reasonably believes that the plan fiduciary (1) has responsibility for managing at least $50 million in assets (for purposes of this paragraph, when dealing with an individual employee benefit plan, a person may rely on representations from the independent plan fiduciary regarding the value of assets under management or (2) is a bank, savings and loan association, insurance company, an investment adviser registered either with the SEC under Section 203 of the Investment Advisers Act or with a state or foreign securities commission (or any agency or office performing like functions).

5. Swap Transactions

SIFMA seeks three clarifications with respect to this carve-out. The first, as noted above, would make this exception applicable to all accounts. There is no reason why a small plan or a very sophisticated IRA owner should not be able to engage in a swap under appropriate circumstances, assuming that the account owner is an eligible contract participant. The second is that it should cover the services inherent in swap transactions, such as, but not limited to, swap clearing arrangements. Third, the carve-out needs to cover pooled funds that hold plan assets, which is a significant omission. These latter two changes are critical to conform this carve-out to the relief the Department recently gave in Advisory Opinion 2013-01A. While the Department has indicated that it did not intend to cut back on that relief, the carve-out is clearly inadequate to cover swap clearing arrangements.

The carve-out should read as follows:

> **SWAP TRANSACTIONS** – The person is a counterparty, service provider or representative thereof or of the plan in connection with a swap or security-based swap if, the plan or plan asset vehicle is represented by a fiduciary independent of the person; the person is a swap clearing firm or other service provider in relation to a swap, swap dealer, security-based swap dealer, major swap participant, or major security-based swap participant; the person (if a swap dealer, security-based swap dealer, clearing firm or other similar service provider), is not acting as an advisor to the plan or plan asset vehicle in connection with the transaction; and in advance of providing any recommendations with respect to a transaction or a series of potential transactions, the person obtains a written representation from the independent plan fiduciary, that the fiduciary will not rely on recommendations provided by the person.

6. Employees of the Plan Sponsor

Under the proposed rule, advice given to plan fiduciaries by the sponsor’s employees will not be fiduciary investment advice, unless the employee receives compensation for it beyond the employee’s regular pay. We think this is a sensible carve-out. However, it leaves out certain very normal situations that are not at all abusive: the employee providing the advice for the plan sponsor may be an employee of an affiliate of the plan sponsor and he or she may be providing the advice for the plan fiduciary but not directly to the plan fiduciary. The proposal should be clarified accordingly.

7. **Platform Providers**

SIFMA seeks three clarifications with respect to this carve-out. The first, as noted above, would make this exception applicable to all accounts, including plan participants and IRAs. It is a serious omission, and not at all in the interest of IRAs, to preclude a mutual fund complex or broker dealer or other financial institution from narrowing the offerings available to IRAs so as to make the choices more manageable for the investor, without recommending particular options from the remaining list of funds. There are more than eight thousand mutual funds and ETFs available in the market; it is unfair and burdensome to tell IRA owners that they are on their own.[40] The Department's sincere effort to protect IRAs may well be leading to their abandonment in the financial markets. In addition, if IRA and self-directed brokerage account platforms are not included in the carve-out, it could be impossible for financial institutions to avoid fiduciary status for IRAs and self-directed brokerage accounts even if they offer a non-fiduciary "self-directed/execution only" IRA accounts (i.e., if any limits are placed on the available universe of investment options, a platform may be created).

SIFMA members do not think that such a path is good policy or in the interest of American retirement investors.

Second, the carve-out should apply to the marketing and provision of brokerage window services and factual information provided to participants through such brokerage windows. Third, the carve-out should explicitly apply to call centers. So long as the information provided to plan participants and IRA owners does not vary from caller to caller, there is no reason why the Department would want to make call centers useless to participants and IRAs. SIFMA concurs with the Department's requirement that the platform provider "discloses in writing to the plan fiduciary, plan participant or IRA that [it] is not undertaking to provide impartial investment

[40] ICI, April 2015.

advice or to give advice in a fiduciary capacity." SIFMA believes that the required disclosure should be provided to all users, and should be prominently displayed on the website and in written materials. It may also be appropriate for the disclosure to be provided with account statements periodically but not more frequently than annually.

8. Objective Advice on the Selection and Monitoring of Investment Alternatives

SIFMA reiterates its comments above for this carve-out. It should apply to IRAs and plan participants. Moreover, it should not be restricted to platform providers. Many service providers and consultants provide objective data to help IRA owners, plan participants and plan sponsors monitor their investment alternatives. There is no reason why this carve-out should not apply to anyone who provides this information. The carve-out should cover situations where the provider merely "identifies investment alternatives that satisfy objective criteria specified by the plan fiduciary, participant or IRA" or "provides objective financial data and comparisons with independent benchmarks to the plan fiduciary, participant or IRA." It should surely cover lists of potential funds to consider, fund screeners or other internet tools that allow individuals to filter through thousands of investment options, especially when the list is being provided to all clients, and not individualized to particular IRA owners or plan participants.

SIFMA suggests that the carve-out require that the platform provider "discloses in writing to the plan fiduciary, plan participant or IRA that it is not undertaking to provide impartial investment advice or to give advice in a fiduciary capacity."

The Department has repeatedly cited studies that find that individuals need access to clearly presented factual information that is not overwhelming. Many studies have shown that participants who have one-on-one education and assistance can digest and understand this data better.[41] SIFMA believes that the Department understands the confusion engendered by a bewildering number of choices for IRAs. We are quite certain that the Department does not want to make investing one's retirement savings harder, or more confusing, or more time-consuming. The Department should rely on the safeguards described in this comment which would permit retail investors to navigate the markets without a paralysis imposed by a Department regulation.

9. Financial reports and valuations

As noted earlier in this comment, SIFMA strongly believes that the Department should reserve the valuation prong of the definition of fiduciary advice until it is prepared to adopt a complete cohesive definition and to justify its inclusion as a fiduciary act when the statute and the legislative history provide no support for that construction. SIFMA strongly believes that the Department should not deal with this area in a piecemeal fashion.

This is particularly true because of the flaws in the way the carve-out is drafted. The carve-out fails to cover bond prices given to a plan or participant, or any other values given to a plan before a trade in the public markets. The carve-out covers valuations of securities provided for regulatory purposes but fails to cover the monthly account statements sent by custodians, brokers and insurance agents every month, as well as online account information and other similar reports. The carve-out will make every fund administrator, third party vendor of pricing information and custodian a fiduciary by providing the pricing for buying shares or units or partnership interests. We do not believe that the Department has thought through the

[41] See Montmarquette, C., and Viennot-Briot, N. (2012). Econometric Models on the Value of Advice of a Financial Advisor. CIRANO. http://www.cirano.qc.ca/pdf/publication/2012RP-17.pdf, which concludes that advised households save at roughly twice the rate of non-advised households and advised investors exhibit behaviors that leave them better prepared for retirement.

ramifications of this section and the narrowness of the carve-out, all the while giving ESOP valuations, its real area of interest, a free pass. SIFMA again urges the Department to reserve the valuation section of the definition and reserve this carve-out.

10. Investment Education

This exception would replace 29 C.F.R. § 2509.96-1 (also known as "Interpretive Bulletin 96-1"), which excludes general financial, investment and retirement information from the scope of investment advice. While it does cover IRAs, SIFMA members are very concerned about its treatment of distribution advice. The preamble descriptions and the operative language are inconsistent and confusing. And there is no question that a safe harbor that is inconsistent and confusing will not be used, for fear of fiduciary liability. Under the proposed rule, in the context of plan information, an educator can discuss varying forms of distribution, including rollovers. However, when providing general information, it cannot discuss distribution options under the plan or specific alternatives or services offered outside the plan, but in that very same subsection, at paragraph (H), it can discuss "General methods and strategies for managing assets in retirement (*e.g.*, systematic withdrawal payments, annuitization, guaranteed minimum withdrawal benefits), including those offered outside the plan or IRA." It seems very unclear to our members how the lead in language to subsection (ii) relates to paragraph (H) thereunder. Similarly, subsection (iv) seems to allow a discussion of distribution options: "questionnaires, worksheets, software and similar materials which allow a plan fiduciary, participant or beneficiary, or IRA owners to evaluate distribution options"; however, paragraph (E) thereunder provides that the interactive material *not* identify any distribution option. This language needs to be reworked.

This carve-out would require a financial professional providing holistic education to omit information which is both appropriate and arguably indispensable to a participant's understanding of his or her choices. The prohibition suggests that the Department, contrary to its clear support of actions that preserve individuals' retirement savings, would, by barring discussions of these options, fail to discourage a participant from liquidating and spending his savings. It would leave participants adrift on required minimum distributions, the complicated rules on inherited IRAs and the question of beneficiaries on their own IRA. The carve-out requires the material to be factual and objective. SIFMA members do not understand the Department's concern that these prescriptive requirements are not enough, and all conversations about distribution options needs to be eliminated. Because of the heightened emphasis in the definition of advice on distributions, this carve-out should specifically permit distribution education and rollover education. It is critical that participants in plans be provided information that supports the public policy objective of keeping retirement assets in retirement vehicles so that the assets will be available in the retirement phase of life. SIFMA strongly urges the Department not to limit discussion of distributions in education.

The education carve-out has another problem as well. Even though the current regulations require presentations to state that other investments with similar characteristics may be available, the DOL has decided that participants and IRA owners cannot understand that examples are not, *per se*, recommendations, no matter how strongly they are warned.

> "Thus, for example, we would not treat an asset allocation model as mere education if it called for a certain percentage of the investor's assets to be invested in large cap mutual funds, and accompanied that proposed allocation with the identity of a specific fund or provider." See 80 FR 21945.

Virtually every study that the Department points to suggests that participants need assistance with financial decision-making. Giving asset classes without allowing examples will not help participants. They will be paralyzed by their choices, and unless they choose to pay for advice from a financial professional, their choices will be uninformed and haphazard, if not entirely incorrect, driven by confusion in the least volatile markets and panic in the most volatile markets. SIFMA believes there must be middle ground here, so that some examples can be given, under circumstances where the disclosure is clear and unambiguous. It is simply not reasonable to believe that participants will be able to grasp abstract descriptions of investment categories with no examples at all. Education that leaves participants lost, and forced to navigate the internet for additional information is a failure. SIFMA urges the Department to allow examples to be given, so long as at least three examples for each asset class are provided, unless there are fewer than three alternatives available in an asset class, in which event all options should be provided as examples.

SIFMA also urges the Department to make two changes to the proposal for rollovers. The first is to carve-out recommendations related to the selling of rollovers, unless there is a prior, explicit understanding that the recommendations are part of an agreement to render fiduciary advice. This carve-out should require, as a condition, that the call center or financial professional make clear that the conversation is a sales call or education, and is not intended as fiduciary or impartial advice. This second carve-out should make clear that so long as the factors contained in FINRA's 2013 rollover release (FINRA Regulatory Notice 13-45) are fairly presented, the conversation should not be deemed fiduciary advice.

In FINRA Regulatory Notice 13-45, FINRA explained that participants generally have four options when they separate from service: leave their account balance in their current plan, roll over their account balance to their new employer's plan, if permitted, roll over their account balance to an IRA, or simply take a distribution, pay the applicable taxes, and use the money for a non-retirement purpose. FINRA noted that the statistics on rollovers tell a graphic story: many participants are more comfortable with their assets in an IRA they control than in their former employer's plan.[42] SIFMA supports an interpretative bulletin or other rulemaking, or a change to the education carve-out in this rule, that makes clear that education on rollovers is not fiduciary advice. SIFMA respectfully suggests a new subsection to the education carve-out which would require the financial professional or call center representative to address each of the following factors taken directly from the FINRA Regulatory Notice in a non-biased fashion:[43]

> (b)(6)(v) Rollover Education. Oral or written information which does not include recommendations or advice but merely lays out the following considerations, each of which must be mentioned without biased emphasis:
>
> > **(A) Investment Options**—An IRA often enables an investor to select from a broader range of investment options than a plan. The importance of this factor will depend in part on how satisfied the investor is with the options available under the plan under consideration. For example, an investor who is satisfied by the low-cost institutional funds available in some plans may not regard an IRA's broader array of investments as an important factor.
> >
> > **(B) Fees and Expenses**—Both plans and IRAs typically involve (i) investment-related expenses and (ii) plan or account fees. Investment-related expenses may include sales loads, commissions, the expenses of any mutual funds in which assets are invested and investment advisory fees. Plan fees typically include plan administrative fees (*e.g.*, recordkeeping, compliance, trustee fees) and fees for services such as access to a customer service representative. In some cases, employers pay for some or all of the plan's administrative expenses. An IRA's account fees may include, for example, administrative, account set-up and custodial fees.

[42] IRAs account for about 28 percent of all U.S. retirement assets, which totaled $19.5 trillion at the end of 2012. Of this amount, IRA assets were $5.4 trillion, compared with $5.1 trillion in defined contribution plans and $9 trillion in other retirement plans. Approximately 98 percent of IRAs with $25,000 or less are brokerage accounts. Rollovers from employer-sponsored retirement plans are the largest source of contributions to IRAs. A June 2013 Employee Benefits Research Institute report states that in 2011, assets rolled over into IRAs were almost 13 times the amount of direct contributions. This is not a new trend; ICI data indicates that from 1996 to 2008 more than 90 percent of funds flowing into traditional IRAs came from rollovers, primarily from plans. In 2013, 49 percent of the traditional IRAs held by U.S. households included rollover funds.

[43] A revised carve-out for education is attached hereto as an appendix.

(C) **Services**—An investor may wish to consider the different levels of service available under each option. Some plans, for example, provide access to investment advice, planning tools, telephone help lines, educational materials and workshops. Similarly, IRA providers offer different levels of service, which may include full brokerage service, investment advice, distribution planning and access to securities execution online.

(D) Penalty-Free Withdrawals—If an employee leaves her job between age 55 and 59½, she may be able to take penalty-free withdrawals from a plan. In contrast, penalty-free withdrawals generally may not be made from an IRA until age 59½.

(E) Protection from Creditors and Legal Judgments—Generally speaking, plan assets have unlimited protection from creditors under federal law, while IRA assets are protected in bankruptcy proceedings only. State laws vary in the protection of IRA assets in lawsuits.

(F) Required Minimum Distributions—Once an individual reaches age 70½, the rules for both plans and IRAs require the periodic withdrawal of certain minimum amounts, known as the required minimum distribution. If a person is still working at age 70½, however, he generally is not required to make required minimum distributions from his current employer's plan. This may be advantageous for the increasing population of Americans who plan to work into their 70s.

(G) Employer Stock—An investor who holds significantly appreciated employer stock in a plan should consider the negative tax consequences of rolling the stock to an IRA. If employer stock is transferred in-kind to an IRA, stock appreciation will be taxed as ordinary income upon distribution. The tax advantages of retaining employer stock in a non-qualified account should be balanced with the possibility that the investor may be excessively concentrated in employer stock. It can be risky to have too much employer stock in one's retirement account; for some investors, it may be advisable to liquidate the holdings and roll over the value to an IRA, even if it means losing long-term capital gains treatment on the stock's appreciation.

The Department may have other required content to suggest and SIFMA would look forward to engaging in a constructive conversation about how all perspectives on rollovers can be fairly presented to a participant without the provider of the information becoming a fiduciary. But we strongly disagree with the Department's current, highly restrictive approach and ask that the Department carefully consider the implications of and possible alternatives to its proposed framework.

The DOL has specifically declined to provide a separate carve-out for call centers. At the very least, this exception should make clear that call centers can use the education carve-out.

12. **Networking Arrangements and Institutional Referrals**

We understand the Department intends the fiduciary definition to capture individualized recommendations and advice as to the selection of investment managers and advisers. However, the Department's proposed language would apply to all recommendations or referrals without limitation. There is no carve-out for referrals to investment managers or other investment advice fiduciaries. This broad definition, especially when coupled with "the specifically directed to" language discussed above, will preclude information and access that is beneficial to retirement investors. The ability of non-fiduciary financial professionals and service providers to recognize and encourage potential opportunities for retirement savings is beneficial to investors and furthers the Department's goal of increasing the adequacy and preservation of retirement savings. For instance, retail bank employees that are not qualified to discuss investments often refer customers to an affiliated adviser within the bank or an affiliated broker-dealer in order to discuss the benefits of retirement savings. SIFMA members do not believe it is in the best interest of retirement investors to chill these referrals and networking arrangements, especially where such referrals would increase investors' access to, and consideration of, retirement savings and where the referred adviser will be acting in the best interest of the customer. Investors are able to distinguish referrals of affiliated services from trusted fiduciary advice. Fiduciary status should extend to those persons that offer advice as to the advisability of an adviser based on the needs of the plan or investor (assuming other requirements for fiduciary status are met), but not to referrals to such advisers where no recommendation or advice is given as to the advisability of engaging any particular adviser. In these circumstances, fiduciary status should be placed with the advice provider, not the introducer.

In addition, we do not believe fiduciary obligations should extend to arms-length referrals where neither side assumes that the counterparty to the plan is acting as an impartial trusted adviser, but the seller is making representations about the value and benefits of a proposed service. SIFMA urges the Department to provide clarification that the counterparty exception or another exception from the fiduciary definition would be available for service providers when selling the services of an affiliate or third-party adviser, such as a networking arrangement under Regulation R or a solicitor arrangement under Rule 206(4)-3 of the Investment Advisers Act of 1940. The Department has not identified any risk of harm under these circumstances where the communications are non-individualized and fully transparent. This is especially true where a referral will satisfy all the conditions set forth in the counterparty exception or where a plan fiduciary has the expertise to evaluate the transaction and to determine whether the transaction is prudent and in the best interest of the plan participants.

A carve-out from the fiduciary definition should be created to provide as follows:

> **NETWORKING AGREEMENTS AND INSTITUTIONAL REFERRALS** – (A) In such person's capacity as a counterparty, service provider to a plan or IRA, representative or affiliate of the counterparty or service provider, or solicitor of the counterparty or service provider, the person provides a recommendation of a person who is going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (a)(1)(i) through (a)(1)(ii) or for asset management, provided such person has not acknowledged in writing that it is acting as a fiduciary (within the meaning of the Act) with

> respect to the recommendation, the person only receives a nominal one-time cash payment from the recommended fiduciary in connection with such recommendation, and the person does not receive a specific separate advisory fee for such recommendation; (B) In such person's capacity as a counterparty, service provider to a plan or IRA, representative or affiliate of the counterparty or service provider, or solicitor of the counterparty or service provider, the person provides advice to a plan fiduciary who is independent of such person and who exercises authority or control with respect to the management or disposition of the plan's assets, with respect to an arm's length service arrangement, sale, purchase, loan or bilateral contract between the plan and a third-party adviser who is going to receive a fee or other compensation for providing any of the types of advice described in paragraphs (a)(1)(i) through (a)(1)(ii) or for asset management, each a "transaction" for purposes of this subclause, if, prior to entering into a relationship that may lead to a transaction, the plan fiduciary represents that it has the requisite sophistication and experience in investment matters, and such person discloses to the fiduciary, participant or beneficiary, as the case may be, that the person has a financial interest in the matter, and that the person is not undertaking to provide impartial financial advice; provided such person has not acknowledged in writing that it is acting as a fiduciary (within the meaning of the Act) with respect to the transaction.

SIFMA reiterates its comments above that this carve-out should apply to IRAs and plan participants as well.

Subsection (d) of 29 CFR 2510.3-21

SIFMA urges the Department to modernize the safe harbor in 2510.3-21(d). The entire basis of the Department's new rule is that times have changed and the rule needs to take into consideration the effects of current plan and market conditions. That being said, the safe harbor should permit trade orders to be given to foreign broker dealers who are registered under broker-dealer laws in their countries. In addition, it should cover transactions in fixed income securities, options, and currency that are not executed on an agency basis. This regulation is not simply about participant directed plans: it covers plans of all sizes and types, and this subsection, which is intended to make sure that limited timing or trade venue decisions does not make one into a fiduciary, needs to cover any market broker or dealer, and not just those in the United States. Accordingly, we suggest the following clarification:

> (d) Execution of securities transactions. (1) A person who is a broker or dealer registered under the Securities Exchange Act of 1934, a reporting dealer who makes primary markets in securities of the United States Government or of an agency of the United States Government and reports daily to the Federal Reserve Bank of New York its positions with respect to such securities and borrowings thereon, or a bank supervised by the United States or a State, *or a bank or broker dealer covered under the laws of a foreign jurisdiction*, shall not be deemed to be a fiduciary, within the meaning of section 3(21)(A) of the Act or section 4975(e)(3)(B) of the Code, with respect to an employee benefit plan or IRA solely because such person executes transactions for the purchase or sale of securities *or currency on behalf of such plan or involving such plan* in the ordinary course of its business as a broker, dealer, or bank, pursuant to instructions of a fiduciary with respect to such plan or IRA, if:
>
> (i) Neither the fiduciary nor any affiliate of such fiduciary is such broker, dealer, or bank; and
>
> (ii) The instructions specify:
>
> (A) The security *or currency* to be purchased or sold;
>
> (B) A price range within which such security *or currency* is to be purchased or sold, *or that the security or currency is to be executed at the current market price*, or, if such security is issued by an open-end investment company registered under the Investment Company Act of 1940 (15 U.S.C. 80a-1, et seq.), a price which is determined in accordance with Rule 22c1 under the Investment Company Act of 1940 (17 CFR270.22c1);
>
> (C) A time span during which such security *or currency* may be purchased or sold (not to exceed five business days); and
>
> (D) The minimum or maximum quantity of such security *or currency* which may be purchased or sold within such price range, or, in the case of a security issued by an open-end investment company registered under the Investment Company Act of 1940, the minimum or maximum quantity of such security which may be purchased or sold, or the value of such security in dollar amount which may be purchased or sold, at the price referred to in paragraph (d)(1)(ii)(B) of this section.

Definitions

SIFMA has the following comments on certain of the definitions used in the proposed regulation.

(1) The term "Recommendation"

The proposed rule defines the term "recommendation" to mean "a communication that, based on its content, context, and presentation, would reasonably be viewed as a suggestion that the advice recipient engage in or refrain from taking a particular course of action." The preamble indicates that the DOL based this definition on FINRA Notice to Members 01-23, which sets forth guidelines for identifying communications that require compliance with the "suitability" rule for securities brokerage transactions (FINRA Rule 2111), and several other FINRA notices (RN 11-02, 12-25, and 12-55)[44]. A later FINRA notice, quoted with approval in the preamble to the proposal, states as follows: "An important factor in this regard is whether – given its content, context and manner of presentation – a particular communication from a firm or associated person to a customer reasonably would be viewed as a suggestion that the customer take action or refrain from taking action regarding a security or investment strategy."

The Department should fully adopt FINRA Notice to Members 01-23, which provides extremely valuable guidance for broker-dealers to distinguish between online tools that are educational and do not provide recommendations, and online tools that provided individualized recommendations. The former types of tools are prevalent and extremely valuable to self-directed investors to make informed investment decisions without paying a fee for advice. The industry has been following this guidance for fourteen years and, especially given that DOL has adopted FINRA's definition of "recommendation" based on an interactive tools or other

[44] 80 FR 21938.

communication's content, context and presentation, DOL should remain consistent with this longstanding approach. Otherwise investors may lose access to such tools in their retirement accounts even though they will remain available to them in their taxable accounts.

SIFMA strongly supports the use of FINRA's guidance on what constitutes a "recommendation" to be used for purposes of the DOL proposal but it should also include the context in which that guidance is provided. Broker dealers that are FINRA members have many years of experience with this guidance and have incorporated it into their policies procedures, supervisory systems and controls, and training. This is a good example of the need to take a coordinated approach to the DOL proposed rule.

SIFMA agrees with the Department that the provision of information, investment ideas, alternatives and suggestions that fall far short of a "call to action" or a "specific endorsement" should not be fiduciary advice in the absence of an agreement or a mutual understanding or mutual arrangement. In addition, the definition needs to provide that the term does not include communications that merely suggest actions or courses of actions for consideration without a recommendation that is a call to action for the individual to engage in the action or course of action. However, as noted above, this definition needs to be read in connection with subsection (a)(2) and the changes suggested therein, to delete the term "specifically directed to" and to include the concept of mutual understanding and some level of reliance or importance as well as some level of qualitative recommendation and not a mere listing of possibilities to consider without such a recommendation. SIFMA strongly disagrees with the substitution of a standard which merely requires that the advice be targeted to an individual, and even where a person clearly warns the recipient that he is not providing individualized advice, an advertisement on television noting the availability of one-on-one to advice, may foil that clear warning.

We suggest that the definition read as follows:

> Recommendation means a communication that, based on its content, context, and presentation, would reasonably be viewed as a call to action or specific endorsement that the advice recipient engage in or refrain from taking a particular course of action. Recommendation does not include communications that merely suggest actions or course of actions for consideration with no call to action to engage in the action or course of action. A communication that would not be a recommendation within the meaning of applicable FINRA rules will not be deemed a recommendation under this section.

(2) The term "Compensation"

In addition, the proposed regulation defines "fee or other compensation, direct or indirect" to mean "any fee or compensation for the advice received by the person (or by an affiliate) from any source and any fee or compensation incident to the transaction in which the investment advice has been rendered or will be rendered." The term specifically includes brokerage fees, mutual funds and insurance sales commissions but sensibly leaves out revenue sharing, which is not shared with individual financial professionals and is generally paid without reference to particular transactions. This definition needs to make clear that revenue sharing that is paid regardless of whether the advice is taken by the participant or plan fiduciary is not compensation for purposes of the regulation.

We are also concerned with the forward looking part of the definition. As written, it covers "compensation incident to the transaction in which the investment advice has been rendered or will be rendered", leaving open whether the test could be met for compensation that is received regardless of whether the advice is taken, such as revenue sharing or training allowances and leaving open how far into the future compensation could be received.   The future tense appears to be an attempt to codify the Department's position that a sales pitch, considered by the recipient in any way, that is followed by acceptance and a fee, can turn that sales pitch into fiduciary advice. SIFMA urges the Department to make clear that an advisor's recommendations under the rule which do not result in compensation for that advisor within a reasonable period of time is not compensation that meets the requirements of the definition.

(3) The term "IRA"

The proposed rule defines IRAs as "any trust, account or annuity described in Code section 4975(e)(1)(B) through (F), including, for example, an individual retirement account described in section 408(a) of the Code and a health savings account described in section 223(d) of the Code." The definition is too broad. SIFMA members see no reason why the regulation should impose these fiduciary standards on savings accounts accumulated for very different reasons: fairly immediate health cost needs or education expenses. The kinds of issues that one considers in making the relatively short term investment decisions for these vehicles is so different from long term retirement savings that these sections should be reserved and dealt with separately.

Transitions

The preamble, but not the rule itself, provides that the final rule will be effective 60 days after publication of the final rule in the Federal Register. However, the requirements of the final rule would become applicable eight months after such publication. All exemptions would be effective on the applicability date as well. The Department seeks comment on whether certain provisions, such as the data collection requirements, should have a further delayed applicability date. We are not certain we understand the difference between an applicability date and an effective date. Neither term is defined in the proposed rule. Neither term is defined in the preamble. What does the effective date mean, if the rule and the exemptions are not effective on that date? Will courts agree that a rule's effective date is not really its effective date? If a person provides individualized advice after the effective date but before the applicability date, is he not a fiduciary? Is the applicability date the first date that liability attaches? If the individualized advice is given before the applicability date, and after the effective date, can the person receive differentiated compensation until the applicability date? Under what exemption? SIFMA would appreciate a clearer explanation of the Department's intentions with these terms.

Regardless of what these terms mean, they are simply inadequate. Sixty days or eight months is not nearly enough time to train all employees, build new systems, create compliance procedures, change compensation systems, block principal trades, block securities that do not meet the definition of "Asset" in the BIC exemption, revise confirmations, re-document all accounts, negotiate new fees, find and secure bonding policies and fiduciary insurance policies, talk to clients about assets they may no longer buy, and how to sell the investments they already have. Congress provided more than two years for the clearing requirements in Dodd-Frank which were far less sweeping than these changes. And when ERISA was enacted, Congress fully understood that financial professionals would need significant time to meet with their clients, review the required changes in their relationship, renegotiate fees, re-document the relationship, revise internal systems to contain required information and to block prohibited trades, create a website, determine how to create a system that provides liquidity and assesses credit risk, by CUSIP, on a daily basis to meet the requirements of the principal transaction exemption, design new confirms, new marketing materials, new educational materials, create supervisory procedures and compliance training, recode all accounts – the list is extraordinarily long and 8 months is very short. ERISA required far less in terms of systems development, new documentation, creation of charts, websites, and asset blocking systems. In 1974, Congress gave broker-dealers almost 10 years to phase in the prohibited transaction provisions relating to purchases and sales and almost three years to change services arrangements.[45] The Department's transition period is simply inadequate. Even if the final rule is published by January 1, 2016, financial professionals will have only 8 months to reach out to about 50 million accounts, have the important conversations with these plan fiduciaries and retirement investors about how their accounts, fees and client relationship will change, and how the rule will prevent those accounts from holding assets that

[45] See Section 413 of ERISA and ERISA Conference Report page 325, et. seq.

they currently hold or might want to hold in the future. Plans, participants and IRAs will be enormously pressured to review their arrangements or take their accounts to other institutions. Simply put, the transition period is too short. If the rule is to be effective within 8 months, at the very least the Department should propose a temporary exemption that permits all transactions permissible under current law to continue for 18 months, so long as clients receive clear and specific disclosure that the financial professional is required to put the client's interest before his own, and that he may have a conflict of interest with respect to the fees he receives in connection with his advice.

A Best Interest Standard

SIFMA believes there are less disruptive and more comprehensive ways to implement a best interest standard for additional protection for individual investors who maintain securities investments. Our members long ago endorsed a best interest or uniform fiduciary standard of care for all retail investors, including the retirement sector, when providing personalized investment advice about securities. SIFMA has encouraged the SEC, which has broad jurisdiction and authority in this space, to take action to establish a uniform fiduciary standard across all retail securities accounts receiving personalized investment advice.

The Dodd-Frank Act granted the SEC the authority to review and set the standard of care for broker-dealers with respect to retail investors through a Congressional mandate. While the SEC has not yet moved forward with a proposed rule, the rules and precedents governing broker-dealers' conduct with respect to retail investors, both in retirement and non-retirement accounts, have been migrating in recent years toward a best interests standard of care. For example, FINRA, under the supervision and oversight of the SEC, has been increasingly refining its definition of suitability under Rule 2111 and most recently through FINRA Notice 13-45, referenced earlier, to require brokers to put clients' best interests ahead of their own.

To further assist the SEC and FINRA and to maintain forward progress towards formalizing a best interest standard across all retail investor securities accounts, SIFMA, on June 3, 2015, proposed a "Best Interests of the Customer Standard for Broker-Dealers",[46] which is designed to lay the groundwork for an investor-focused, comprehensive regulatory solution that works for investors and broker-dealers alike.

SIFMA believes that an optimal "best interests of the customer" legal standard for broker-dealers should do the following:

1. Apply across all investment recommendations made to individual retail customers in all brokerage accounts (not be limited to just IRA accounts);
2. Serve as a benchmark for, be consistent with, and integrate seamlessly into, the SEC uniform fiduciary standard that ultimately emerges under Dodd-Frank § 913;
3. Provide interim, strong, substantive, "best interests" protections for retail customers; and
4. Follow the traditional securities regulatory approach of establishing a rules-based heightened standard, including robust disclosure, coupled with robust examination, oversight, and enforcement by the SEC, FINRA and state securities regulators, as well as a private right of action for investors, as exists today.

SIFMA believes that our proposal outlines the broad contours of how a best interests standard for broker dealers might be developed as part of the path forward on this most important investor protection issue. Any approach by the DOL for retirement accounts must be entirely consistent with the views and rulings of the securities regulators, or the costs of compliance will increase unreasonably as institutions attempt to reconcile inconsistent interpretations of these requirements – how to define markups and markdowns, when disclosure must be provided,

[46] See http://www.sifma.org/newsroom/2015/sifma_proposes_best_interests_standard_for_broker-dealers.

required content on confirms, scope of required records --leading to confusion on the part of financial professionals, compliance professionals and clients. Investor confusion and market disruption are a certain result if the government does not get this right.

SIFMA and its members appreciate the opportunity to comment and look forward to meeting with the Department to discuss our concerns. For further discussion, please contact the undersigned at 202-962-7329.

Sincerely,

Lisa J. Bleier
Managing Director, Federal Government Relations
and Associate General Counsel

Revisions of Investment Education Carve-out

(6) Investment education. The person furnishes or makes available any of the following categories of investment-related information and materials described in paragraphs (b)(6)(i) through (iv) of this section to a plan, plan fiduciary, participant or beneficiary, eligible employee, IRA or IRA owner irrespective of who provides or makes available the information and materials (*e.g.*, plan sponsor, fiduciary or service provider), the frequency with which the information and materials are provided, the form in which the information and materials are provided (*e.g.*, on an individual or group basis, in writing or orally, or via call center, video or computer software), or whether an identified category of information and materials is furnished or made available alone or in combination with other categories of information and materials identified in paragraphs (b)(6)(i) through (iv), provided that the information and materials do not include (standing alone or in combination with other materials) recommendations with respect to specific investment products or specific plan or IRA alternatives, or recommendations on investment, management, or value of a particular security or securities, or other property.

(i) Plan information. Information and materials that, without reference to the appropriateness of any individual investment alternative or any individual benefit distribution option for the plan or IRA, or a particular eligible employee, participant or beneficiary or IRA owner, describe the terms or operation of the plan or IRA, inform a plan fiduciary, eligible employee, participant, beneficiary, or IRA owner about the benefits of plan or IRA participation, the benefits of increasing plan or IRA contributions, the impact of preretirement withdrawals on retirement income, retirement income needs, varying forms of distributions, including rollovers, annuitization and other forms of lifetime income payment options (*e.g.*, immediate annuity, deferred annuity, or incremental purchase of deferred annuity), advantages, disadvantages and risks of different forms of distributions, or describe investment objectives and philosophies, risk and return characteristics, historical return information or related prospectuses of investment alternatives under the plan or IRA.

(ii) General financial, investment and retirement information. Information and materials on financial, investment and retirement matters that do not recommend specific investment products, specific plan or IRA alternatives or distribution options available to the plan or IRA or to eligible employees, participants, beneficiaries and IRA owners, or specific alternatives or services offered outside the plan or IRA, unless at least three examples are provided but which inform the plan fiduciary, participant or beneficiary, or IRA owner about--

(A) General financial and investment concepts, such as risk and return, diversification, dollar cost averaging, compounded return, and tax deferred investment;

(B) Historic differences in rates of return between different asset classes (*e.g.*, equities, bonds, or cash) based on standard market indices;

(C) Effects of inflation;

(D) Estimating future retirement income needs;

(E) Determining investment time horizons;

(F) Assessing risk tolerance;
(G) Retirement-related risks (*e.g.*, longevity risks, market/interest rates, inflation, health care and other expenses); and
(H) General methods and strategies for managing assets in retirement (*e.g.*, systematic withdrawal payments, annuitization, guaranteed minimum withdrawal benefits), including those offered outside the plan or IRA.
(iii) Asset allocation models. Information and materials (*e.g.*, pie charts, graphs, or case studies) that provide a plan fiduciary, participant or beneficiary, or IRA owner with models of asset allocation portfolios of hypothetical individuals with different time horizons (which may extend beyond an individual's retirement date) and risk profiles, where--
(A) Such models are based on generally accepted investments theories that take into account the historic returns of different asset classes (*e.g.*, equities, bonds, or cash) over defined periods of time;
(B) All material facts and assumptions on which such models are based (*e.g.*, retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, and rates of return) accompany the models;
(C) Such models do not recommend any specific investment product or specific alternative available under the plan or IRA unless three examples are provided; and
(D) The asset allocation models are accompanied by a statement indicating that, in applying particular asset allocation models to their individual situations, eligible employees, participants, beneficiaries, or IRA owners should consider their other assets, income, and investments (*e.g.*, equity in a home, Social Security benefits, individual retirement plan investments, savings accounts and interests in other qualified and non-qualified plans) in addition to their interests in the plan or IRA, to the extent those items are not taken into account in the model or estimate.
(iv) Interactive investment materials. Questionnaires, worksheets, software, and similar materials which provide a plan fiduciary, eligible employee, participant or beneficiary, or IRA owners the means to estimate future retirement income needs and assess the impact of different asset allocations on retirement income; questionnaires, worksheets, software and similar materials which allow a plan fiduciary, eligible employee, participant or beneficiary, or IRA owners to evaluate distribution options, products or vehicles by providing information under paragraphs (b)(6)(i) and (ii) of this section; questionnaires, worksheets, software, and similar materials that provide a plan fiduciary, participant or beneficiary, or IRA owner the means to estimate a retirement income stream that could be generated by an actual or hypothetical account balance, where--
(A) Such materials are based on generally accepted investment theories that take into account the historic returns of different asset classes (*e.g.*, equities, bonds, or cash) over defined periods of time;
(B) There is an objective correlation between the asset allocations generated by the materials and the information and data supplied by the participant, beneficiary or IRA owner;

(C) There is an objective correlation between the income stream generated by the materials and the information and data supplied by the eligible employee, participant, beneficiary or IRA owner;

(D) All material facts and assumptions (*e.g.*, retirement ages, life expectancies, income levels, financial resources, replacement income ratios, inflation rates, rates of return and other features and rates specific to income annuities or systematic withdrawal plan) that may affect a participant's, eligible employee's, beneficiary's or IRA owner's assessment of the different asset allocations or different income streams accompany the materials or are specified by the eligible employee, participant, beneficiary or IRA owner;

(E) The materials do not recommend any specific investment alternative available or distribution option available under the plan or IRA, unless at least three examples are provided or unless such alternative or option is specified by the participant, beneficiary or IRA owner; and

(F) The materials either take into account other assets, income and investments (*e.g.*, equity in a home, Social Security benefits, individual retirement account/annuity investments, savings accounts, and interests in other qualified and non-qualified plans) or are accompanied by a statement indicating that, in applying particular asset allocations to their individual situations, or in assessing the adequacy of an estimated income stream, eligible employees, participants, beneficiaries or IRA owners should consider their other assets, income, and investments in addition to their interests in the plan or IRA.

(v) The information and materials described in paragraphs (b)(6)(i) through (iv) of this section represent examples of the type of information and materials that may be furnished to participants, beneficiaries and IRA owners without such information and materials constituting investment advice. Determinations as to whether the provision of any information, materials or educational services not described herein constitutes the rendering of investment advice must be made by reference to the criteria set forth in paragraph (a) of this section.

(vi) Rollover Education. Oral or written information which does not include recommendations or advice but merely lays out the following considerations, each of which must be mentioned without biased emphasis:

> **(A) Investment Options**—An IRA often enables an investor to select from a broader range of investment options than a plan. The importance of this factor will depend in part on how satisfied the investor is with the options available under the plan under consideration. For example, an investor who is satisfied by the low-cost institutional funds available in some plans may not regard an IRA's broader array of investments as an important factor.
>
> **(B) Fees and Expenses**—Both plans and IRAs typically involve (i) investment-related expenses and (ii) plan or account fees. Investment-related expenses may include sales loads, commissions, the expenses of any mutual funds in which assets are invested and investment advisory fees. Plan fees typically include plan administrative fees (*e.g.*, recordkeeping, compliance, trustee fees) and fees for

services such as access to a customer service representative. In some cases, employers pay for some or all of the plan's administrative expenses. An IRA's account fees may include, for example, administrative, account set-up and custodial fees.

(C) Services—An investor may wish to consider the different levels of service available under each option. Some plans, for example, provide access to investment advice, planning tools, telephone help lines, educational materials and workshops. Similarly, IRA providers offer different levels of service, which may include full brokerage service, investment advice, distribution planning and access to securities execution online.

(D) Penalty-Free Withdrawals—If an employee leaves her job between age 55 and 59½, she may be able to take penalty-free withdrawals from a plan. In contrast, penalty-free withdrawals generally may not be made from an IRA until age 59½.

(E) Protection from Creditors and Legal Judgments—Generally speaking, plan assets have unlimited protection from creditors under federal law, while IRA assets are protected in bankruptcy proceedings only. State laws vary in the protection of IRA assets in lawsuits.

(F) Required Minimum Distributions—Once an individual reaches age 70½, the rules for both plans and IRAs require the periodic withdrawal of certain minimum amounts, known as the required minimum distribution. If a person is still working at age 70½, however, he generally is not required to make required minimum distributions from his current employer's plan. This may be advantageous for the increasing population of Americans who plan to work into their 70s.

(G) Employer Stock—An investor who holds significantly appreciated employer stock in a plan should consider the negative tax consequences of rolling the stock to an IRA. If employer stock is transferred in-kind to an IRA, stock appreciation will be taxed as ordinary income upon distribution. The tax advantages of retaining employer stock in a non-qualified account should be balanced with the possibility that the investor may be excessively concentrated in employer stock. It can be risky to have too much employer stock in one's retirement account; for some investors, it may be advisable to liquidate the holdings and roll over the value to an IRA, even if it means losing long-term capital gains treatment on the stock's appreciation.

APPENDIX 1

Comment on the Department of Labor Proposal and Regulatory Impact Analysis

July 17, 2015

EXECUTIVE SUMMARY

NERA Economic Consulting has been retained by SIFMA to review and comment on the U.S. Department of Labor's ("DOL") proposed conflict of interest rule and definition of the term "fiduciary" under ERISA (the "proposal"), and associated Regulatory Impact Analysis ("RIA"). The estimates in the above documents form the basis of the Department of Labor's argument that the proposed conflict of interest rule would provide a net "benefit" to the public.

To study these costs associated with the DOL proposal, NERA also collected account-level data from a number of financial institutions in order to construct a representative sample of retirement accounts. Our dataset includes tens of thousands of IRA accounts, observed over a period from 2012 through the first quarter of 2015.

Briefly, our findings are as follows:

- The DOL proposal may effectively make the commission-based brokerage model unworkable for investment accounts covered by ERISA due to the operational complexity and costs of compliance that would be required under the Best Interest Contract Exemption. Using our account-level data, we find that:
    - Some commission-based accounts would become significantly more expensive when converted to a fee-based account under the DOL proposal.
    - Investors can and do select the fee model (commission vs. fee) that best suits their own needs and trading behavior.
    - A large number of accounts do not meet the minimum account balance to qualify for an advisory account.

    - There is no evidence that commission-based accounts underperform fee-based accounts.

- In 2011, the DOL estimated that consumers who invest without professional advice make investment errors that collectively cost them $114 billion per year. Applying the DOL's own logic to the present proposal, combined with the likelihood that a large number of investors will lose access to advice, will result in aggregate costs that may exceed the DOL's own estimates of the benefits of the proposal.

- The RIA produces many different numbers representing different underlying assumptions, resulting in industry cost estimates that vary wildly from about $2 bil./year to $50 bil./year. The range of numbers is so wide it suggests no scientific confidence in their own methodology.

- The academic research cited in the RIA is misapplied.
    - While the academic literature focuses on mutual funds, it is applied more widely to other assets such as variable annuities in order to come up with the asset base of $1.7 trillion in retirement assets.
    - The most frequently cited paper in the RIA takes results from a statistical analysis on certain types of funds and misapplies those results to all funds. This likely exaggerates the importance of the findings cited by the DOL.
    - The academic literature cited in the RIA does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts. Therefore, any findings based on this research are inappropriate as a basis for the DOL proposal.

- Overall the DOL's misapplied use of the academic literature and erroneous conclusions on investor behaviors render their regulatory impact analysis unreliable and incomplete.

Contents

I. COSTS OF IMPEDING THE COMMISSION-BASED INVESTMENT MODEL

The Department of Labor's ("DOL") proposed conflict of interest rule and definition of the term "fiduciary" under ERISA (the "proposal"), and associated Regulatory Impact Analysis ("RIA")[1,2] have led many to conclude that the proposal would effectively make the commission-based brokerage model unworkable for investment accounts covered by ERISA and similar sections of the IRS code due to the operational complexity and costs of compliance that would be required under the Best Interest Contract exemption. In this section, we use account-level data to pursue the question of how this result would affect existing holders of commission-based accounts.

There are at least two immediate consequences to the proposed rule change. The first is that some commission-based accounts would become more expensive, in the sense that average fees would increase, particularly for investors who trade infrequently. Second, advisory or "fee-based" accounts currently have minimum balance requirements. These account balance requirements are in place to ensure that the firm serving the client can at least break even on the operating costs associated with administering advisory accounts. Using account-level data, we can estimate the percentage of consumers currently in commission-based accounts who would not meet the minimum account balance requirements and therefore lose access to professional investment advice under the DOL proposal.

We begin with a discussion and summary of the account-level data that NERA has collected for this study.

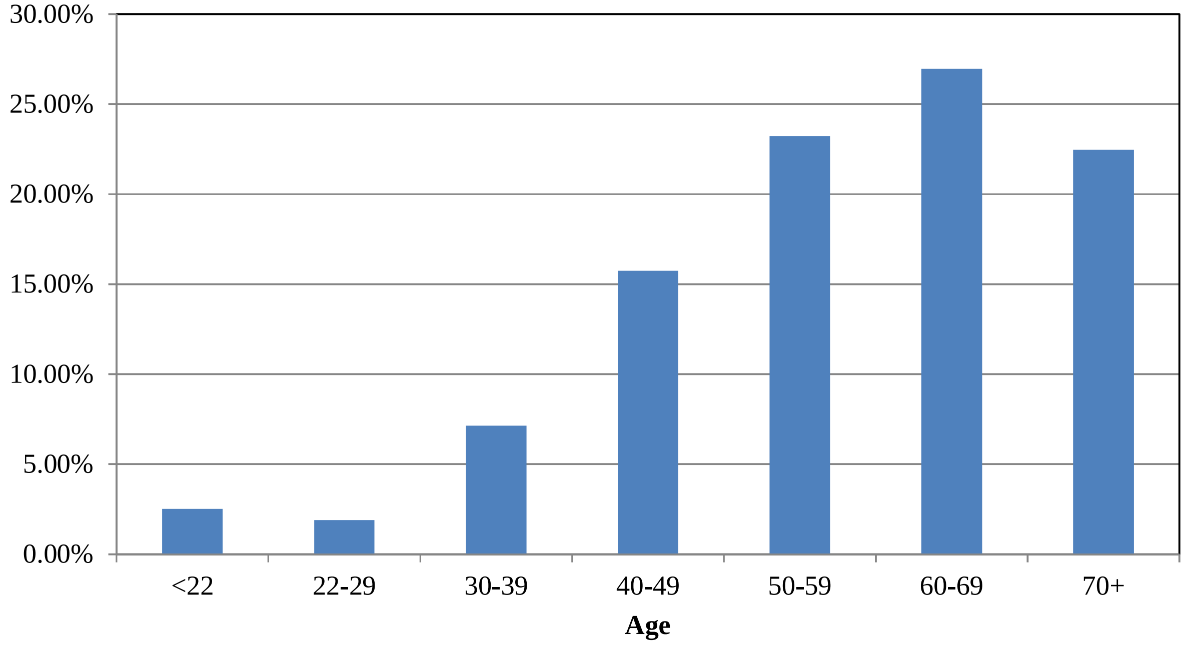
A. Summary of Data

The RIA itself recognizes (p. 101) "the absence of comprehensive data" with which to conduct a complete analysis of the proposal. To address that void, we collected account-level

[1] 29 CFR 2509 and 2510, DOL, Definition of the Term "Fiduciary"; Conflict of Interest Rule-- Retirement Investment Advice; Proposed Rule in Federal Register Volume 80, Number 75 (Monday, April 20, 2015), Pages 21927-21960.
[2] "Fiduciary Investment Advice Regulatory Impact Analysis", Department of Labor, Available on-line at www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

data from a number of financial institutions in order to construct a representative sample of retirement accounts. Our dataset includes over 63,000 IRA accounts, with data ranging from 2012 through the first quarter of 2015. The investors in our dataset are distributed across a wide range of age groups, with the bulk of IRAs held by investors aged 50 or older, as shown in Exhibit 1.

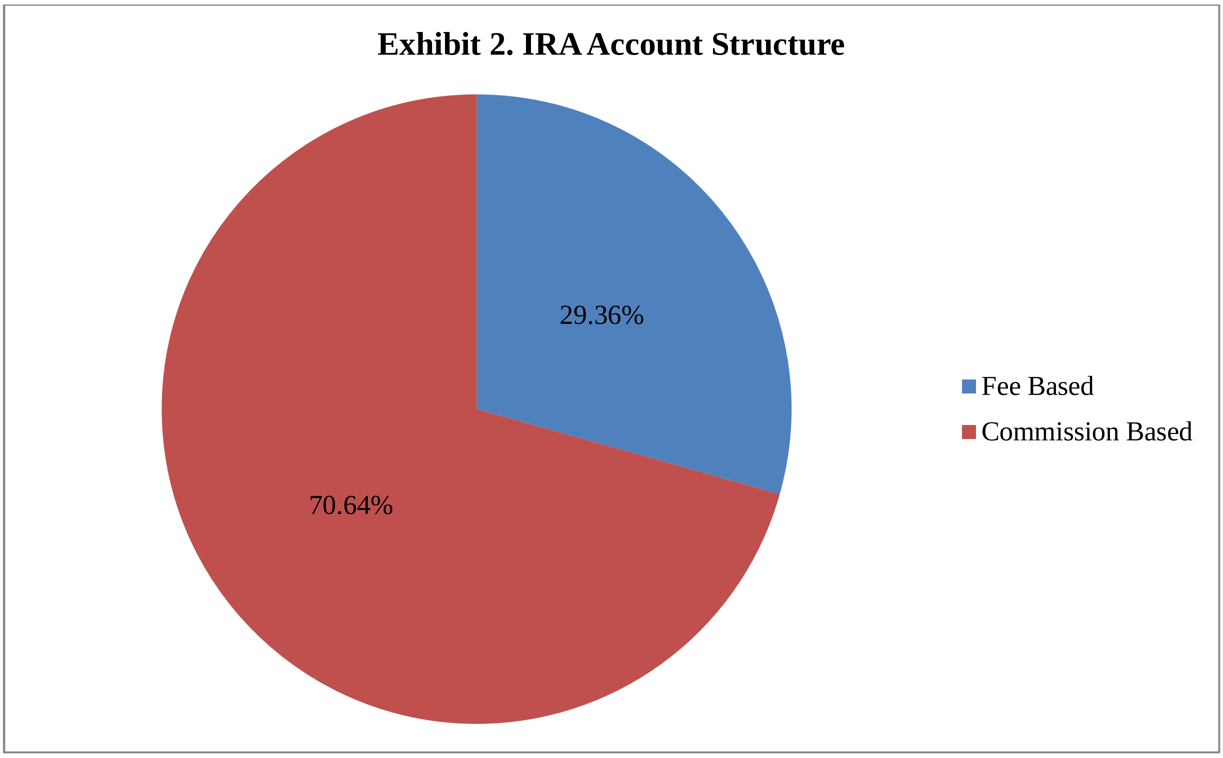
Exhibit 1. Distribution of IRAs by Age



The data we collected from the participating firms contains various types of account-level data fields, including: balances, fees, activity, and positions. In order to conduct an analysis, we merged the data from the various firms into one combined dataset.

Fees

Based on data received from participating firms, we classify IRAs into two broad fee-type categories: fee-based and commission-based accounts. Fee-based accounts are charged a fixed fee as a percentage of assets whereas commission-based accounts are charged fees based on trading and other activity. As shown in Exhibit 2, approximately 70.6 percent of our accounts are commission-based; the rest are fee-based.



Fees include all proceeds paid by the account-holder directly to the firm, such as management fees and trading commissions.[3] They exclude, however, fees paid to third-parties such as mutual fund managers.

The median account balance in our sample is $57,072, with the 25th and 75th percentiles falling at $17,511 and $166,794 respectively.[4] These summary statistics are shown in Table 1 below.

[3] Fees exclude revenue that the firm may receive indirectly from the account-holder, such as markup/markdown revenue or 12b-1 fees. Recognizing that such indirect revenues are not included in our fee data, we construct returns which are net of *all* fees, both direct and indirect. These net returns are presented in section I.E.

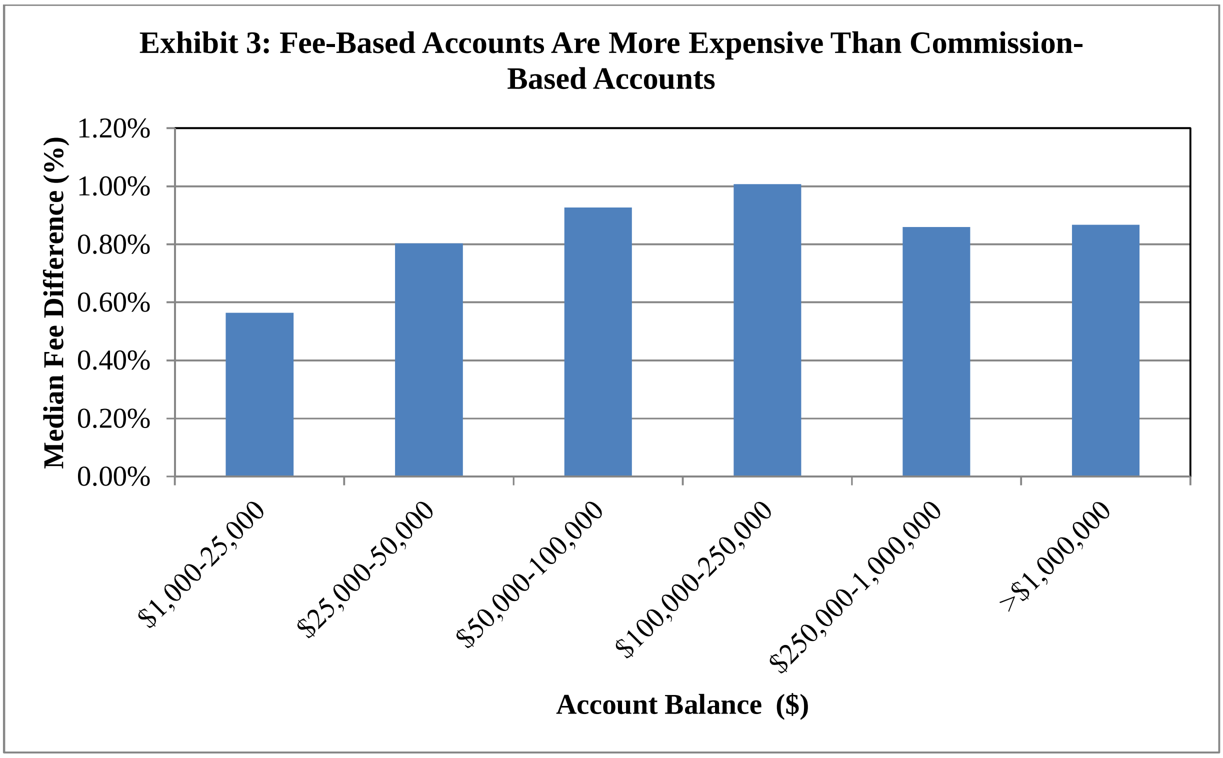
[4] In our analyses, we exclude accounts with balances below $1,000.

Table 1. Account Balances

	Account Balance ($)
Mean	174,034
Median	57,072
25th Percentile	17,511
75th Percentile	166,794

B. Some Accounts Would Become More Expensive under the DOL Proposal

Our account-level dataset allows us to identify a large number of accounts as having a fee structure which is either fee-based, or commission-based. In Exhibit 3, we present the difference between median fee-based and commission-based account fees, as a percentage of account balance, for various levels of account balance. The chart shows that this difference is always greater than zero; in other words, holders of fee-based accounts pay higher fees, in percentage terms, for all levels of account balance.



The differences tend to be in the range of about 57 basis points (bps) for relatively small accounts (those with balances below $25,000) up to about 1 percent for accounts with balances from $100,000 to $250,000. This suggests that investors would pay more if moved to fee-based accounts. Indeed, the magnitude of the increased cost is on par with the 1 percent "cost of conflicted advice" claimed in the White House/CEA memo that preceded the DOL proposal. The numerical results are reported in Table 2, below.

Table 2. Fees by Balance and Account Type

	Median		
Balance Range	**Fee Based**	**Commission Based**	**Difference**
$1,000-25,000	1.24%	0.67%	0.57%
$25,000-50,000	1.16%	0.36%	0.80%
$50,000-100,000	1.20%	0.27%	0.93%
$100,000-250,000	1.25%	0.24%	1.01%
$250,000-1,000,000	1.09%	0.22%	0.86%
Greater than $1,000,000	0.99%	0.12%	0.87%

C. Account-Level Data Suggests that Investors Select the Fee Model that Best Suits Their Own Needs and Trading Behavior

In the data, one of the most striking behavioral distinctions between fee-based and commission-based accounts is that the former tend to trade more frequently. We also calculated investors' aggregate trading activity by looking at both the number and dollar amount of purchases and sales in each account.[5] We measure trading activity in two ways: number of trades and account turnover. Number of trades counts each discrete purchase and sale during the time period. Account turnover takes the minimum of the total dollar amount purchased and the total dollar amount sold as a percentage of the average dollar balance during the year. Summary statistics of trading activity are presented below in Table 3.

[5] Where we could not break out dividends from new investments, trades may include dividend reinvestments.

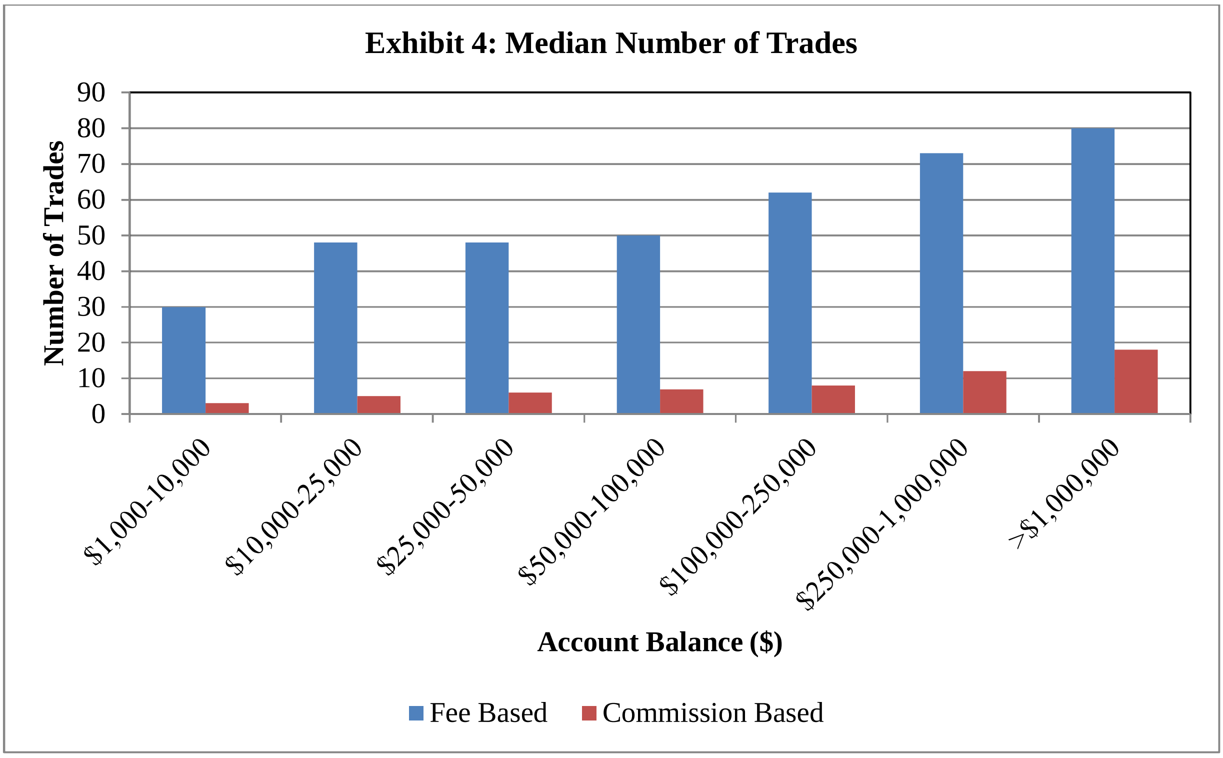
Table 3. Trading Activity

	Number of Trades	Account Turnover
Mean	54	34.11%
Median	16	14.79%
25th Percentile	4	4.84%
75th Percentile	56	39.31%

Exhibit 4 below shows the number of trades, or transaction frequency, of fee-based and commission-based accounts in 2014 for various account balance levels.

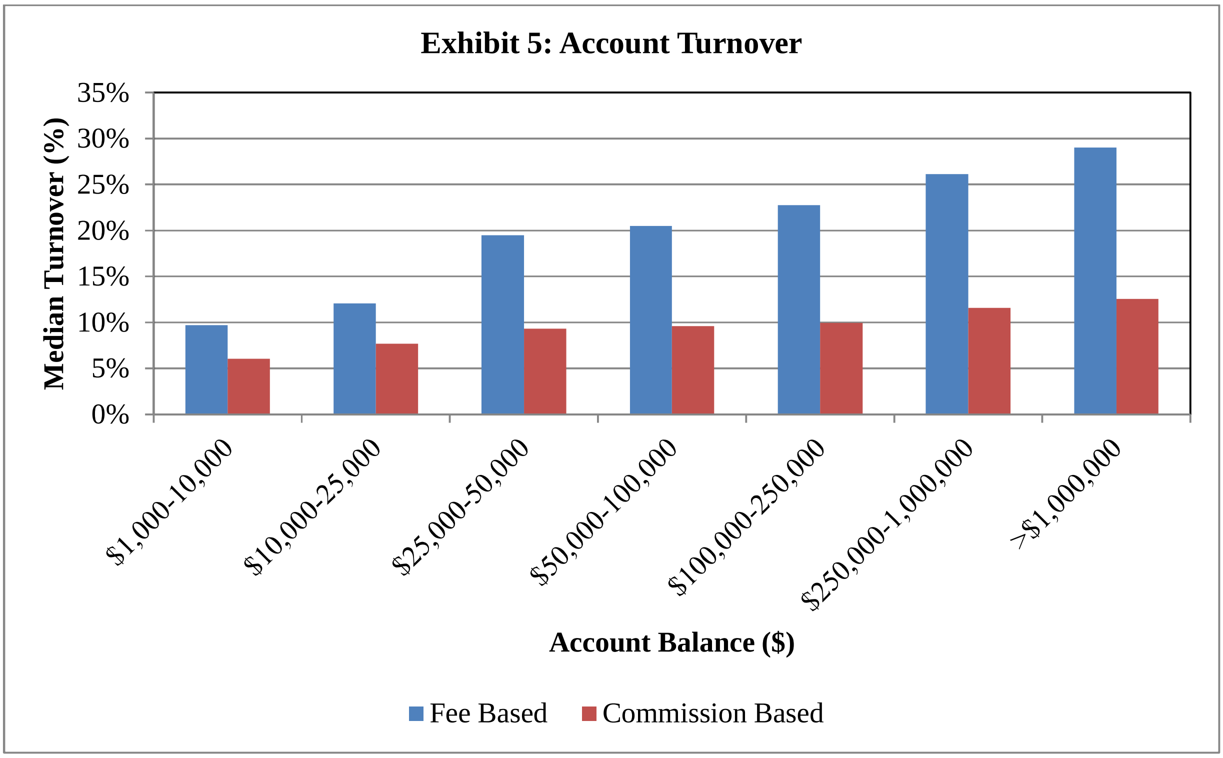
In 2014, the median trade frequency in commission-based accounts was just 6 trades. By comparison, in fee-based accounts the median trade frequency was 57 trades, with larger accounts generally trading more frequently than smaller ones.

Thus, the data are consistent with the idea that investors who expect to trade often rationally choose fee-based accounts whereas those that do not trade often are likely to choose commission-based accounts.



Additionally, it is worth noting that the data does not seem to show “churning,” the needless buying and selling of securities. We see the median commission-based account had traded 6 times in 2014.   Such trading is more consistent with a buy-and-hold strategy than churning.

The interpretation of the account-level data as being consistent with investors who trade infrequently self-selecting into commission-based accounts is further supported by account turnover. The median dollar-value of transactions, as a fraction of account balance, is show in Exhibit 5 below, for various levels of account balance.



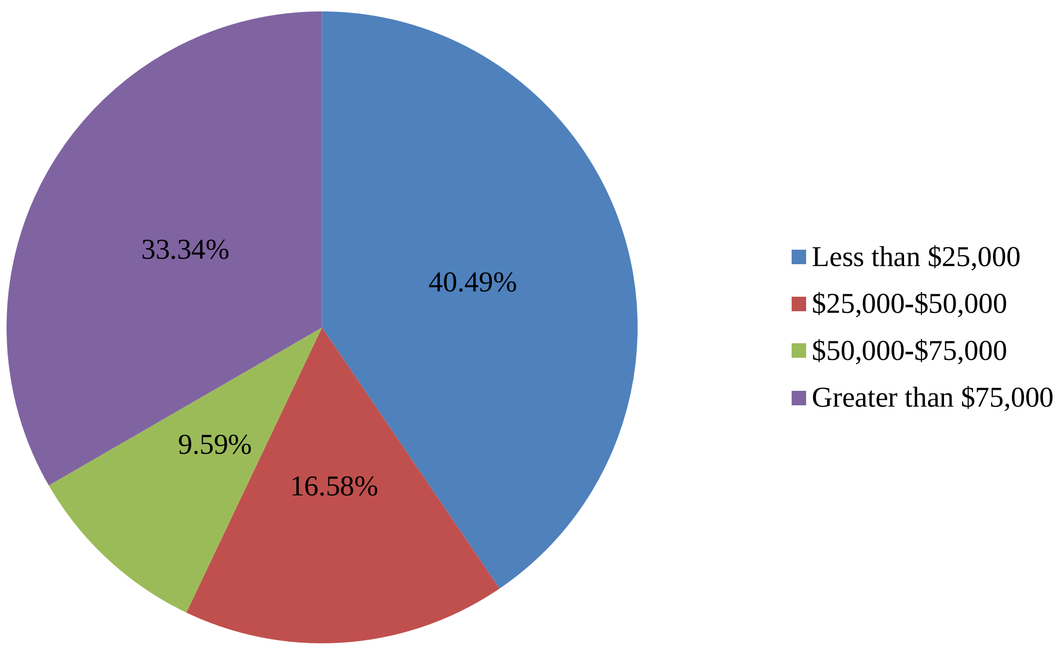
The median commission-based account across all balances only turns over 8.9 percent of its assets annually. For fee-based accounts the median turnover is 22.1 percent.

D. Some Account Balances Are Too Small for RIA Accounts

As mentioned above, a primary concern with the DOL proposal is that it would make commission-based accounts unworkable. If this turns out to be the case, investors will have to move to fee-based accounts or lose access to professional investment advice entirely.
Using our account-level data, we can estimate the number of investors who currently have commission-based accounts with balances below the minimum required account balance for advisory accounts.[6]

The results are shown in Exhibit 6. Using the conservative minimum account balance of $25,000, over 40% of commission-based accounts in our dataset would not be able to open fee-based accounts. Using a $50,000 threshold, over 57% of accounts would not meet minimum balance requirements for a fee-based account. If the effective threshold is $75,000, two-thirds of account holders would be left without any professional investment advice.

Exhibit 6: Commission-Based Accounts by Account Balance



[6] An important limitation in our data is that we have collected account-level data, which may not coincide with household-level data. We may therefore be understating the ability of some households to combine separate IRA accounts held within the same household to achieve the minimum balance requirement. This limitation also likely explains the existence of fee-based accounts smaller than $10,000 in our dataset.

E. Commission-Based Accounts Do Not Underperform

We calculate returns on a quarterly basis by calculating the change in account balance, adjusting for net flows during the quarter.[7] Since fees are deducted from account balances, either directly or indirectly, returns calculated based on account balances are net of fees.

We find that the median annualized return across all accounts in our sample, over the period from June 30, 2012 to March 31, 2015, is 10.3 percent.

In terms of differential fee structures, if investors in commission-based account are subject to the "cost of conflicted advice", then we would expect to see an underperformance in terms of the returns they earn. Indeed, this is explicitly the argument made in the DOL proposal.

Over the time periods for which we have data, commission-based and fee-based accounts exhibit similar performance, when calculated net of fees. The median differences in returns are shown, quarter by quarter, in Table 4. As the data show, the difference in return is sometimes positive and sometimes negative but small in magnitude. Moreover, the difference in returns is not statistically significant.

Table 4. Fee-Based Returns Less Commission-Based Returns

Date Range	Difference in Median Quarterly Return
06/30/12-09/30/12	-0.14%
09/30/12-12/31/12	0.63%
12/31/12-03/31/13	-1.96%
03/31/13-06/30/13	-0.91%
06/30/13-09/30/13	0.62%
09/30/13-12/31/13	-0.08%
12/31/13-03/31/14	-0.44%
03/31/14-06/30/14	-0.18%
06/30/14-09/30/14	-1.04%
09/30/14-12/31/14	0.04%
12/31/14-03/31/15	0.33%
Average	**-0.28%**

[7] Net flows include cash and other transfers to and from the account that are not investment-related (i.e.: withdrawals and contributions). Net flows were constructed to exclude fees, dividends, and interest, to the extent it was possible to identify these payments in the underlying transaction data. To eliminate the potential impact of outliers on our findings, we removed the top and bottom 1 percent of returns from our calculations (where such outliers may reflect the timing of transactions in our data, and not be reflective of actual returns).

Overall, from June 30, 2012 to March 31, 2015, the average difference (where again the difference is the fee-based return minus the commission-based return) is -0.28 percent. Thus, there is no support in this data for the contention that commission-based accounts underperform.[8] An alternative interpretation of the finding that returns are roughly equal across the two fee structures is that investors self-select into account types that are appropriate for them and that this leads to equilibrium.

II. Cost of Losing Access to Advice

In order to conduct a proper cost-benefit analysis, it is important to consider all of the costs associated the proposed rule. Indeed, the DOL Regulatory Impact Analysis itself states (p.99-100) that:

"A full accounting of a rule's social welfare effects would encompass all of the rule's direct and indirect effects as would be manifest in general market equilibrium. Likewise, that full accounting would consider pure social welfare costs – that is, reductions in economic efficiency – which are not the same as simple compliance costs."

The RIA goes on to recognize that (p. 100): *"The quantitative focus of this analysis, however, is on the proposal's most direct, and directly targeted, effects: gains to retirement investors, and compliance costs to advisers and others."*

But the DOL fails to measure one important cost—the cost of the loss of advice to investors. In this section we partly address this shortcoming by explicitly considering the costs that would be incurred by those consumers who completely lose access to professional investment advice as a result of the DOL proposal.

In prior studies, the DOL itself acknowledged this cost. An October 2011 DOL cost-benefit analysis published in the Federal Register on the "final rule" relating to the provision of investment advice under ERISA included estimates of the costs to consumers of not having access to advice.[9] In that document, the DOL estimated that participant-directed retirement

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[8] The sign of the difference might be read to mean that commission-based accounts outperform fee-based accounts in our dataset, but in fact the difference is not statistically different than zero in any of the quarters in our sample period.

[9] 29 CFR 2550, DOL, Investment Advice – Participants and Beneficiaries, Final Rule, October 2011.

savings account holders make investment mistakes in the absence of professional advice valued at an aggregate of “more than $114 billion in 2010” (p.66151).

Moreover, the 2011 DOL cost-benefit analysis estimated the effects of a change in public policy on investors’ access to professional investment advice. In particular, the DOL estimated that the enactment of the Pension Protection Act of 2006 (P.L. 109-280, the “PPA”) increased access to advice, and hence reduced aggregate investing errors by $7 billion to $18 billion per year. These are extremely large numbers, and hence clearly indicate the DOL’s own estimation of the importance to investors of access to professional advice.

A. Estimates of Number of Investors Who Will Lose Access to Advice

As discussed in section I.A above, our account-level data allows us to identify a large number of accounts as having a fee structure which is either fee-based, or commission-based, by account balance. For example, we noted above that 40.49 percent of the accounts that are currently commission-based have balances below $25,000 in our sample.

If the DOL proposal were to make commission-based accounts unworkable for broker-dealers, these accounts could no longer be maintained. Moreover, many commission-based accounts have small balances and so would be below the minimum account balance for advisory accounts. These investors will be left on their own with no access to professional investment advice.

If we were to take at face value the DOL’s methodology in the 2011 cost-benefit analysis discussed above, and assume a minimum-balance threshold of $25,000, the new fiduciary standard would cause a loss of access to professional advice for 40.49 percent of commission-based retirement account holders. It would take a relatively small number of such accounts to lose advice for this to result in an aggregate cost that exceeds the $17 billion in purported benefits claimed in the White House/CEA memo.

Moreover, this is based on a conservative estimate of the minimum balance, at only $25,000. Even at this level, the aggregate cost could easily be on par with the DOL’s own estimates of the “cost of conflicted advice”.

Hence, using the DOL’s own approach, the costs of the proposal likely exceed its benefits once we account for other costs such as the cost of compliance.

B. Implications of Losing Access to Advice: Individual Investors Make Systematic Errors When Investing on Their Own

In this section we first review the extensive academic and professional literature on the value to investors of having access to professional investment advice. The discussion begins with a survey of the potential pitfalls faced by many individuals who invest on their own. We then discuss the established literature that documents ways in which the use of professional advisors tends to lead to fewer such investment errors.

Additionally, it is worth noting that below, in section III.D, we discuss an earlier 2011 cost-benefit analysis on the Pension Protection Act of 2006 in which the DOL itself recognized the implications of investors losing access to professional investment advice. The conclusions of that DOL study are similar to the academic findings discussed in this section.

1. The disposition effect and mental heuristics

Ever since the seminal work of Kahneman and Tversky (1979, 1992), it has been widely accepted that individual investors are prone to making systematic mistakes in the way they evaluate and treat investment decisions in the presence of uncertainty.[10] Indeed, Kahneman was awarded the Nobel Prize in Economics for this work in 2002. This research agenda was typically accompanied by experimental data, but not backed up with actual accounts and transactions of individual investors.

In the 1990's, however, Odean (1998) built upon the earlier literature by analyzing the trading records of ten thousand accounts at a large nationwide discount brokerage firm. The dataset he collected covered the period 1987 through 1993.[11] The data includes an account identifier, trade dates, the security traded, a buy-sell indicator, the quantity traded, the commission paid and the principle amount. The study compared the selling price for each stock sold to its average price to determine whether that stock is sold for a gain or loss. One of the primary findings of the paper was that investors demonstrate a strong preference for realizing winners rather than losers. This phenomenon is now widely known as the "disposition effect" for individual investors.

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[10] Kahneman, D and A. Tversky (1979), "Prospect Theory: An Analysis of Decision under Risk," *Econometrica* **47** (2): 263 and Tversky, A and D. Kahneman (1992), "Advances in prospect theory: cumulative representation of uncertainty," *Journal of Risk and Uncertainty* **5** (4): 297–323.

[11] Odean, T. (1998), "Are Investors Reluctant to Realize Their Losses?" *Journal of Finance*, 53, 1775-1798.

Since Odean (1998), the disposition effect has been confirmed by numerous studies. Goetzmann and Massa (2004) construct a variable based on investor trades that acts as a proxy for the representation of disposition-prone investors in the market and test how it relates to stock returns. [12] The authors report a strong negative correlation between the disposition effect and stock returns. Grinblatt and Han (2005) also study the disposition effect, and in particular the tendency of investors to hold on to their losing stocks.[13] They attribute this behavior to prospect theory, or the tendency to under weigh outcomes that are merely probable in comparison to outcomes that are obtained with certainty, and to a psychological phenomenon known as "mental accounting". The authors find that the tendency for households to fully sell winning stocks is weaker for wealthy investors with diversified portfolios of individual stocks.

Franzini (2006) uses a database of mutual funds holdings to construct a measure of reference prices for individual stock and confirms the existence of the disposition effect.[14] Moreover, the author suggests that the disposition effect can induce under-reaction by individual investors to news, leading to return predictability and post-announcement price drift. In particular, bad news travels slowly among stocks trading at large capital losses, in turn leading to a negative price drift, and good news travels slowly among stocks trading at large capital gains.

Nor is this literature limited to academic circles. The Morgan Stanley Consulting Group (2014), for example, studied the various behavior biases that can impair the performance of individual investors in managing their own portfolios.[15] The authors point to "psychological blindspots" that negatively influence investors such as overconfidence, mental accounting, anchoring biases, framing biases and loss aversion. Their research suggests that a financial advisor can mitigate the effects of these problems because they have a clearer understanding of the investment process.

2. Mental heuristics disproportionately affect people with fewer savings

As argued above, the academic literature has documented evidence that individual investors display irrational and costly investing behavior in the form of the disposition effect.

[12] Goetzmann, W. and M. Massa (2004), "Disposition Matters: Volume, Volatility and Price Impact of Behavioural Bias," *Centre for Economic Policy Research*, Paper No. 4814.
[13] Grinblatt, Mark and Bing Han (2005), "*Prospect theory, mental accounting and momentum," Journal of Financial Economics,* 78, 311-339.
[14] Frazini, Andrea (2006), "The Disposition Effect and Underreaction to News," *The Journal of Finance*, 61, No. 4
[15] Morgan *Stanley Consulting Group*, "The Value of Advice," (2014), available on-line at www.morganstanleyfa.com/public/projectfiles/thevalueofadvice.pdf

Beyond this general observation, there is also a strand of research that shows that these flaws tend to disproportionately affect people with lower levels of wealth.

Grinblatt and Keloharju (2000) employ the central register of shareholdings for Finnish stocks in the Finnish Central Securities Depository (FCSD), a comprehensive data source which covers 97 percent of the total market capitalization of Finnish stocks beginning in 1995.[16] The data set reports institutional holdings and stock trades on a daily basis. The authors find that generally the more sophisticated the investor and the greater the wealth invested in stocks, the less contrarian (buying losing stock and selling winning stock) is the investment strategy. The degree of contrarianism appears to be inversely related to a ranking of the sophistication of investor types.

Dhar and Zhu (2002) analyze the trading records of a major discount brokerage house and confirm the existence of the disposition effect.[17] The paper finds empirical evidence that wealthier and individual investors in professional occupations exhibit less disposition effect. Trading experience also tends to reduce the disposition effect.

Calver, Campbell and Sodini (2009) study a dataset containing the disaggregated wealth of all households in Sweden between 1999 and 2002. The authors find that contrary to rational expectations, households are more likely to fully sell directly held stocks if those stocks have performed well and more likely to exit direct stockholding if their stock portfolios have performed well.[18] This paper examines changes in household behavior over time, specifically decisions to scale up or down the share of risky assets in the total portfolio, to enter or exit risky financial markets, to full sell individual risky assets and to scale up or down the share of individual assets in the risky portfolio. By doing so, the authors develop an adjustment model with different target risky shares across households. The authors find that wealthy, educated investors with better diversified portfolios tend to rebalance more actively. Specifically, the authors point to wealth and portfolio diversification as more relevant than income in predicting the strength of the disposition effect

[16] Grinblatt, Mark and Matti Keloharju (2000), "The investment behavior and performance of various investor types: a study of Finalnd's unique data set" *Journal of Financial Economics*, 55, 43-67.
[17] Dhar, Ravi and Ning Zhu (2002), "Up Close and Personal: An Individual Level Analysis of the Disposition Effect," *Yale ICF Working Paper No. 02-20.*
[18] Calver, Laurent E. and John Y. Campbell and Paolo Sodini (2009), "Fight or Flight?" *The Quarterly Journal of Economics*, 124, 1.

Cerqueira Leal, Rocha Armada and Duque (2010) use a database of 1,496 trading records of individual investors in the Portuguese stock market from January 1, 1999 to December 31, 2002, consisting of initial position, account movements, events and daily closing stock prices.[19] The authors then calculate the "proportions of gains realized and the proportions of losses realized" based on each investor's portfolio for each day of the sampling period. The authors find that less sophisticated investors (defined by average account value, number of shares traded and number of trades) exhibit a stronger disposition effect.

3. Individual investors churn

Aside from the disposition effect described above, another well-known error that is commonly observed in un-advised, self-directed, individual investors is the tendency to trade too often, or "churn". In a seminal paper, Barber and Odean (2000), analyze the returns earned on common stock investment by 66,465 self-directed households. The net return earned by these households underperforms a value-weighted market index by about 9 basis points per month (or 1.1 percent annually).[20] Those that trade the most earn an annual return rate of 11.4 percent, while the market returns 17.9 percent. The poor performance of the average household can be traced to the costs associated with this high level of trading. The authors find a negative correlation between trading frequency and investment returns.

Similarly, Barber, Lee, Liu and Odean (2007) use a complete trading history of all investors in Taiwan, and document that the aggregate portfolio of individual investors suffers an annual penalty of 3.8 percentage points.[21] These losses virtually all come from aggressive trading. In contrast, institutional investors enjoy an annual performance boost of 1.5 percentage points--even after commission and transaction taxes. Foreign institutional investors garner nearly half of the institutional profits. The author points out that investors who are saving to meet long term goals would benefit from effective guidance regarding best investment practices.

[19] Cerqueira Leal, Cristiana and Manuel J. Rocha Armada, and Joao C. Duque (2010), "Are All Individual Investors Equally Prone to the Disposition Effect All The Time? New Evidence from a Small Market," *Frontiers in Finance and Economics*, 7, No. 2, 38-68.

[20] Barber, M. Brad and Terrance Odean (2000), "Trading is Hazardous to Your Wealth: The Common Stock Investment Performance of Individual Investors" *The Journal of Finance*, 60, No. 2.

[21] Barber, Brad M., Yi-Tsung Lee, Yu-Jane Liu, and Terrance Odean (2007) "Just How Much Do Individual Investors Lose by Trading?" *AFA 2006 Boston Meetings Paper*.

C. Benefits of Financial Advisors

Having established that individual investors are prone to making systematic mistakes in their investing due to behavioral biases, it is natural to ask whether such errors are reduced, on average, by having access to professional advice. The answer, unsurprisingly, tends to be "yes" in the by extensive academic and professional literature.

1. Portfolio allocations that are more diversified and closer to model portfolios

Bluethgen, Gintschel, Hackethal and Mueller (2008) examine a dataset of 12,000 German bank accounts, categorizing bank customers as "advised customers" or "self-directed", and find that financial advice enhances portfolio diversification, and makes investor portfolios more congruent with predefined model portfolios.[22] While the bank in the study derived more revenues from advised clients, the advised clients' portfolios also resembled more closely the optimal portfolios prescribed by financial theory. The authors conclude that financial advisory service has a "significant impact on household investment behavior."

Gerhardt and Hackethal (2009) collect a data set on 65,000 private investors and analyzed the portfolio composition and trading behavior of more than 14,000 persons and note that there are clearly positive effects to working with an advisor.[23] These benefits include: less speculative trading and a more diversified portfolio.

A study commissioned by the Investment Funds Institute of Canada (2010) analyzed a longitudinal database with Canadian households' financial behaviors and attitudes.[24] The study isolated 3200 households and broke the sample into two groups – those who had an advisor in both years and those who did not have an advisor in either year. The authors found that households that received investment advice had substantially higher investable assets that non-advised households, controlling for age and income level. Additionally, investors without advice save less, utilize tax-advantaged savings opportunities less, and invest in securities with less opportunity for future investment growth than their advised counterparts.

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[22] Bluethgen, Ralph, Andreas Gintschel, Andreas Hackethal, and Armin Mueller (2008), "Financial Advice and Individual Investors' Portfolios."

[23] Gerhardt, Ralf and Andreas Hackethal (2009), "The Influence of Financial Advisors on Household portfolios: A study on Private Investors switching to Financial Advice," February 14, 2009.

[24] The Investment Funds Institute of Canada (2010), "The Value of Advice Report," available on-line at www.ific.ca/wp-content/uploads/2010/07/IFIC-Value-of-Advice-Report-2010-July-2010.pdf/4001/

A paper by the Investment Funds Institute of Canada (2012) stresses the importance of the CIRANO 2012 research, as well as citing papers from Australia and the United States.[25] Summarizing the existing literature, the paper notes that research proves that advice has a positive and significant impact on wealth accumulation, leads to better long term investment strategies and benefits the wider macroeconomy.

Kramer (2012) compares portfolios of advised and self-directed Dutch individual investors to investigate whether financial advisers add value to individual investors' portfolios.[26] The author finds that advised portfolios are more diversified and perform better than self-directed portfolios, thus reducing avoidable risk. The author (at least partly) attributes the reduction of idiosyncratic risk observed in advised portfolios to advisory intervention

In a widely-cited paper, Kinniry, Jaconetti, DiJoseph and Zilbering (2014), argue that through suitable asset allocation using broadly diversified funds/ETFs, cost effective implementation, rebalancing, behavioral coaching, asset location, spending strategy, and total-return versus income investing strategies, advisors can potentially add about 3 percent in net returns to investors.[27] For some investors, the value of working with an advisor is peace of mind. The value of an advisor for investors "without the time, willingness, or ability to confidently handle their financial matters" should not be ignored by "the inability to objectively quantify it." The authors argue that value added cannot be analyzed as an annual figure because "the most significant opportunities to add value occur during periods of market duress or euphoria when clients are tempted to abandon their well-thought-out investment plan."

Mardsen, Zick and Mayer (2011) argue that working with an advisor is related to several important financial planning activities including goal setting, calculation of retirement needs, retirement account diversification, use of supplemental retirement accounts, accumulation of emergency funds, positive behavioral responses to the recent economic crisis and retirement confidence.[28]

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[25] The Investment Funds Institute of Canada (2012), "The Value of Advice Report," available on-line at www.ific.ca/wp-content/uploads/2013/02/IFIC-Value-of-Advice-Report-2012.pdf/1650 /

[26] Kramer, Marc M. (2012), "Financial Advice and Individual Investor Portfolio Performance," *Financial Management,* 41, No. 2, 395-428.

[27] Kinniry, Francis M., Jr., Colleen M. Jaconetti, Michael A. DiJoseph, and Yan Zilbering (2014), "Putting a value on your value: Quantifying Vanguard advisor's Alpha," *The Vanguard Group.*

[28] Mardsen, Mitchell, Cathleen D. Zick, and Robert N. Mayer (2011), "The Value of Seeking Financial Advice," *Journal of Family and Economic Issues,* 32, No. 4, 625-643.

Winchester, Huston and Finke (2011) collect data containing 3,022 respondents with at least $50,000 in annual income.[29] These individuals also had equity holdings that they could control or direct during market downturns. The authors used "investor prudence" as the dependent variable and noted whether the individuals rebalanced their portfolio over a market decline. The authors find that investors who use a financial advisor are about one-and-a half times more likely to adhere to long-term investment decisions. Moreover, investors with a written financial plan are almost twice as likely to make optimal long term financial decisions.

2. Advisors help investors stop making investing mistakes

Shapira and Venezia (2001) argue that professionally-managed accounts experienced better roundtrip performance than those administered independently.[30] The authors find that the disposition effect, or the tendency of investors to sell shares whose price has increased, while keeping assets that have dropped in value, is significantly weaker for professional investors. This indicates that professional training and experience reduces judgmental biases, even though it cannot eliminate them. The authors point to this as an advantage in enlisting professional advice.

Maymin and Fisher (2011) used data from a boutique investment management firm, Gertstein Fisher.[31] The data includes all account and household information, client introduction history, notes, and portfolio allocations and performances since 1993. The authors test five predictions by analyzing the contacts actually recorded between clients and the manager in the data set. The authors conclude that the advisor's role in helping investors stay disciplined and on plan in the face of market volatility, including dissuading them from excessive trading, is one that is highly valued by the individual investor.

3. Tax minimization

Horn, Meyer and Hackethal (2009) use transaction data from a German bank from 1999-2008, to study a natural experiment of the introduction of a withholding tax in Germany in order to see how private investors react to changes in taxation.[32] The authors conclude that financial

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[29] Winchester, Danielle D., Sandra J. Huston, and Michael S. Finke (2011), "Investor Prudence and the Role of Financial Advice," *Journal of Financial Service*, 65, No. 4, 43-51.
[30] Shapira, Zur and Itzhak Venezia (2001). *Patterns of Behavior of Professionally Managed and Independent Investors*, Journal of Banking and Finance, 25, No. 8, 1573-587.
[31] Maymin, Philip Z. and Gregg S. Fisher (2011), "Preventing Emotional Investing: An Added Value of an Investment Advisor." *The Journal of Wealth Management*, 13, No. 4.
[32] Horn, Lutz, Steffen Meyer and Andreas Hackethal (2009), "Smart Investing and the Role of Financial Advice – Evidence from a natural Experiment Using Data Around a Tax Law Change," Working Paper Series.

advisors help people make smarter investment decisions because of their financial sophistication and experience in tax-related investment decisions.

Martin and Finke (2012) uses both the 2004 and the 2008 waves of the National Longitudinal Survey of Youth to estimate the impact of financial advice on retirement savings and the change in accumulated retirement wealth between 2004-2008.[33] The authors compare the effectiveness of creating one's own retirement plan versus using a professional advisor. The authors find that the use of a comprehensive financial professional overwhelmingly increases the likelihood that households will go through the process of calculating retirement needs. Respondents who rely on an advisor to help plan for retirement are more likely to own tax-advantaged accounts. Authors conclude that planning, with the help of a comprehensive advisor, improves retirement outcomes.

4. Increased savings

Montmarquette and Nathalie (2015) used Ipsos Reid collected data in the form of a 45-question internet survey from 18,333 Canadian Households.[34] The data were filtered to produce a high quality sample of 3,610 households. After splitting up the data into "advised households" and "non-advised households" the authors used econometric modelling in order to isolate the benefits of advisors in the accumulation of wealth.

Econometric results show that participants retaining the services of a financial advisor for more than 15 years have about 174 percent more financial assets (in other words, 2.73 times the level of assets) than non-advised respondents. The authors conclude that a highly plausible explanation for this finding comes from the greater savings and improved asset selection that is associated with having a financial advisor. Those investors who have advice are more likely to trust financial advisors, associate satisfaction with financial advisors and have confidence in financial advisors.

Similarly, in a KPMG Econtech (2009) paper based on the results of a regression analysis from an economy-wide model, the authors conclude that an individual who has a financial planner is estimated to save $2,457 more in a year compared to similar individuals without

[33] Martin, T. K. and Michael S. Finke (2012), "*Planning for Retirement,*" (December 31, 2012), available at SSRN: papers.ssrn.com/sol3/papers.cfm?abstract_id=2195138

[34] Montmarquette and Nathalie Viennot-Briot (2015), "The Value of Advice," Annals of Economics and Finance, 16-1, 69-94. This paper was also published as Montmarquette and Veinnot-Briot (2012), "Econometric Models on the Value of Advice of a Financial Advisor," at the Centre interuniversitaire de recherché en analyse des des organisations.

financial advisors/planners.[35] Investors with a financial planner have greater savings and investment balances than those who do not.

A study by Standard Life (2012) based on collected data from the UK, reports that the current average pension pot for consumers who have been advised on their retirement planning is £74,554.30, nearly double that of those not seeking advice.[36] Those who have taken advice put nearly a third more a month into their pension plan. On investments, people with an adviser save for longer and contribute more, leading to an average investment value which is over £40,000 higher than the average for those who haven't sought advice.

Lastly, Antunes, Macdonald and Stewart (2014) construct a hypothetical scenario using collected survey data that included age, average savings, average income and the presence of an advisor.[37] After collecting the data, the authors assume that 10 percent of the income of non-advised savers is now saved at the higher rate of those who do receive financial advice in order to capture the increased savings level that is correlated with having an advisor. This paper then applied the percentage difference between this savings rate and the baseline savings rate to the Conference Board of Canada's long term national forecasting model to quantify the economic impact of the increased savings in the long run. On top of positively impacting an investor's savings rate, the presence of an advisor was also shown to boost real GDP, turn consumer expenditures positive and raise the aggregate household savings rate.

5. Economies of scale with respect to the cost of information

In a highly-regarded paper by Stoughton, Wu and Zechner (2010), the authors create a model with three classes of agents: the active portfolio manager, the set of financial advisers and the pool of investors in the economy.[38] The authors first derive an equilibrium assuming that financial advisers are independent and must charge their investors their full costs in order to break even and allow portfolio manager to provide payments to the adviser. Then, the authors run the model to solve for the optimal amount of rebates preferred by the portfolio manager and

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[35] "Value Proposition of Financial Advisory Networks" (2009), *KPMG Econtech*. www.fsc.org.au/downloads/uploaded/2009_1105_KPMGEcontech(FinalReport)_7d94.pdf

[36] Standard Life (2012), "Value of Advice Report," available on-line at www.unbiased.co.uk/Value-of-Advice-Report-2012.pdf

[37] Antunes, Pedro, Alicia Macdonald and Matthew Stewart (2014), "Boosting Retirement Readiness and the Economy Through Financial Advice," *The Conference Board of Canada.*

[38] Stoughton, Neal M., Youchang Wu, and Josef Zechner (2010), "Intermediated Investment Management," *Journal of Finance,* 66, No. 3. 947-980.

the impact on management fees, fund sizes and flows. Finally, the paper derives the equilibrium without an adviser and compares all the scenarios. The authors find that financial advisers facilitate the participation of small investors in actively managed portfolios by economizing on information costs.

It is also interesting to note that the DOL itself wrote, in a 2011 cost benefit analysis of the final rule on investment advice under ERISA[39] (p. 66156) that "The Department therefore expects this final rule to produce cost savings by harnessing economies of scale and by reducing compliance burdens." "For example, an adviser employed by an asset manager can share the manager's research instead of buying or producing such research independently."

D. The Cost of Losing Access to Professional Investment Advice

While the 2015 DOL regulatory impact analysis (RIA) ignored the costs of investors losing access to advice, the 2011 SEC staff's 913 study as well as the 2011 DOL cost-benefit analysis, both mentioned above, both discussed the costs of investors not having access to advice.

We note that the DOL's 2010 proposal differs from the current one in some of its details. However, both proposals raise the same troubling implications for current investors in commission-based accounts by increasing the complexity and compliance costs associated with offering that fee structure to customers.

1. Review of the SEC (2011) assessment: costs of imposing a fiduciary standard on brokers

As mentioned above, the SEC staff undertook a study in 2011 designed to evaluate the effectiveness of existing regulatory standards for investment advisers and brokers. The study was mandated under Section 913 of Title IX of the Dodd-Frank Act and analyzed some of the potential costs associated with changes to the current regulatory framework (see p.143-165), including imposition of a fiduciary standard on brokers.

In this section we review the discussion in SEC (2011) regarding the potential costs and expenses to retail customers, and the potential impact on the profitability of their investment

[39] See footnote 10.

decisions, including access to the range of products and services offered by broker-dealers, resulting from imposing on broker-dealers the fiduciary standard associated with the Investment Advisers Act of 1940.

The primary concern mentioned in SEC (2011) is with respect to the cost and availability to retail investors of accounts, products, services, and relationships with broker-dealers, which could inadvertently be eliminated or impeded (for example, through higher costs to brokers being passed on to investors).[40]

In general imposition of a new regulatory standard of conduct on broker-dealers has the potential for additional costs on broker-dealers, which would be passed on to the customers at least in part, according to the standard economic theory of "effective incidence". That theory simply states that it is likely that at least some portion of the regulatory costs imposed by the government is ultimately passed on to the public.[41] In turn, costs passed on to retail investors would have the effect of eroding the profitability of their investments.

The net cost impact on retail customers would likely depend on a complex interplay of various factors, such as investor wealth, investor willingness to pay additional fees, and size of the particular broker-dealers in question as well as the competitive landscape. To take an extreme example, in relation to the UK experience, the FSA found[42] that smaller firms and firms with less revenue were more likely to either exit the market or alter the types of services provided, in response to new government regulations.

The following discussion presents some further detail on specific concerns discussed in SEC (2011).

a. **Brokers may deregister and register as investment advisers and, in the process, convert their brokerage accounts into advisory accounts subject to advisory fees.**

One concern expressed in SEC (2011) associated with the imposition of a fiduciary standard is the possibility that brokers would convert existing accounts from commission-based

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[40] See p. 155-159.

[41] See, for example, Mukherjee, S. (2002), Modern Economic Theory, at p.833.

[42] Oxera, Retail Distribution Review Proposals: Impact on Market Structure and Competition, prepared for the Financial Services Authority, Mar. 2010

accounts to fee-based accounts, in order to respond to new requirements placed on those account. The ultimate cost impact of this would depend on the actual fees and commissions, the relative extent to which the accounts in question had been actively trading, and any increased costs associated with providing advice for a fee.[43]

Additionally, there could also be "fee layering" (whereby fees are charged based both on the value of the assets as well as account fees such as administrative and custodial fees), especially for less actively traded accounts.[44]

An Oliver Wyman/SIFMA 2010 study[45] notes that there are significant cost differences between broker-dealer and advisory accounts, and if a change in the regulatory regime has the effect of pushing more clients toward the higher-cost model then this could be a suboptimal outcome for those investors. They estimate cumulative returns to retail customers with $200,000 in assets would be reduced by $20,000 over the next 20 years in such a scenario.

The 2011 SEC study states on p.162 that: "One possible way that costs could increase is if broker-dealers whose customers want advice and who currently provide the full range of brokerage services…for a single commission (or mark-up) and perhaps minor account level fees, simply converted these accounts to investment adviser status and cease to provide execution services to retail investors who sought advice. If that were the case, custody costs to the retail investors would be higher. Advice costs charged, at least initially upon conversion (and absent the investor researching competitors' prices), would also be higher for those investors who buy and hold, because either an hourly or asset-based fee would likely exceed the current commission or mark-up on a retail trade."

The 2011 SEC study goes on to note: "In sum, to the extent that broker-dealers respond to a new standard by choosing from among a range of business models, such as converting brokerage accounts to advisory accounts, or converting them from commission-based to fee-based accounts, certain costs might be incurred and ultimately passed on to retail investors in the

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[43] See p. 155-159.
[44] See p. 172
[45] Oliver Wyman, Securities Industry and Financial Markets Association, Standard of Care Harmonization: Impact Assessment for SEC, Oct. 2010.

form of higher fees or lost access to services and products. Any increase in costs to retail investors detracts from the profitability of their investments."[46]

b. Broker-dealers may unbundle their services and provide them separately through affiliates or third parties.

The SEC (2011) study notes that broker-dealers might choose to unbundle their services and provide some of the component services through third parties.[47] A brokerage relationship involves various component functions: finding customers; providing advice to those customers; executing orders; clearance and settlement services; custodial services; and recordkeeping services, such as trade confirmations and account statements.

SEC (2011) argues that costs to broker-dealers are likely to depend on whether these services were provided by one firm or whether they were divided among affiliates. For example, a broker can self-clear securities transactions or contract with a third-party clearing broker to clear transactions. A broker can act as custodian for securities itself or contract with a third party such as a bank.

Brokers could decide to divide some or all of these functions. As noted in SEC (2011), to the extent broker-dealers may transfer accounts or personnel to affiliates, this may generate additional administrative costs.

2. The DOL (2011) Federal Register Study

While the most recent 2015 DOL RIA did not provide estimates of the cost to investors of losing professional investment advice, an earlier DOL (EBSA) study in 2011, previously cited, did in fact do so. The 2011 DOL *Federal Register* article published the final rule relating to the provision of professional investment advice to plans and beneficiaries of IRAs, under ERISA.

The 2011 DOL publication explicitly argues that participants in participant-directed retirement savings accounts make mistakes. In particular, the study notes (p.66151) that:

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[46] See p. 162.

[47] See p. 164, 173.

"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. Specifically, these 'prohibited transaction' provisions of section 406 of ERISA and section 4975 of the Internal Revenue Code prohibit fiduciaries from dealing with DC plan or IRA assets in ways that advance their own interests."

The DOL estimates this error rate costs an aggregate of "more than $114 billion in 2010" (p.66151). The study goes on to say (p. 66159) that: "The Department is highly confident in its conclusion that investment errors are common and often large, producing large avoidable losses (including foregone earnings) for participants. It is also confident that participants can reduce errors substantially by obtaining and following good advice. While the precise magnitude of the errors and potential reductions therein are uncertain, there is ample evidence that that magnitude is large."

The DOL then argued that the PPA, by permitting a broader array of investment advice under ERISA, decreased the amount of errors made by investors. For example, the study states (p.66152): "the Department believes this final regulation will provide important benefits to society by extending quality, expert investment advice to more participants, leading them to make fewer investment mistakes. The Department believes that participants, after having received such advice, may pay lower fees and expenses, engage in less excessive or poorly timed trading, more adequately diversify their portfolios and thereby assume less uncompensated risk, achieve a more optimal level of compensated risk, and/or pay less excess taxes."

The DOL estimated that the reduction in investment errors due to the expansion of availability of investment advice would amount to between $7 billion and $18 billion annually, or approximately 6 percent to 16 percent of the $114 billion total in investment errors made per year.[48] At the upper range these numbers are as large as the supposed cost of conflicted advice that the DOL Fiduciary Standard is designed to alleviate.

[48] The DOL stated that it based its estimates on the retirement assets in DC plans and Individual Retirement Accounts reported by the Federal Reserve Board's Flow of Funds Accounts (Mar. 2011), at www.federalreserve.gov/releases/z1/Current/. The study also refers the reader to earlier DOL studies including 74 FR No 164 (Aug. 22, 2008), 74 FR No 12 (Jan. 21, 2009), and 75 FR No 40 (Mar. 2, 2010).

The investment mistakes discussed in the 2011 RIA are grounded in the behavioral finance literature, which we have discussed in detail above. For example, the DOL stated (p. 66153) that “in practice many investors do not optimize their investments, at least not in accordance with generally accepted financial theories. Some investors fail to exhibit clear, fixed and rational preferences for risk and return. Some base their decisions on flawed information or reasoning. For example some investors appear to anchor decisions inappropriately to plan features or to mental accounts or frames, or to rely excessively on past performance measures or peer examples. Some investors suffer from overconfidence, myopia, or simple inertia.”

The study then goes on to focus on five types of investment mistakes:

a) *Fees and Expenses.* The DOL stated that it believes that (p. 66153) “there is a strong possibility that at least some participants, especially IRA beneficiaries, pay inefficiently high investment prices.” However, it is not clear what empirical evidence the DOL used as its basis for this statement.

b) *Poor Trading Strategies.* The study cited churning, failure to rebalance, attempts to time the market, and chasing past returns as examples of strategies that tend to underperform.

c) *Inadequate Diversification.* The DOL claims that DC plan participants sometimes concentrate their assets excessively in stock of their employer, as well as being under-invested in international equity or debt.

d) *Inappropriate Risk.* The study notes that investors may construct portfolios that are too risky or too safe, given their preferences.

e) *Excess Taxes.* The DOL study mused that some households appear to follow sub-optimal strategies with respect to minimizing taxes, such as not placing taxable bonds in tax-deferred accounts. However, the DOL also stated that (p. 66154) “the Department currently has no basis to estimate the magnitude of excess taxes that might derive from participants’ investment mistakes.”

Despite the rather lengthy description of the above types of investment errors, the DOL did not use data from actual investor-held accounts to estimate the magnitude of the associated losses. Instead, they made a variety of assumptions, summarized as follows:

1) The DOL assumed that approximately 40 percent of DC plan sponsors provided access to investment advice before the PPA.[49] After enactment of the PPA, they assumed this percentage increased to between 56 and 69 percent.

2) They assumed that about 25 percent of plan participants that are offered advice use the advice (both pre-PPA and post-PPA). For IRAs, they assumed that 33 percent used advice pre-PPA, and between 50 percent and 80 percent post-PPA.[50,51]

3) Investors who received advice make mistakes about half as often as those who are unadvised (they also consider other fractions).

Finally, the above assumptions are combined with the previously mentioned assumption that aggregate investment errors cost consumers about $114 billion per year to arrive at the final estimates of between $7 billion to $18 billion per year from having increased access to professional investment advice.

Taking the DOL's methodology and results at face value, by their own calculations the loss of access to advice, by even a small fraction of investors, would result in investment errors so large as to be of the same magnitude as the problem that the DOL is purportedly trying to solve—the "cost of conflicted advice," by the DOL's own reckoning, is on par with the losses that would be incurred by a government policy that curtails the availability of professional investment advice.

III. THE COST OF CONFLICTED INVESTMENT ADVICE

We begin with a review of the claims of harm associated with purportedly conflicted investment advice, as put forth in White House memo entitled "The Effects of Conflicted Investment Advice on Retirement Savings" ("WH/CEA memo") published in February 2015 and the Department of Labor's (DOL) proposed conflict of interest rule and definition of the term

[49] The DOL attributed these numbers at least partly to surveys including Hewitt Associates LLC, *Survey Findings: Hot Topics in Retirement, 2007* (2007); Profit Sharing/401(k) Council of America, *50th Annual Survey of Profit Sharing and 401(k) Plans* (2007); and Deloitte Development LLC, *Annual 401(k) Benchmarking Survey, 2005/2006 Edition* (2006).
[50] These are based on Employee Benefit Research Institute, *2007 Retirement Confidence Survey, Wave XVII,* Posted Questionnaire (Jan. 2007); Hewitt Associates LLC, *Survey Findings: Hot Topics in Retirement, 2007* (2007); Profit Sharing/401(k) Council of America, *50th Annual Survey of Profit Sharing and 401(k) Plans* (2007); and Deloitte Development LLC, *Annual 401(k) Benchmarking Survey, 2005/2006 Edition* (2006).
[51] It is interesting to note that the DOL assumed that "a large majority of IRA beneficiaries who invest in mutual funds purchase them via such professionals."

“fiduciary” under ERISA (the “proposal”), and associated Regulatory Impact Analysis (“RIA”).[52,53]

The estimates in these documents form the basis of the Department of Labor’s argument that the proposed conflict of interest rule would “benefit” the public. The Regulatory Impact Analysis in particular purports to quantify these benefits in dollar terms. As shown in detail in the next section, however, the RIA fails to do so. The RIA produces many different numbers representing different underlying assumptions, and results in estimates that vary wildly over an incredible set of values. This range of numbers is so wide as to suggest no scientific confidence in the DOL’s methodology. As a result, the estimates in the RIA provide little confidence as to the actual benefits, if any, arising from the DOL’s proposal.

A. Estimates of the Benefits of the Proposal Vary Wildly in the RIA

In the WH/CEA memo entitled “The Effects of Conflicted Investment Advice on Retirement Savings” published in February 2015, the authors estimated that a baseline aggregate cost to consumers from purportedly conflicted advice is about $17 billion per year. They calculated this number as one percent times the total number of mutual funds and variable annuities in IRAs. The one-percent factor came from their assessment of an average of estimates produced by various academic papers using differing methodologies and datasets.

However, this number does not appear in the subsequent DOL Regulatory Impact Analysis published two months later in April 2015. Instead, the RIA provides many different numbers, all generated by different sets of assumptions.

Table 5 summarizes the various estimates of the cost of purportedly conflicted advice that appeared in the RIA. A review of the table indicates an astounding range of different estimates. On the low end, there is mention in three separate places in the RIA (p. 8, p. 102, and p. 106) of an estimated cost from $20 billion to $22 billion over a ten year horizon. These numbers appear to come from an analysis that assumes the new DOL rules will eliminate 50 percent of

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[52] 29 CFR 2509 and 2510, DOL, Definition of the Term ``Fiduciary''; Conflict of Interest Rule-- Retirement Investment Advice; Proposed Rule in Federal Register Volume 80, Number 75 (Monday, April 20, 2015), Pages 21927-21960.

[53] “Fiduciary Investment Advice Regulatory Impact Analysis”, Department of Labor, Available on-line at http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

underperformance due to front-end-load sharing, and that this is the only effect considered. These numbers equate to between $2 billion to $2.2 billion per year (setting aside discount rates and any growth in the asset base over time), which are about 13 percent of the WH/CEA memo's $17 billion per year estimate.

On the high range, the RIA states on p. 7 and p. 98 that the costs of conflicted advice could be "nearly $1 trillion" over a horizon of 20 years. This is consistent with approximately $50b in costs per year (again, setting aside discount rates, compounding of returns and other dynamic assumptions the DOL may have made). The estimate seems to come from an analysis in which it is assumed that investors lose 200 basis points (two percentage points) of annualized return per year due to "conflicted advice," instead of the 100 bps (one percentage point) assumed in the WH/CEA memo. It is not clear where the 200 bps number comes from. Nor is it clear why this number is so large, given that simply doubling the 100 bps number should approximately double the estimate from $17 billion per year to $34 billion per year. Presumably, the DOL increased the number from $34 billion to $50 billion by apparently compounding returns over time, but the RIA does not specify this in enough detail to be certain.

One reason for the incredible range in aggregate estimates is that the RIA numbers vary in terms of the horizon of interest (some are per year, some cover a 10-year horizon, and some cover a 20-year horizon), assumptions made (e.g., some assume a 100 bps reduction in investment performance, and others assume a 200 bps reduction in performance), and the universe of assets that are considered (e.g., some consider all mutual funds held in individual retirement accounts ("IRAs") while others focus only on front-end load mutual funds, and so forth).

Nevertheless, given the variety to the DOL's own numbers, the "benefit" estimates do not provide a credible foundation on which to base significant changes in policy and regulation. The very wide range in the numbers suggests that the DOL itself does not have a good measure of the dollar magnitude of purportedly conflicted advice that they seek to ameliorate.

This range of numbers is so wide as to provide no scientific confidence in the DOL's own methodology, and is inconsistent with a cost-benefit analysis that is concrete enough to form the basis of a change to federal government policy.

An additional problem with the "benefits" of the proposal, as presented by the DOL, is that the academic literature on which they base their argument does not directly apply to the question of how to best define and implement a fiduciary standard under ERISA.

B. The RIA Misapplies the Academic Literature

In this section, we discuss some important ways in which the RIA misapplies the existing academic literature in an attempt to justify the DOL proposal.

Before discussing the methodological shortcomings, we note that much of the academic literature which is cited by the RIA is based on data which is now dated and may no longer be relevant. Significant changes have occurred in the past several years. Indeed, one of the most salient recent developments is that mutual fund fees have been declining substantially, and that has occurred independently of any explicit government driven interventions.

Over the period 1990-2013, front-end sales loads have declined by nearly 75 percent for equity funds and hybrid funds, and even more than that for bond funds.[54] The ICI argues this decline, at least in part, may reflect the increasing role of mutual funds in helping investors save for retirement. That is, mutual funds now often waive load fees on purchases made through defined contribution plans, such as 401(k) plans.

Additionally, nearly all net new cash flows in recent years have accrued to no-load mutual funds. Net flows to load mutual funds have been negative for all four years of the most recent data.[55]

1. The cited literature focuses on mutual funds, yet the DOL applies the results more widely

The academic research that serves as the basis for conflicted cost-of-advice estimates focuses on the commissions embedded in mutual fund purchases and sales. These are typically front-end loads, although there may be back-end loads and on-going fees such as 12b-1 fees.[56]

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[54] See Chapter 5 of the 2014 Investment Company Fact Book, *Mutual Fund Expenses and Fees*, available on-line at http://www.icifactbook.org/fb_ch5.html

[55] *Id*., in Figure 5.10.

Yet the DOL proposal extends far beyond mutual funds. To cite one example, the proposal ends the existing prohibited transaction exemption for variable annuities and states that they would be able to be sold only under existing compensation structures under the Best Interest Contract Exemption. Other assets classes, such as options on stocks, do not appear to be permitted for sale to IRA accounts under any of the proposed exemptions.

There is no justification provided, therefore, as to why the DOL would propose making such radical shifts to the way in which all assets are sold to IRA account holders, given that the academic literature on which the RIA relies so heavily is almost exclusively limited to the mutual fund literature. There is no basis in the academic literature for extrapolating conclusions applicable to mutual funds to other investment products that may not even have front-end sales loads.

2. **The research cited in the RIA takes results associated with higher-than-average load funds and misapplies them to all funds.**

One of most heavily cited academic papers in the RIA is Christoffersen, Evans and Musto (2013).[57] It is cited dozens of times, and is one of the leading sources of the baseline estimate of 100 bps per year in apparent "cost of conflicted advice" that the DOL claims is suffered by investors in commission-based retirement accounts.

It is therefore important to understand the claims that actually appear in Christoffersen et al. (2013). In particular, their study finds evidence that a subset of funds, those whose front-end loads are higher than other funds with similar characteristics, underperformed the average return of their fund category during the next year. In formulating much of their "cost of conflicted advice" aggregate figures, the DOL then assumes that *all* IRAs invested in front-end load funds

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[56] The RIA attempts to portray brokers and investment advisers in the professional IRA market as charging excessive fees to investors, yet it fails to mention one of the most salient developments in recent years – namely, that mutual fund fees have been declining substantially. It is notable that this has occurred independently of any explicit government driven interventions. Investment Company Institute (ICI) expense ratio data for three broad types of mutual funds over the years 2000-2013 indicate, for example, that in 2000 equity mutual fund investors incurred average expense ratios of 99 basis points. By 2013, that number fell to 74 basis points, a decline of 25 percent. The same basic pattern is true for hybrid and bond funds. In terms of front-end sales loads, it is again the case that they have declined substantially over time with no explicit government intervention. Over the period 1990-2013, they have declined by nearly 75% for equity funds and hybrid funds, and even more than that for bond funds. Additionally, nearly all net new cash flows in recent years have accrued to no-load mutual funds. Net flows to load mutual funds have been negative for all four years of the most recent data. See Chapter 5 of the 2014 Investment Company Fact Book, *Mutual Fund Expenses and Fees*, available on-line at http://www.icifactbook.org/fb_ch5.html

[57] Christoffersen, Susan E. K., Richard Evans, and David K. Musto (2013) "What Do Consumers' Fund Flows Maximize? Evidence from Their Brokers' Incentives," *Journal of Finance*, Vol. 68(1), p. 201-235.

suffer the same underperformance, thereby mistakenly applying a result from a subset of load funds to all load funds.

The extrapolation the DOL made is analogous to the following: Suppose we conduct medical research and find that people who consume more salt than average have a lower life expectancy by five years, and we then conclude that eating no salt will increase the life expectancy of everyone by five years. This is a logical fallacy. We have no evidence that people who eat a “normal” amount of salt would benefit from reduced salt intake, and so extrapolating to them is an error in logic.

Again, we emphasize this point because an official cost-benefit analysis needs to be precise and free of logical fallacies. By incorrectly extrapolating from a subset of mutual funds to all mutual funds, the DOL is effectively applying the 100 bps cost number to assets for which it does not apply. Hence, the benefit side of the cost-benefit analysis presented in the RIA is seriously flawed. The result is that it is impossible to conclude whether the benefits of the DOL proposal outweigh the costs.

3. The academic literature cited in the RIA does not compare the costs and benefits of fiduciary accounts with those of brokerage accounts

The academic literature on which the DOL relies, such as Christoffersen, Evans, and Musto (2013), Bergstresser, Chalmers, and Tufano (2009),[58] Del Guercio and Reuter (2014),[59] generally compares the performance of mutual funds with loads (paid as commission to brokers) versus mutual funds sold directly to the public.

None of these academic studies actually compares the performance of accounts with a financial advisor who is a fiduciary to the performance of accounts with a broker or other financial advisor that is not a fiduciary. Hence they are using results that do not address the central question of the proposal. It is absolutely inappropriate to conclude that investors would

[58] Bergstresser, Daniel, John Chalmers, and Peter Tufano (2009), “Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry”, The Review of Financial Studies, 22(10), p. 4129-4156.

[59] Del Guercio, Diane and Jonathan Reuter (2014) “Mutual Fund Performance and the Incentive to Generate Alpha”, The Journal Of Finance, Vol. 69(4), p. 1673-1704.

be better off under an expanded fiduciary standard on the basis of the academic literature being cited.

The bulk of the literature considers data at the mutual fund level and measures their loads and performance. These can be compared to direct-to-public investments such as a “S&P 500” index fund. The academic research generally has not undertaken a direct way of comparing how investors would fare under a fiduciary standard in relation to a broker-based suitability model or a self-direction model because that analysis requires account-level data from actual investors, rather than aggregate fund-level data.[60]

Absent account-level data, the DOL is drawing fallacious conclusions. Even if it were true that fund loads cause underperformance—which is not proven—there is no reason to conclude that consumers would be better off in fiduciary advised accounts based on the evidence cited by the DOL. Fiduciary advisors do not work for free. They must also be compensated for their work, and in some cases they may be providing a great deal more service than a commission-based non-fiduciary broker and may need even more compensation. If certain investors are forced out of commission-based accounts, they may either lose access to advice entirely, or they may switch to advisory accounts which may charge more, not less. Moreover, this increased expense is likely to be particularly acute for low-balance and low-activity accounts who may pay very low annual fees and loads because their portfolios tend to be static. Hence the DOL proposal is likely to disproportionately hurt low-income Americans.

[60] A small number of academic papers have looked at account-level data, but these are generally limited to extremely small sample sets that are not in any way representative of the spectrum of American consumers. For example, Chalmers and Reuter (2014) collect account level data, but it is limited to faculty and administrators in the Oregon University’s optional retirement plan (ORP). See Chalmers, J. and J. Reuter (2014), “What is the Impact of Financial Advisors on Retirement Portfolio Choices and Outcomes?” working paper, University of Oregon.

Table 5
The Cost of Conflicted Advice Estimated by DOL Varies Widely

Entry (1)	Page (2)	Amount (3)	Horizon (4)	Methodology (5)	Notes (6)
Estimates found in *The Effects of Conflicted Investment Advice on Retirement Savings* [1]					
1	2	$17 bil.	per year	100 bps (from academic lit) * $1.7 trillion assets in IRA funds	N/A
Estimates found in *Fiduciary Investment Advice: Regulatory Impact* [2]					
1	7	100 bps	per year	"Careful review" of academic literature	N/A
2	7, 98	$210 bil.	10 years	Applying performance gap (100 bps based on academic lit) to the current IRA marketplace	100 bps figure is the average underperformance associated with conflicts of interest in the mutual funds segment
3	7, 98	$500 bil.	20 years	See above	N/A
4	7, 98	$430 bil.	10 years	Applying performance gap (200 bps based on academic lit) to the current IRA marketplace	200 bps figure is based on academic studies that suggest that the underperformance of broker-sold mutual funds may be even higher than 100 bps, possibly due to loads that are taken off the top and/or poor timing of broker sold investment
5	7, 98	"nearly" $1 tril.	20 years	See above	On pg. 8 the RIA also mentions that adviser conflicts "could cost IRA investors as much as $410 bil. over 10 years and $1 tril. over 20 years. The $410 bil. number seems to come from the 200 bps points, but the RIA is unclear

6	8	$410 bil.	10 years	DOL estimate based on reduction in excessive trading, associated transaction costs, timing errors, improvements in performance of IRA investments other than front-load mutual funds	See above
7	8, 101	$40-44 bil.	10 years	DOL estimate based of assumption that rule will eliminate 100 percent of underperformance due to variable front-end-load sharing	"Baseline scenario" where the 1975 rule remains in place. Loads projected to decrease over time at the same rate as the baseline scenario. Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing. DOL considers this estimate "conservative". Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds
8	8, 101	$88-100 bil.	20 years	See above	See above
9	8, 102, 106	$30-33 bil.	10 years	DOL estimate based of assumption that rule will eliminate 75 percent of underperformance due to variable front-end-load sharing	The Report offers no basis for the selection of 75 percent underperformance
10	8, 102, 106	$20-22 bil.	10 years	DoL estimate based of assumption that rule will eliminate 50 percent of underperformance due to variable front-end-load sharing	The Report offers no basis for the selection of 50 percent underperformance

11	105	$44.1 bil.	10	Loads decrease over time at twice the rate of the baseline scenario. Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing and increased investment performance for broker-sold mutual funds. The DOL considers this estimate "reasonably high" Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds	N/A
12	105	$99.7 bil.	20	See above	N/A
13	105	$65.6 bil.	10	Represents upper limit. Loads paid by investors immediately fall to zero Quantifying gains expected to accrue to IRA investments in front-end load mutual funds attributable to variations in load sharing and increased investment performance for broker-sold mutual funds. The DOL considers this to be an "illustration but does not expect the proposal to result" in this number. Quantified gains pertain only to 13 percent of all IRA assets that are involved in front-end-load mutual funds	N/A
14	105	$135.1 bil.	20	See above	N/A
15	98	$18 bil.	per year	Applying performance gap (100 bps) to the current IRA marketplace	N/A

16	98	$10 bil.	per year	Christoffersen, Evans, and Musto (2013) find that each 100 basis points in load sharing paid to an unaffiliated adviser reduces future returns by 50 bps and 100 bps paid to a captive broker reduces future performance by 15 bps. Authors of the RIA project these results onto the current IRA marketplace	N/A
17	98	$125 bil.	10 years	See above	N/A
18	98	$285 bil.	20 years	See above	N/A
19	98	$26 bil.	per year	Harm to consumers if industry has simply shifted conflicted revenue streams, rather than reducing conflicts	This refers to a hypothetical where the industry shifts away from front-end load mutual funds into other revenue streams with conflicts of interest. Appears to be based off of Christoffersen, Evans, and Musto (2013).
20	98	$300 bil.	10 years	See above	See above
21	98	$700 bil.	20 years	See above	See above
22	101	$80 bil.	10 years	Underperformance seen by focusing only on how load shares paid to brokers affect the size of loads IRA investors holding load funds pay and the returns they achieve	The Report assesses the gains to investors attributable to the rule by specifically quantifying benefits in an area of the IRA market where the conflicts are well measured-namely front-end load mutual funds
23	101	$200 bil.	20 years	See above	See above

Sources:

[1] *The Effects of Conflicted Investment Advice on Retirement Savings.* The White House. February 2015

[2] *Fiduciary Investment Advice: Regulatory Impact Analysis.* The Department of Labor

APPENDIX: THE COST OF COMPLYING WITH THE DOL PROPOSAL

The Regulatory Impact Analysis published by the DOL also reported estimates for the costs of implementing the DOL's new Fiduciary Standard rules. These are essentially limited to compliance costs.

A detailed overview is presented in Table 6. Turning to the top row, compliance costs are estimated to range from range from $240 million to $570 million per year (equivalently, $2.4 billion to $5.7 billion over a 10 year horizon, abstracting from applying discount rates, inflation corrections or other dynamic adjustments).

Perhaps more important than the baseline numbers, however, is the incredibly complex and opaque, ad hoc, methodology and set of assumptions which were used to formulate these estimates.

For example, The DOL's cost estimates for complying with the DOL's proposed fiduciary rule rely on data submitted by SIFMA to the SEC in 2013 (the "SIFMA Data").[61] The SIFMA Data was collected and submitted by SIFMA to the SEC for the purpose of estimating the costs of complying with potential SEC fiduciary rule changes under Dodd-Frank Section 913.[62] Although the DOL states that "*there will be substantive differences between the [DOL]'s new proposal and exemptions and any future SEC regulation that would establish a uniform fiduciary standard…* ", the DOL nevertheless relies on the SIFMA Data as part of the basis for its cost estimates.[63] DOL's stated reason for doing so is that there are *"some similarities between the cost components"* in the SIFMA Data and the costs that would be required to comply with the DOL proposal.

However, the phrase "some similarities" implies there are some differences and the DOL is, by definition, unable to address the compliance costs that may arise due to such differences in the two regulatory regimes in question.

The SIFMA Data estimates the costs of implementing an SEC-established uniform fiduciary standard in two parts. The first was the cost for broker-dealers to develop and maintain

[61] Regulatory Impact Analysis, http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf, at pp. 160 – 65.

[62] SIFMA Comment to SEC dated July 5, 2013, http://www.sifma.org/issues/item.aspx?id=8589944317.

[63] Regulatory Impact Analysis at p. 161.

a disclosure form and customer relationship guide, similar to the Form ADV Part 2A that registered investment advisors use today.

The DOL proposal does *not* require a Form ADV Part 2A-type disclosure for broker-dealers, but it would require an extensive range of new disclosure obligations that do not exist today. These include: (i) contractual disclosures under the Best Interests Contract Exemption, (ii) point of sale disclosure, including the total cost of the acquired asset over periods of 1, 5, and 10 years; (iii) annual fee and compensation disclosure; (iv) public website disclosure, including a list of all direct or indirect material compensation; and (v) aggregated data regarding inflows, outflows, holdings, and returns, including the identity and amounts of revenue received, which DOL reserves the right to publicly disclose.

The disclosure estimates in the SIFMA Data are for broker-dealers to adopt an essentially "known quantity" disclosure form that is used by advisors today. The disclosure estimates in the SIFMA Data do not address any of the new disclosure obligations in the DOL proposal. Hence it is erroneous for DOL to use SIFMA's disclosure estimates to approximate the costs of the extensive, new, separate and distinct, disclosures required under the DOL proposal.

The second part of the SIFMA Data is the estimated cost of implementing compliance oversight and training programs to adapt to a new SEC standard. In providing these estimates, SIFMA member firms were asked to make a host of assumptions. None of these assumptions, however, include the new obligations and potential liabilities that the DOL proposal may create, including: (i) new contractual liability under the Best Interest Contract Exemption, including potentially significant individual and class action litigation exposure; (ii) compliance with a new DOL exemption in order to engage in principal transactions; (iii) new restrictions on products that may be offered and sold, and (iv) the costs of creating the new data and information that are subject to the new disclosures outlined above.

In sum, the SIFMA Data applies to estimating the cost of a contemplated SEC fiduciary regime, under specific assumptions that were applied to such a contemplated SEC approach. It is not methodologically appropriate to use the SIFMA Data to estimate the cost of a separate and distinct DOL regime, with separate and distinct requirements, obligations, liabilities, and costs.

The DOL further compounds the apparent inconsistency by relying on the SIFMA Data and then suggesting that "*the SIFMA submission significantly overestimates the costs of the new* *proposal*."[64] The DOL thus appears to be relying on inputs into its cost analysis that it does not view as accurate, thereby undermining the reliability of its own methodology.

Lastly, we note that the US Chamber of Commerce submitted a comment letter to the OMB on May 20, 2015 outlining their view that the Department of Labor vastly underestimated the compliance costs associated with the proposed Fiduciary rule.[65] Specifically, the Chamber states (on p. 2) that real costs associated with the information collection requests alone may be "five to ten times greater" than the DOL's estimate of $792 million over ten years. The ten-page letter goes on to detail the various shortcomings and implausible assumptions made by the DOL in their calculations.

While we will not undertake to comment on the OMB letter, it does serve to emphasize the clear shortcoming of the DOL's estimates. Namely, they are not based on a scientific or empirical approach and the resulting estimates may or may not be wildly inaccurate reflections of the true costs. As a result, it would be inappropriate to include them as part of a formal assessment of the costs and benefits of a proposed change in public policy.

[64] Regulatory Impact Analysis at p. 162.

[65] Available on-line at http://www.uschamber.com/sites/default/files/oira_comments.pdf.

Table 6
The Costs of Compliance Are Based on Complex and Opaque Set of Assumptions

Estimates found in *Fiduciary Investment Advice: Regulatory Impact* [1]

Page	Source	Amount	Horizon	Notes
(1)	**(2)**	**(3)**	**(4)**	**(5)**
157	Department of Labor Estimate	$2.4b-5.7 bil.	10 years	Total compliance cost. Cost mostly reflects the costs incurred by new fiduciary advisers to satisfy relevant PTE conditions
162	SIFMA estimate of average start up cost to develop and implement new, comprehensive supervisory systems, procedures and training	$5 mil.	one year	Estimated costs that would be incurred by broker-dealers
162	SIFMA estimate of annual on-going costs	$2 mil.	annual	
165	DOL estimated start-up cost of compliance for medium firms based on values provided by SIFMA	$663,000	one year	$5 million x (0.133). 0.133 is the estimated ratio of medium firms and large firms' cost based on figures provided for RIAs in the IAA comment letter
165	DOL estimated start-up cost of compliance for small firms based on values provided by SIFMA multiplied by DoL's ratio	$242,000	one year	5 million x (0.048). 0.048 is the estimated ratio of small firms and large firms' cost based on figures provided for RIAs in the IAA comment letter
166	DOL total estimated start-up cost of compliance in the first year	$892 mil.	one year	
165	DOL estimated on-going cost of compliance for medium firms	$265,000	annual	$2 million x 0.133 (the IAA ratio)
165	DOL estimated on-going cost of compliance for small firms	$96,900	annual	$2 million x 0.048 (the IAA ratio)
166	DOL estimated on-going cost of compliance after first year	$357 mil.	annual	
166	Estimated start-up cost of compliance for large firms based on values provided by the IAA	$1 mil.	one year	
166	DOL estimated start-up cost of compliance for medium firms based on values provided by the IAA	$145,000	one year	The DoL took the ratio between the cost SIFMA and IAA provided (.2181) and derived the costs from that ratio referred to as the

				"ADV ratio"
166	DOL estimated start-up cost of compliance for small firms based on values provided by the IAA	$53,000	one year	SIFMA estimates multiplied by ADV ratio
166	DOL total start-up cost of compliance after first year based on IAA	$195 mil.	one year	See above
166	Estimated on-going cost of compliance for large firms based on values provided by the IAA	$436,000	annual	See above
166	Estimated on-going cost of compliance for medium firms based on values provided by the IAA	$58,000	annual	SIFMA estimates multiplied by ADV ratio
166	Estimated on-going cost of compliance for small firms based on values provided by the IAA	$21,000	annual	See above
166	DOL estimated total annual ongoing costs for subsequent years based on IAA	$78 mil.	annual	See above

Cost of Developing and Maintaining a Disclosure Form and Customer Relationship Guide

161	SIFMA reported start-up cost for preparing a relationship guide similar to the Form ADV 2A	$2.8 mil.	one year	
161	SIFMA reported "low" start up cost	$1.2 mil.	one year	
161	SIFMA reported "high" start-up cost	$4.6 mil.	one year	
161	SIFMA reported average annual on-going cost	$631,000	annual	

Costs Incurred by Registered Investment Advisors

166	DoL Analysis of cost for legal consultation for small firms	$3,840	one year	Hourly rate of $480. 8 hours assumed
166	DoL Analysis of cost for legal consultation for medium firms	$7,680	one year	Hourly rate of $480. 16 hours were assumed.
166	DoL Analysis of cost for legal consultation for large firms	$19,200	one year	Hourly rate of $480. 40 hours were assumed.
167	DoL Analysis of costs of training for a large firm in the first year	$30,000	one year	
167	DoL Analysis of costs of training for a large firm after the first year	$10,000	annual	
167	DoL Analysis of costs of training for a medium firm in the first year	$4,000	one year	

167	DoL Analysis of costs of training for a medium firm after the first year	$1,500	annual	
167	DoL Analysis of costs of training for a small firm in the first year	$1,500	one year	
167	DoL Analysis of costs of training for a small firm after the first year	$1,500	annual	
167	Total cost to evaluate compliance with rule and provide training for a large RIA firm in the first year	$49,200	one year	
167	Total cost to evaluate compliance with rule and provide training for a medium RIA firm in the first year	$11,700	one year	
167	Total cost to evaluate compliance with rule and provide training for a small RIA firm in the first year	$5,300	one year	
167	Total cost to evaluate compliance with rule and provide training for a large RIA firm in the subsequent years	$10,000	annual	
167	Total cost to evaluate compliance with rule and provide training for a medium RIA firm in the subsequent years	$1,500	annual	
167	Total cost to evaluate compliance with rule and provide training for a small RIA firm in the subsequent years	$500	annual	
167	Total Cost for IRA firms in the first year	$110.8 mil,	one year	
167	Total Cost for IRA firms in the subsequent years	$11.9 mil.	annual	

Costs Incurred by Plan Service Providers

168	Start-up cost for a large firm	$49,000	one year	
168	Start-up cost for a medium firm	$12,000	one year	
168	Start-up cost for a small firm	$5,000	one year	
168	Aggregate start-up cost for training employees	$24.1 mil.	one year	
169	On-Going Costs for small firm	$10,000	annual	2,275 small service providers, 437 medium service providers, 142 large service providers
169	On-Going Costs for medium firm	$2,000	annual	
169	On-Going Costs for large firm	$1,000	annual	
169	Aggregate on-going costs for training employees, yearly	$3.2 mil.	annual	

				2,275 small service providers, 427 medium service providers, 142 large service providers

Additional Costs

171	Increased insurance premiums for consultants, firms and broker-dealer representatives	premiums for these affected service providers could be expected to increase 10 percent; average insurance premium is $3,000 per representative. Premium increase would be $300 per insured	N/A	DoL estimates that 50% of the cost reflects the expenses and profits of insurance carriers, while the remainder is not a cost but a transfer in the form of compensation paid to those harmed by the insured fiduciary investment adviser
172	one year premium increase for broker dealer representatives	$87 mil.	one year	290,000 broker dealers multiplied by $300
173	Cost of premiums and transfers from firms to plans or IRA investors	$63 mil.	annual	418,00 BD representatives and plan service provider employees could experience a $300 increase. 50% is paid out as compensation and 50% is paid to the insuring firm
174	First year cost for each BD representative converting to RIA status	$5,600	one year	50 hours preparing for Series 65 exam (at $106.06/hour) plus additional costs
174	Total first year cost of BD to RIA conversion	$59.4 mil.	one year	
174	Ten year cost of BD to RIA conversion	$445 mil.	ten years	
177	first year cost for producing and distributing the disclosures and subsequent compliance	$77.4 mil.	one year	
177	on-going cost for subsequent years for producing and distributing disclosures	$29.2 mil.	annual	
177	first year cost of the 6.3 million disclosures required under the new Principal Transactions PTE	$57.4 mil.	one year	
	on-going cost of the 6.3 million disclosures required under the new Principal Transactions PTE	$47.8 mil.	annual	
177	Disclosure requirements required by the amended PTE 86-128	$198,000	annual	
177	Seller's Carve-Out disclosures	$6.2 mil.	annual	Assumes 43,000 disclosures

178	The Platform Provider Carve-Out	$39,000	annual	Assumes 1,800 disclosures
178	The Investment Education Carve-Out	$121,000	annual	Assumes 2,800 disclosures
178	Total exemptions and carve-outs cost in the first year	$141.5 mil.	one year	Assumes 92.4 million additional disclosures
178	Total exemptions and carve-outs cost in the subsequent years	$83.5 mil.	annual	
178	Total exemptions and carve-outs cost in 10 years	$791.8 mil.	10 years	

Mentioned But Not Quantified

175	Increased traffic in Call Centers
176	Cost of creating or updating contracts
176	transitional impacts on the financial sector market
176	impact on asset providers
177	costs for complying with the new and amended PTEs

Sources

[1] *Fiduciary Investment Advice: Regulatory Impact Analysis*. The Department of Labor

Our work in this matter is ongoing and we may update or change our opinions as we continue our review and analysis.

APPENDIX 2

Deloitte.

Report on the Anticipated Operational Impacts to Broker-Dealers of the Department of Labor's Proposed Conflicts of Interest Rule Package

July 17, 2015

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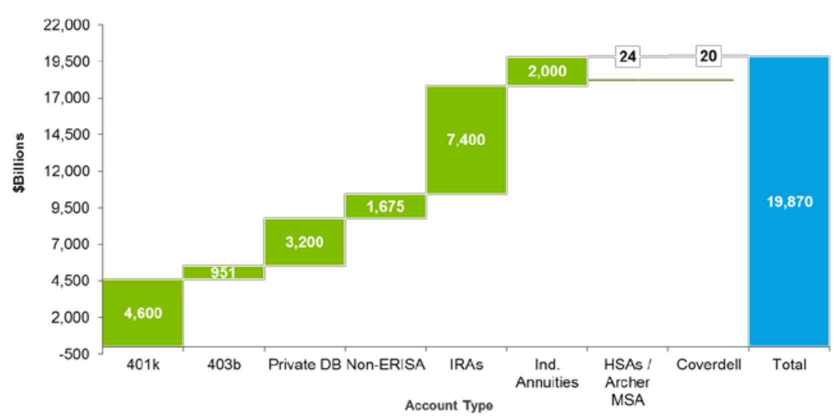
Executive Summary

Introduction

On April 20, 2015, the Department of Labor ("DOL") proposed[1] a new definition of investment advice fiduciary under 29 CFR 2510.3-21 and a series of prohibited transaction exemptions (referred to as the "Rule Package" throughout the document). From the DOL's perspective the amended rules are designed to provide further protection to the public from "questionable retirement investment advice" by requiring retirement advisors to follow strict "fiduciary" standards[2]. However, the Securities Industry and Financial Markets Association ("SIFMA") working group members who participated in the study ("SIFMA Working Group") indicated that they believe the potential effects of the proposed changes extend beyond the realm of retirement advice and will have broad and extensive operational impacts into many areas of financial services institutions, including profound changes to existing business models, compensations practices of broker-dealers, available investments, client relationships and firm operations and infrastructure.

Existing rules in this area were defined by the Employee Retirement Income Security Act of 1974 ("ERISA"), which was enacted at a time when professionally managed defined benefit pension funds were the retirement norm. Over the past 40 years, however, self-managed investments such as Individual Retirement Accounts ("IRAs") and other defined contribution arrangements such as 401(k) plans have taken over as the primary ways to save for retirement, which has increased the availability and variety of retirement savings options for individuals. In the view of the SIFMA Working Group, the DOL's Rule Package may have unintended consequences for the broker-dealer industry as well as individual investors which the industry serves. Consider Figure I.1 that shows almost $20 trillion in US retirement assets will be affected by the proposed Rule Package[3]:

Figure I.1 – Dollar Amount of Retirement Assets by Account Type in 2014



[1] Federal Register Vol. 80, No. 75 - Proposed Rules – Employee Benefits Security Administration (4/20/2015)

[2] Source: Department of Labor "Fiduciary Investment Advice – Regulatory Impact Analysis" http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf

[3] Source: ICI "The U.S. Retirement Market", (4Q 2014); Devenir "HSA Research Report", (Dec 2014); Strategic Insight "529 Industry Analysis", (2015)

Approach

To understand the views of the broker-dealer industry on the extent of the operational impacts of the proposed rule to the financial services community, SIFMA engaged Deloitte & Touche LLP ("Deloitte") to facilitate a study with a SIFMA Working Group comprised of over 140 senior operations, technology, and legal professionals from approximately 40 SIFMA member firms whose business include providing individual investors with financial advice and services (referred to as the "SIFMA Working Group" throughout this report). The SIFMA Working Group analyzed the requirements of the proposed Rule Package across the customer life cycle to primarily understand the technology or operational reformation needed to align existing processes with new obligations of the proposed rule. Additionally, process flow diagrams were developed to illustrate the requirements and necessary process augmentations[4] identified by the SIFMA Working Group to operationalize the Rule Package's requirements from the point of view of financial services firms, investment professionals (e.g., client facing financial advisors or registered representatives) and customers.

Through the analysis, the SIFMA Working Group sought to identify operational "hot spots" reflecting required operational changes to systems, personnel, processes and business models. Finally, SIFMA conducted a cost survey with a subset of the SIFMA Working Group to understand how the Rule Package requirements may impact operational expenses for implementing and maintaining the operational changes, processes and systems that will be required to comply with the Rule Package.

The findings represent the views expressed by the SIFMA Working Group as communicated to Deloitte through facilitated discussions and surveys. Deloitte has aggregated and summarized these views, but was not asked to and did not independently verify, validate or audit the information presented by the SIFMA Working Group[5].

Summary of the findings

The collective views of the SIFMA Working Group yielded five themes[6] that indicated broker-dealers will likely face immense challenges in operationalizing the requirements of the proposed Rule Package. Given the business and legal frameworks within which the financial services industry operates, the SIFMA Working Group identified areas where the proposed Rule Package will be impractical or impossible to implement as currently drafted (e.g., contracts signed before service provider is hired or before the first sales pitch; two indicative quotes before any approval of a principal transaction; a written chart provided to clients projecting future performance and future cost before any trade). It was noted by the SIFMA Working Group that they believe that the proposed Rule Package is so broad in scope, subjective and ambiguous in certain areas that it will be impossible to build operational systems and processes to ensure compliance, to create objective surveillance systems, or to run risk and compliance routines in connection with the requirements. Finally, the SIFMA Working Group noted that the proposed Rule Package will impose requirements that may conflict with other existing regulatory obligations.

The SIFMA Working Group expressed concern that the punitive and automatic nature of excise taxes for non-compliance, even in instances of immaterial or inadvertent non-compliance, coupled with the

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[4] Illustrative process flow diagrams may not be all inclusive of actual implementation requirements

[5] This engagement was performed in accordance with Standards for Consulting Services established by the American Institute of Certified Public Accountants. Deloitte & Touche LLP did not provide any assurances regarding the sufficiency of the services provided for SIFMA's purpose. Deloitte & Touche LLP services provided in conjunction with this assignment do not constitute an engagement to provide audit, review, compilation or attestation services as described in the pronouncements on professional standards issued by the American Institute of Certified Public Accountants and, accordingly, Deloitte & Touche LLP did not provide any assurance concerning the reliability of any assertion that is the responsibility of another party. These services did not result in the issuance of any written or oral communication by Deloitte & Touche LLP expressing an opinion or any other form of assurance with respect to financial data or internal controls to SIFMA or any third party.

[6] The themes and views identified by the SIFMA Working Group and represented in this report are not all inclusive of all impacts or costs associated with the proposed Rule Package.

view that many of the Rule Package requirements are impractical and ambiguous, may cause some financial services firms to exit the market, terminate smaller accounts or migrate to wrap programs where suitable.

The five themes identified by the SIFMA Working Group, which will be discussed in detail in the following pages, are as follows:

- **It will be unfeasible or impossible to operationalize certain Rule Package requirements**
  - Operationally Impractical
    - Disclosure challenges and challenging operations
    - Financial market implications and credit rating limitations
    - Best Interest and Principal Transaction Exemption Contract implications

- **Significant personnel, process and technology changes and investments to operations, business and compliance will be required to comply with the Rule Package**
  - Operationally Onerous
    - Substantial changes and investments to systems and processes
    - Large-scale new data collection and management requirements
    - High-dollar cost to implementing and maintaining

- **Rule Package requirements will create disruptions to business operations and customer experience**
  - Impediment to Business
    - Negative impacts to customer experience
      - Customer confusion as a result of the Rule Package
      - Impact of investment education limitations
      - Investment option limitations and disadvantages

- **Rule Package requirements may conflict with existing regulatory obligations**
  - Potential Regulatory Implications
    - Migration to multiple and various types of accounts
    - Inconsistencies with other existing rules and guidance

- **The Rule Package is ambiguous and broad in certain areas, which challenges the operationalization of the Rule Package's requirements**
  - Rule Package Ambiguity
    - The definitions of terms are not clear
    - The scope of requirements is not clear
    - Other areas of the Rule Package require clarification

1. It will be unfeasible or impossible for firms to operationalize certain Rule Package requirements

Operationally Impractical

The SIFMA Working Group identified several requirements of the proposed Rule Package that will be unfeasible or impossible for firms to operationalize within existing business, operational and compliance frameworks. Specifically, the SIFMA Working Group noted concerns with the industry's ability to operationalize components of the contract and disclosure requirements of the Best Interest Contract Exemption and Principal Transaction Exemption. Examples were identified by the SIFMA Working Group where the nature of financial markets, products, business models, third-party relationships or operational processes will be challenging for firms to meet the obligations of the proposed Rule Package.

1.1 Disclosure challenges and illogical operational structures

Under the proposed Best Interest Contract Exemption obligations, firms and investment professionals will be required to provide new disclosures to customers at the point of sale, annually and through a webpage. The SIFMA Working Group identified several components of the Best Interest Contract Exemption disclosure requirements as impractical to implement due to legal restrictions and illogical operational processes including:

- <u>The potential inability to obtain information from third parties as a result of how information is collected and shared amongst various stakeholders will make it difficult for firms to provide annual disclosures within 45 days of year end</u> – Information around fees for inclusion in the annual disclosure to customers may not be available to firms within the 45 day timeframe. The expectation that firms will be able to obtain this information and perform necessary calculations of direct and indirect fees for products in the allotted timeframe will be difficult. The SIFMA Working Group noted that some vendors pay certain fees and compensations to institutions after close of the business year which may take more than 45 days to receive, reconcile and post.

- <u>Attributing direct and indirect compensation and fees earned by firms and investment professionals to the individual investor and transactions will likely be a lengthy, complicated process</u> – Currently, many compensation fees earned by firms and investment professionals are not directly attributable to specific transactions and customers due to the nature of revenue sharing arrangements and other compensation models utilized by product companies. Specifically, the SIFMA Working Group indicated there will be complications on precisely attributing the revenue sharing in specific transactions to the corresponding specific account. Additionally, because the Rule Package does not enumerate the methodology that should be used to attribute these fees, these calculations may vary and be performed inconsistently across the industry.

- <u>The SIFMA Working Group noted the calculation of indirect compensation and fees attributable to specific transactions and investors will be an impractical process that ultimately does not result in the disclosure of fees that materially affect the customers' bottom line</u> – The SIFMA Working Group emphasized that there are indirect compensation and fees paid by firms that are passed through to investors, the indirect compensation and fees often cannot be attributed to specific transactions or investors and may not be material fees to individual investors or specific transactions. Attributing the indirect compensation and fees will likely require updates to calculations, technology and systems and will be impossible for certain products. Furthermore, the calculations of the indirect compensation and fees specific to customers would likely not yield material fee amounts for individual investors attributed to their specific transactions. For example, the SIFMA Working Group noted that fees that intermediaries pay to the manufacturer of an investment product often depend upon the amount of a product that an intermediary places with customers over a period. As such, the intermediary will not know the exact fee associated with a product until the end of a calculating period. Additionally, because the Rule Package lacks guidance on how to calculate and attribute fees, these calculations may vary and be performed inconsistently across the industry.

Figure 1.1 is an excerpt from the Best Interest Contract Exemption process flow (See Appendix) illustrating the points where the SIFMA Working Group indicated that Rule Package requirements are expected to impact the processes within the transaction/maintenance portion of the customer transaction life cycle:

Figure 1.1 – Best Interest Contract Exemption Process Impacts of the Rule Package to the Transaction/Maintenance portion of the customer life cycle

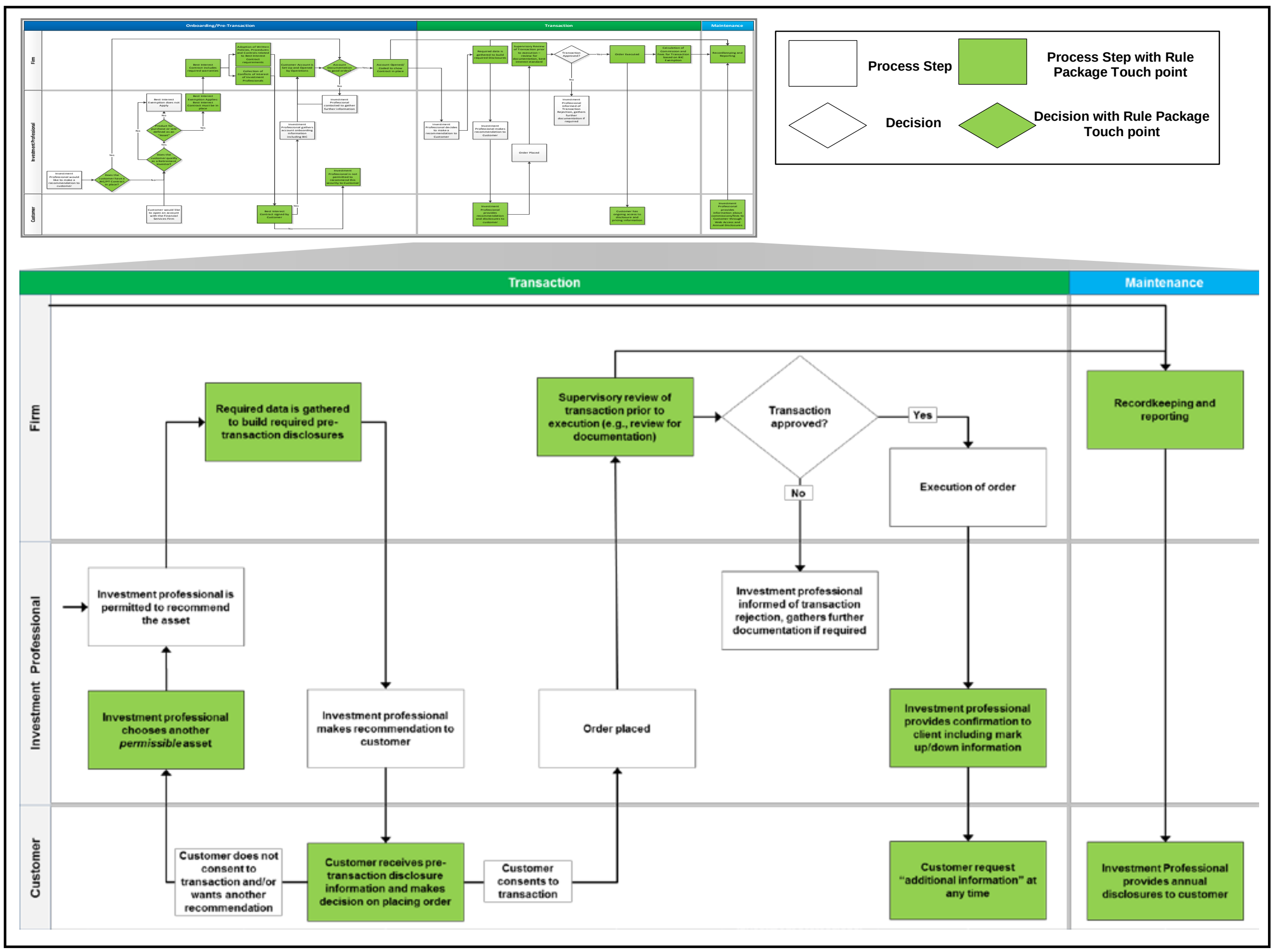
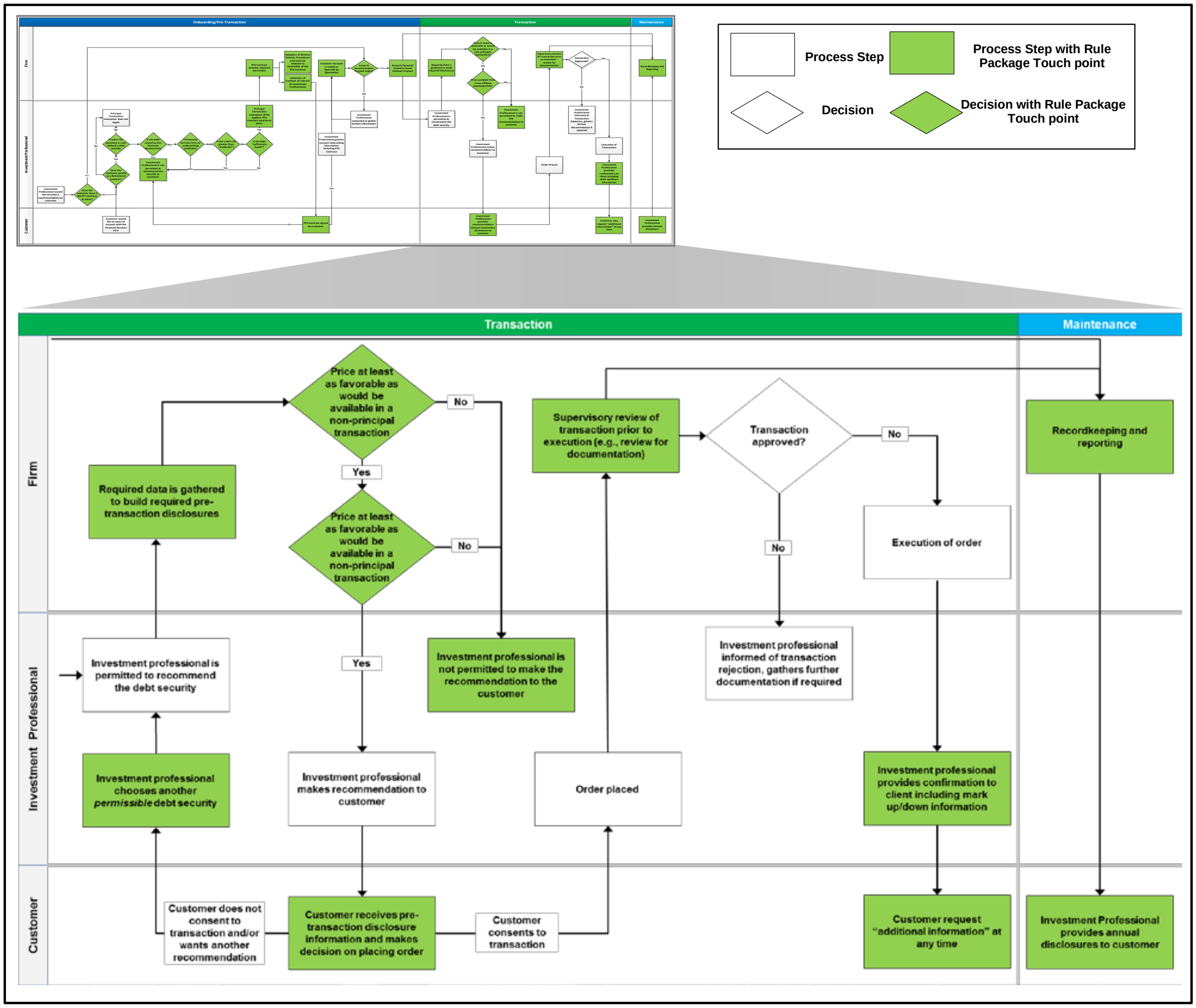


Figure 1.2 is an excerpt from the Principal Transaction Exemption process flow (See Appendix) illustrating the points where the SIFMA Working Group indicated that Rule Package requirements are expected to impact the processes within the transaction/maintenance portion of the customer transaction life cycle:

Figure 1.2 – Principal Transaction Exemption Process Impacts of the Rule Package to the Transaction/Maintenance portion of the customer life cycle



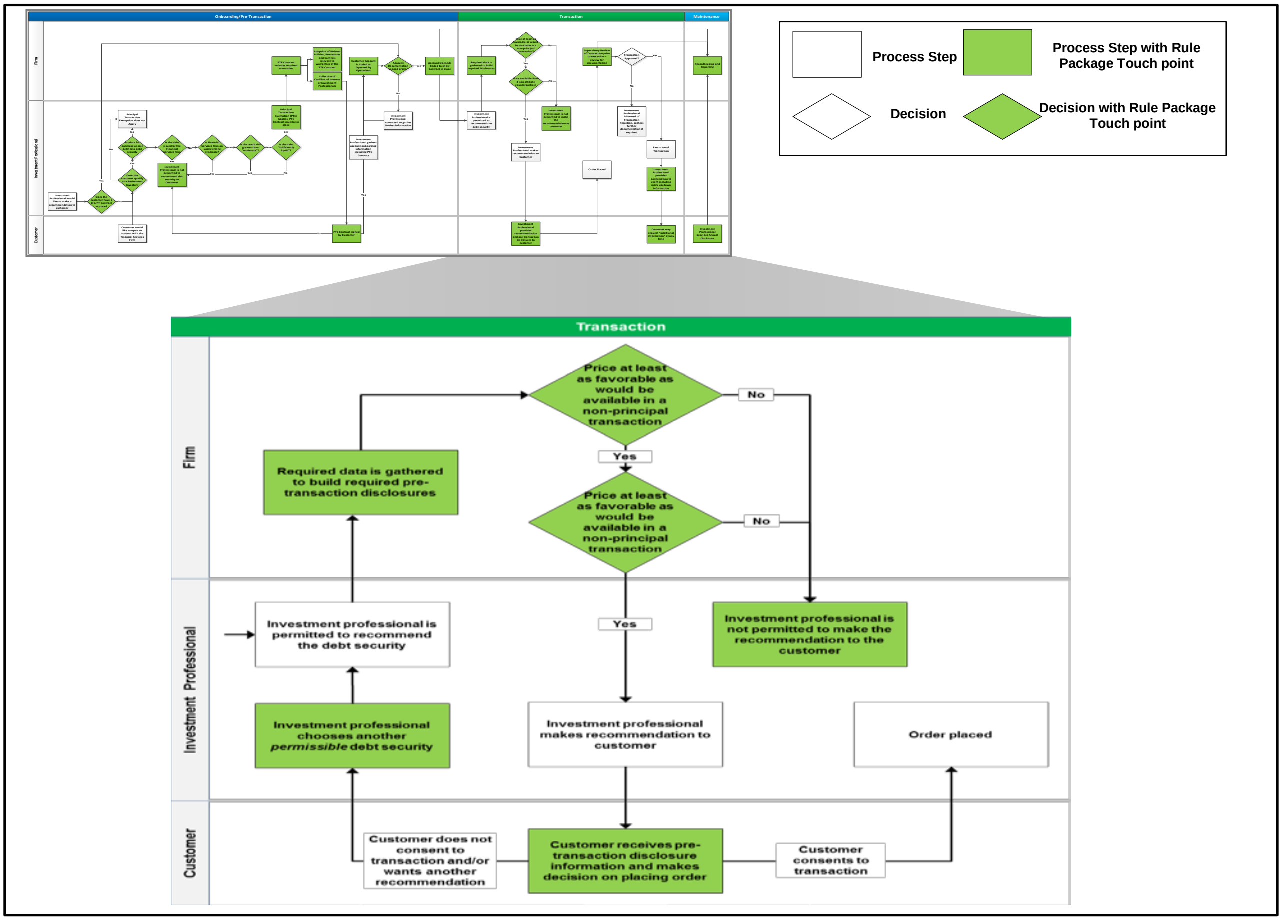
1.2 Financial market implications and credit rating limitations

The SIFMA Working Group identified several instances where financial market implications and credit rating limitations may prevent components of the Principal Transaction Exemption disclosure requirements from being operationalized. Under the proposed Principal Transaction Exemption requirements, transactions must not involve debt securities with greater than "moderate credit risk" or that are not "sufficiently liquid" such that a sale at approximately "fair market value" would not be possible in a reasonably short period. Obtaining precise and timely credit risk ratings at the point of sale will not be possible for all debt securities because of the dynamic nature of the market. Additionally, the continuously changing financial market conditions would likely impact the accuracy and effectiveness of the Principal Transaction Exemption's liquidity and disclosure requirements. Under the proposed Principal Transaction Exemption obligations, investment professional and firms will be required to disclose mark up and mark down information as well as price quotes when making a recommendation to a customer. The price quotes need to reflect that the current transaction will be at least as favorable to customers as would be available in a (a) non-principal transaction and (b) contemporaneously offered by two counterparties. The natural changing conditions of the financial market environment will make these disclosures requirements difficult and may create unintended harm to consumers. Specifically, the SIFMA Working Group cited the following concerns pertaining to financial market implications and credit rating limitations that will prevent the proposed Rule Package from being implemented as written include:

- <u>Obtaining accurate and timely credit risk ratings at the point of sale will not be possible for all debt securities due to the nature of the securities rating system currently in place</u> – Depending on the specific debt security, there will be limited consistency in determining ratings as a result of securities not being rated at all or the rating being outdated.
- <u>As a result of liquidity being a point in time determination, concluding if a debt security is "sufficiently liquid" will be difficult and subjective</u> – Given that liquidity is dependent on market conditions, ongoing monitoring of liquidity will be difficult, time consuming and potentially inaccurate with changes or fluctuations in the financial markets. Additionally, liquidity may be hard to measure and monitor as it changes under different scenarios that are largely dependent on the order size and market conditions at the time of a transaction.
- <u>A change in price, credit rating and/or liquidity prior to transaction execution will lead to a repetitive disclosure process with unintended harmful consequences to customers as a result of best execution limitations and pricing disparities</u> – Financial market fluctuations will create situations where there are changes to prices, credit ratings or liquidity conditions in the time between the initial transaction disclosure recommendation and the customer's decision to execute the transaction. For the firm to stay in compliance with the exemption, the investment professional would be required to perform additional disclosures if prices, credit ratings or liquidity changes during this time period. Delays caused from performing repetitive disclosure process may have unintended harmful consequences to customers such as best execution requirements and pricing disparities.

Figure 1.3 below is an excerpt from the Principal Transaction Exemption process flow (See Appendix) illustrating the pricing determination and the points where the SIFMA Working Group indicated that Rule Package requirements are expected to impact the illustrative process:

Figure 1.3 – Principal Transaction Exemption Process Impacts of the Rule Package related to pricing determinations



1.3 Best Interest and Principal Transaction Exemption Contract Implications

The SIFMA Working Group identified several instances where the proposed Rule Package's contract requirements will make existing business operations difficult or impractical. The contract requirements specify that investments professionals, firms and customers enter into a multi-party agreement ("Multi-party Contract"). The Best Interest Contract Exemption and Principal Transaction Exemption obligations require the Multi-party Contract be executed in writing before providing any advice or recommendations that would be considered "Investment Advice" as outlined in fiduciary standard definition of the proposed Rule Package.

Specifically, the SIFMA Working Group expressed concerns around existing business operations that will become unfeasible as a result of the Multi-party Contract requirements including:

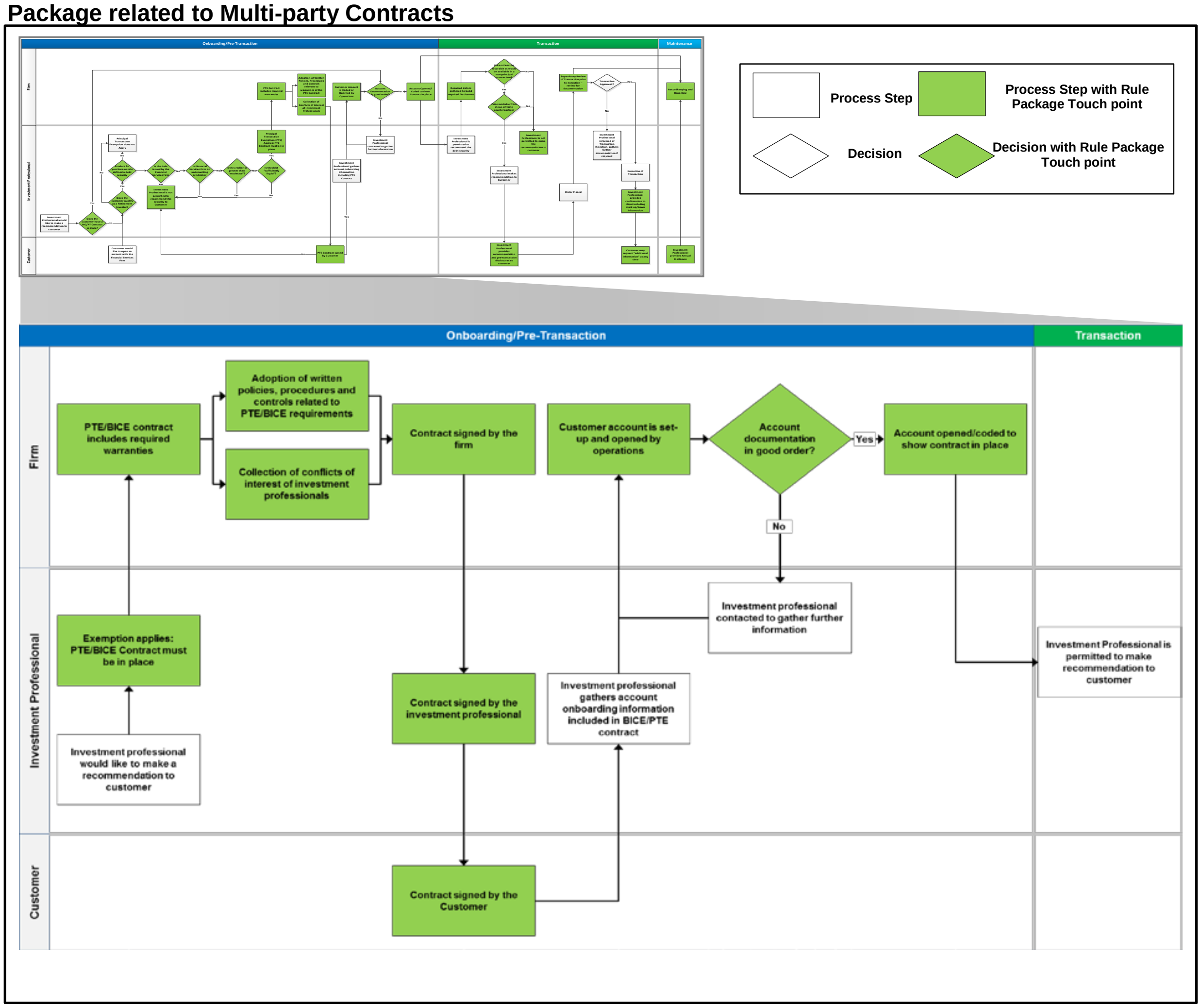
- <u>Current guidance models (e.g., call centers) will be prohibited or impractical under the Rule Package</u> – Many current call center models include call center employees who are registered persons and give guidance to customers. However, due to the nature of call centers, these employees are generally not assigned to specific accounts, making implementation of a Multi-party Contract impractical or impossible. Call centers will only be able to provide generic information to customers unless a Best Interest Contract or Principal Transaction Exemption is implemented between that specific call center staff and the customer, which may negatively impact the customer experience. Firms will be required to instruct call centers to provide no investment guidance, generic or otherwise, out of increased liability risk and fear of excise taxes.

- Limitations of Multi-party Contract may make existing business operations challenging and negatively impact customers if investment professionals are unavailable to service their specific account – If a new contract is needed every time one of the Multi-party Contract participants changes or is unavailable, it may negatively impact the client or limit business operations. For example, if the investment professional is not available, a recommendation or transaction cannot be made because the Multi-party Contract is non-transferable between investment professionals.

- Mass account transfers, acquisitions and firm wind-ups may result in harm to the customer – Firms would be required to complete Multi-party Contracts for applicable accounts **prior** to providing advice to customers in order to complete transactions. Financial service firms would be burdened with a time consuming and complex process when completing a mass transfer without the use of negative consent letters, as prescribed in the exception under FINRA Rule 2510. This could negatively impact the marketplace leading financial service firms to not accept mass transfers or to not step in during financial crises simply due to the operationally onerous requirements for retirement accounts. Overall, the customer would be harmed most by the financial services firms' inability to quickly service the retirement accounts and provide protection for the customer in a potentially volatile marketplace.

Figure 1.4 below is an excerpt from the Best Interest Contracts and Principal Transaction Exemptions process flows (See Appendix) illustrating the process of executing Multi-party Contracts between the financial services firm, investment professional and customer. The figure highlights the points in the process flow where the SIFMA Working Group noted that the Rule Package requirement is expected to impact the illustrative process:

Figure 1.4 - Best Interest Contract and Principal Transaction Exemption Process Impacts of the Rule Package related to Multi-party Contracts



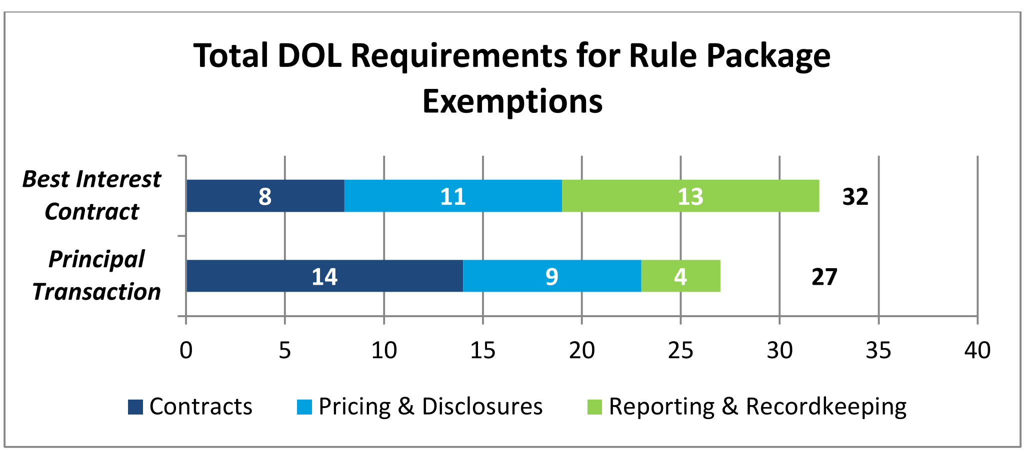
2. Significant personnel, process and technology changes and investments to operations, business and compliance will be required to comply with the Rule Package

Operationally Onerous

Significant changes to people, process, and technology will be required for firms and investment professionals to comply with the proposed Rule Package. The SIFMA Working Group identified several instances where firms will need to make substantial investments and transformations to business, compliance and operational frameworks. The proposed Rule Package will require a considerable overhaul to existing systems inclusive of technology and processes. In addition, firms across the industry will need to develop and implement new systems and tools, which are expected to entail significant effort and time. The SIFMA Working Group also identified cases where the technology functionality to capture data point requirements of the proposed Rule Package do not currently exist and will require a firm to acquire, implement and maintain these capabilities (See Figure 2.4 and 2.5 for further detail on data point requirements). Lastly, the SIFMA cost survey (see section 2.3 for results) indicated that the data implications coupled with onerous system overhauls will likely require firms to incur significantly higher expenses to operationalize the proposed Rule Package requirements than originally estimated by the DOL.

Figure 2.1 below provides an overview of the requirements that firms must meet to qualify for the Best Interest Contract and Principal Transaction Exemptions. The figure illustrates the number of requirements categorized by contracts, pricing & disclosures and reporting & recordkeeping for the Best Interest Contract and Principal Transaction exemptions.

Figure 2.1 – Number of requirements related to contracts, pricing & disclosures, reporting & recordkeeping within the Best Interest Contract and Principal Transaction Exemptions



2.1 Substantial changes and investments to systems and processes

The SIFMA Working Group voiced concerns that the proposed Rule Package will require changes to systems impacting current controls, supervision, surveillance, data collection and data management as depicted in Figure 2.2 below. Due to the new Rule Package affecting only retirement accounts, firms will need to bifurcate applicable field, middle and back office systems and processes to accommodate different standards and regulatory requirements for retirement and non-retirement accounts. Modifications to current systems and processes will be essential to comply with the proposed Rule Package which is expected to lead to significant cost expenditures for firms and ultimately increase costs for investors. However, as described in additional detail below, some firms may not be able to modify or to bifurcate systems and processes currently in place which will require firms to build or buy new systems and technology. Organizations that have the scale and financial capacity to operationalize the proposed Rule Package will likely have a competitive advantage over the firms with limited resources and capabilities.

Figure 2.2 below illustrates examples of systems present in many financial service firms and where the SIFMA Working Group noted potential impacts of the Rule Package that could require updates and builds to systems:

Figure 2.2 – Illustrative impacts to Financial Service Systems

	Potential impacts, may not be all inclusive					
Examples of Systems	**Bifurcation**	**Controls**	**Supervision**	**Surveillance**	**Data Collection**	**Data Management**
Onboarding/Pre-Transaction						
Front Office Customer Account	X	X	X	X	X	X
Middle/Back Office Customer Account	X	X	X	X	X	X
Customer Account Documentation		X	X	X	X	X
Conflicts of Interest Documentation and Maintenance		X	X	X	X	X
Account Opening Supervision		X	X	X	X	X
Account Opening Surveillance		X	X	X	X	X
Provider Platforms	X	X	X	X	X	X
Investment Professional Product Training	X	X	X	X		
Investment Professional Product Information	X	X	X	X		
New Product Approval		X	X	X		
Product Approval including Measuring Credit Rating and Liquidity		X	X	X		
Transaction						
Execution	X	X	X	X	X	X
Clearing	X	X	X	X	X	X
Security Master	X	X	X	X		
Transaction Supervision	X	X	X	X	X	X
Transaction Surveillance	X	X	X	X	X	X
Disclosure Disbursement		X	X	X	X	X
Front Office Documentation and Maintenance	X	X	X	X	X	X
Customer Relationship Management	X	X	X	X	X	X
Pricing Determinations		X	X	X	X	X
Pricing Documentation	X	X	X	X	X	X
Middle/Back Office Transaction	X	X	X	X	X	X
Maintenance						
Recordkeeping	X	X	X	X	X	X
Webpages and Customer Web Access	X	X	X	X	X	X
Ongoing Customer Communications (Mailings, Account Statements)	X	X	X	X	X	X

The SIFMA Working Group expressed concerns regarding the bifurcation of current systems including the following:

- Due to the DOL Rule Package only covering retirement type accounts, firms will need to bifurcate accounts, systems, processes and other infrastructure - The DOL proposal is only applicable to retirement type accounts (defined as qualified plans and IRAs) which would lead to different requirements, restrictions and prohibitions for the various types of customer accounts. This will likely result in firms' needing to bifurcate processes, build duplicate websites, trading pipes and accounting systems (e.g., online account client access), processes and other infrastructure which would result in costs to the firm, as indicated in the SIFMA cost survey results in section 2.3. A client accessing their accounts online would need to go to one website for nonretirement accounts and another website for retirement accounts causing confusion amongst customers and investment professionals. Furthermore, only two of the six carve-outs apply to all retirement accounts, which increases the likelihood firms will need to bifurcate current systems and processes.

The DOL proposal includes components that will require a transformation of a firm's day-to-day operations, systems and processes including the following: supervision, compliance, data collection and retention, sales and marketing, and education and training. Specifically, the SIFMA Working Group noted the following:

- Firms will be required to expand the technology capabilities to monitor agency transactions within IRAs - The inclusion of discretionary IRAs within Prohibited Transaction Exemption 86-128, but the exclusion on nondiscretionary IRAs from that exemption, moving them instead to Best Interest Contract Exemption, will cause confusion and errors. All discretionary accounts will need to be re-documented because of the new disclosure requirements for discretionary IRAs. Firms would be required to identify existing accounts that are considered discretionary and non-discretionary IRAs, and identify these accounts on an ongoing basis in order to monitor for permissible activities within these accounts. The process of identifying applicable accounts would be lengthy and complex for some firms. Furthermore, the current proposal would require financial service firms to create separate monitoring and recordkeeping processes for different types of IRAs. This separation would require changes to account coding, as well as ongoing maintenance of lists of permissible securities within different types of accounts to allow oversight of the activity in these accounts.

- Supervisory and compliance programs will require an overhaul to implement new controls, monitoring and surveillance processes in accordance with the proposed Rule Package requirements - Firms will be required to enhance supervisory and compliance programs to evidence, document and ensure compliance with Rule Package requirements prior to execution of a transaction. This includes revision or creation of applicable compliance procedures and surveillance routines to review trades and advice prior to execution of a transaction. Additionally, legal opinions will be required in advance of the design of certain documents (e.g. disclosure charts required by the Best Interest Contract Exemption, the Best Interest Contracts, warranties and updated or new applicable policies and procedures). New processes will require additional compliance personnel and technology enhancements to meet compliance recordkeeping requirements for substantiating that conditions of the Rule Package have been met.

- The effort to revise all marketing material (e.g. investor kits, websites, fact sheets) to comply with the Investment Education carve-out will likely be a costly and extensive exercise - To meet the narrowed Investment Education carve-out requirements firms will need to revise virtually all marketing content such as written material, websites and investor kits. Firms will have to implement systems and processes to (1) identify which pieces of marketing material that are currently in use no longer align to the carve-out; (2) suspend use of that material; (3) update the material and submit for approval to issuers and regulators and (4) implement updated supervisory processes to comply with new requirements. The process of updating the materials will be a lengthy and costly process as firms will need to review updated materials with product issuers as well as submit marketing materials for regulatory review and approval, which incurs a cost with each piece filed with regulators. Firms will need to undertake additional effort to retrain employees, including call center representatives, on what types of information would be permissible to communicate to an investor. Figure 2.3 below provides an overview, as defined by the SIFMA Working Group, of the types of marketing materials that the Rule Package will impact and the process that many firms would have to go through.

Figure 2.3 – Steps and impacts for review of marketing materials as a result of the Investment Education carve-out

Types of marketing and communications material that will require consideration for usage	
• Asset allocation tools	• Print advertising
• Call center scripts	• Quick cards
• Education seminar presentations	• Radio advertisements
• Fact sheets – funds	• Request for proposal responses
• Fact sheets – providers	• Television advertisements
• Forms	• Video presentations
• Fund prospectus material	• Voice response systems
• Internal sales tools and applications	• Web tools
• Investor kits	• Webinars
• Investment analysis tools	• Public facing websites

Finally, the SIFMA Working Group expressed concerns that many firms are not able to modify or bifurcate various systems and processes currently in place forcing firms to take on the costs associated with acquiring new technology to ensure investment professionals and firms will be in compliance with the proposed Rule Package including:

- Technology solutions may not exist, which will require effort and time for the development of new solutions to assist firms with meeting the proposed Rule Package obligations – Introducing firms may have customized contracts and business models that require specialized operational solutions at the clearing firm/vendor level. Clearing firms/vendors who service these introducing firms may be required to develop new systems and tools, which will entail substantial and time-consuming investments. Additionally, the process to implement new systems and tools with introducing brokers will require time and customization by firm to accommodate the variety of business models of introducing brokers who utilize third party clearing firms.

- Firms do not currently have the technology and tools in place for monitoring and surveillance to ensure investment professionals provide advice only on products that are permissible under the proposed Rule Package - Firms will be required to build systems that capture permissibility of products by account type, first inventorying the accounts into account types and then aligning a firms security master list to determine which products would be permissible. Firms will be required to build a system to monitor that advice given in an account is utilized in that account on permissible securities only, including documenting and maintaining records to evidence advice given. Furthermore, firms will be required to build processes, systems and oversight to accommodate customers who hold securities in their retirement accounts that are non-permissible securities under the prohibited exemption transactions in the Rule Package.

- Technology and control frameworks will require updates to accommodate implementation of credit rating and liquidity standards - The Rule Package requires that a debt security must be "sufficiently liquid" or greater than a "moderate credit risk" to comply with the Principal Transaction Exemption. Currently, control frameworks and technology in place to detect and monitor credit rating and liquidity standards may be challenging to customize in a manner that will allow for daily changes. The Rule Package will require firms to create new technology and control frameworks be created for ongoing maintenance of liquidity and credit rating information and to gather and document this information to assist in determining if a product is permitted for sale.

- Technology updates will be required to include mark up/down information on customer confirmations documents - The Rule Package requires the customer is provided with information related to the mark up and mark down on the written confirmation, this is not currently captured by firms on the written confirmation provided to customers and will require updates to internal systems and technology to capture. Furthermore, FINRA ("Financial Industry Regulatory Authority") recently released Regulatory Notice 15-52 requesting comment on a proposed FINRA rule that will require firms to disclose additional information on customer confirmations for transactions in fixed income securities. Specifically, FINRA is proposing that, for same-day, retail-size principal transactions, firms disclose on the customer confirmation the price to the customer, the price to the member of a transaction in the same security, and the differential between those two prices. The proposed Rule Package requirements do not necessarily correspond with the potential requirements proposed by FINRA for customer reporting, this may result in firms completing duplicative updates or changes to technology to comply with multiple authorities. Legal opinions will need to be obtained to determine how to calculate markups and markdowns. Confirms solely for retirement accounts will need to be designed, back-tested, and programming done so that the appropriate confirm is attached to retirement accounts in principal transactions.

- Technology and control frameworks will require updates for documentation to evidence fiduciary standard, including evidence of price comparisons, liquidity determinations and credit ratings - The Rule Package requires substantiation of fiduciary standard which will require firms to document determinations and maintain documentation to evidence reliance on the exemption. The SIFMA Working Group noted that this information (illustrated in Figures 2.4 and 2.5) is not required to be maintained at this time and firms will be required to update retention capabilities or acquire a data warehouse to accommodate additional documentation as well as expand current control frameworks to ensure documentation is properly maintained.

2.2 Large-scale new data collection and management requirements

The SIFMA Working Group identified several instances where the proposed Rule Package will require new data points that firms must capture, aggregate, calculate, monitor and store. Changes to technology and processes will be needed to acquire, implement, and maintain the capabilities to address these data implications. Firms will need to expend effort and resources to develop and aggregate data that currently does not exist or is maintained on disparate systems. New processes and technology functionality around data will be required to monitor compliance and track exemption applicability. Lastly, firms may need to develop new data repositories which can lead to additional cost and effort to acquire, store and maintain new data points for disclosures and recordkeeping requirements.

Figure 2.4 below illustrates data points outlined within the Rule Package for compliance with the Best Interest Contract Exemption and the impact areas identified by the SIFMA Working Group where build out of systems, conversions, and implementations of processes, controls and oversight frameworks will be required for compliance:

Figure 2.4 – Illustrative impacts to firms when considering operational needs to gather and maintain the data points listed in the Best Interest Contract exemption

Potential Required Data Points			Potential Impacts, may not be all inclusive				
			System Build to Collect	**Conversion to Dollar Amount**	**Implementation of Process**	**Implementation of Controls**	**Implementation of Oversight**
Disclosures							
	Initial Transaction Disclosure	Acquisition Costs of Transaction		X		X	X
	Initial Transaction Disclosure	Ongoing Costs of Product	X	X	X	X	X
	Initial Transaction Disclosure	Disposition Costs for 1-, 5- and 10-year Periods	X	X	X	X	X
	Initial Transaction Disclosure	Reasonable Assumptions about Investment Performance	X	X	X	X	X
	Annual Disclosure	List of Assets Bought and Sold During the Year (along with sales price)	X	X	X	X	X
	Annual Disclosure	Total Dollar Amount of Direct Fees paid by the investor with respect to assets bought, sold and held	X	X	X	X	X
	Annual Disclosure	Total Dollar Amount of Indirect Fees paid by the investor with respect to assets bought, sold and held	X	X	X	X	X
	Annual Disclosure	Total Dollar Amount of Expenses paid by the investor with respect to assets bought, sold and held	X	X	X	X	X
	Annual Disclosure	Total Dollar Amount of Direct Compensation received by the Investment Professional with respect to assets bought, sold and held	X	X	X	X	X
	Annual Disclosure	Total Dollar Amount of Indirect Compensation received by the Investment Professional with respect to assets bought, sold and held	X	X	X	X	X
	Annual Disclosure	Total Dollar Amount of Direct Compensation received by the Financial Services Firm with respect to assets bought, sold and held	X	X	X	X	X
	Annual Disclosure	Total Dollar Amount of Indirect Compensation received by the Financial Services Firm with respect to assets bought, sold and held	X	X	X	X	X
	Webpage	Direct Compensation payable to the Investment Professional for assets bought, sold and held by an investor in the last 365 days	X		X	X	X
	Webpage	Indirect Compensation payable to the Investment Professional for assets bought, sold and held by an investor in the last 365 days	X		X	X	X
	Webpage	Direct Compensation payable to the Financial Services Firm for assets bought, sold and held by an investor in the last 365 days	X		X	X	X
	Webpage	Indirect Compensation payable to the Financial Services Firm for assets bought, sold and held by an investor in the last 365 days	X		X	X	X
	Webpage	Direct Compensation payable to any affiliates for assets bought, sold and held by an investor in the last 365 days	X		X	X	X
	Webpage	Indirect Compensation payable to any affiliates for assets bought, sold and held by an investor in the last 365 days	X		X	X	X
	Webpage	Variations in compensation within and among assets	X		X	X	X
Recordkeeping							
		Intention to Rely on Exemption	X		X	X	X
		Inflows	X		X	X	X
		Outflows	X		X	X	X
		Holdings	X		X	X	X
		Returns	X		X	X	X
		Substantiation that conditions of the exemption were met	X		X	X	X

Figure 2.5 below illustrates data points outlined within the Rule Package for compliance with the Principal Transaction Exemption and the impact areas identified by the SIFMA Working Group where build out of systems, conversions, and implementations of processes, controls and oversight frameworks would be required for compliance:

Figure 2.5 - Illustrative impacts to firms when considering operational needs to gather and maintain the data points listed in the Best Interest Contract exemption

			Potential impacts, may not be all inclusive				
			System Build to Collect	Conversion to Dollar Amount	Implementation of Process	Implementation of Controls	Implementation of Oversight
Potential Required Data Points	Disclosures						
	Initial Transaction Disclosure	Transaction Occurs on a Principal Basis		X		X	X
		Price at which the Financial Institution will Transact	X	X	X	X	X
		Mark Up and Mark Down	X	X	X	X	X
		Agency Transaction Pricing	X	X	X	X	X
		Two other bids from Contemporaneous Non-Affiliates	X	X	X	X	X
		Written Confirm including Mark Up/Mark Down		X	X	X	X
	Annual Disclosure	List of Principal Transactions During the Year	X	X	X	X	X
		Prevailing Market Price at which the debt security was purchased or sold	X	X	X	X	X
		Mark Up and Mark Down on each transaction	X	X	X	X	X
	Recordkeeping						
	Intention to Rely on Exemption				X	X	X
	Substantiation that conditions of the exemption were met		X	X	X	X	X

The SIFMA Working Group expressed specific concerns pertaining to data that firms would need create, capture, aggregate, calculate and/or maintain with respect to the proposed Rule Packages' disclosure requirements of the Principal Transaction and/or Best Interest Contract Exemptions include:

- <u>The volume and type of data required to meet the Best Interest Contract Exemption webpage disclosures obligations is multi-faceted and not currently available</u> – Aggregation and documentation of new data points to meet requirements will be a potentially lengthy and costly process that will involve enhancements to current technology. (See Figure 1.5 above)

- <u>Data requirements for the initial transaction disclosures currently exists in multiple systems and are not readily available</u> – The data points and cost information required for the Best Interest Contract Exemption's Initial Transaction Disclosures is currently maintained in multiple systems or sits with multiple sources. (See Figure 1.6 above) The proposed Rule Package requires the all-in cost and anticipated future costs of the assets be disclosed to the customer at the point of sale. Firms will be required to build systems, processes and data repositories to aggregate, calculate and maintain this information. Processes, controls and supervision will also need to be implemented to ensure accuracy, completeness and compliance.

- <u>Gathering contemporaneous pricing information for the Principal Transaction Exemption point of sale disclosures will require firms to implement new technology capabilities to capture data points that are not currently captured</u> – Non-affiliate contemporaneous or historical pricing information for determining the security's mark up or mark down at the point the security was placed in a firms inventory is not currently available and would need to be developed. It will be a challenging task for firms to build systems that will aggregate information from disparate sources and covert it to dollar amounts, including algorithms to determine if the amounts should be calculated using LIFO, FIFO, weighted averages or some other method. Firms must also build and implement additional processes, controls, and supervision will be required to ensure data integrity and completeness. (See Figure 1.6 above)

Additionally, specific concerns pertaining to the data implications of the proposed Rule Packages' Principal Transaction and/or Best Interest Contract Exemptions reporting and recordkeeping requirements include:

- <u>The data points required to meet new reporting obligations are not currently captured or calculated by firms</u> – Changes to technology and processes would be needed for firms to capture required reporting information and perform calculations for new data points related to pricing and fees. Additionally, updates to industry technology would be needed for reporting required data to the DOL as many of the data points (including detailed pricing information, such as advisor compensation) are not required to be maintained and/or reported at this time. To provide this information to the DOL, firms would need to build systems that are formatted in a manner determined by the DOL, which has not been provided within the Rule Package.

- <u>Storing the required data to meet new recordkeeping obligations would require creation of a new large data repository within each firm with cost and effort implications</u> – The industry is not currently required to store information on inflows, outflows, holdings or other data points required to meet the Best Interest Contract Exemption. Creating the infrastructure to capture this data would be a challenge to build and maintain.

Lastly, firms will need to create and build new processes and technology functionality will be needed to monitor compliance and track exemption applicability of the proposed Rule Packages' Seller carve-out and Swap carve-out requirements include:

- <u>The technology capabilities currently do not exist to capture the data point requirements on both new and existing accounts to monitor proposed Swap carve-out obligations</u> – Firms will need to create an indicator to identify specific Swap carve-out requirements by account. The process to implement the technology functionality may be challenging and would likely require that all existing accounts be updated with new classifications.

- <u>In order to monitor for the Seller carve-out requirements, including monitoring assets and plan participants to ensure the exemption remains applicable, new technology functionality would need to be built in order to capture required data points</u> – The Seller carve-out only applies to plans with more than 100 participants and over $100M in ERISA assets. To understand and monitor if a plan meets these qualifications, financial firms would need to develop new system functionality to track the participant and total asset requirements on an ongoing basis. Firms will need to expand current documentation repositories and control checks to record and maintain this information.

2.3 High-dollar cost for firms to implement and maintain

To assess the financial impact across the industry, SIFMA conducted a survey of 18 SIFMA Working Group member firms in which they were asked to estimate the cost to comply with the Rule Package as it is currently written ("2015 Cost Survey"). The surveyed firms were grouped into small, medium and large categories based on their net capital as of 12/31/14.[7]

[7] The firm size categories used in the SIFMA cost survey are the same categories used by the DOL in their Regulatory Impact Analysis (source: http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf , Page 158, Section 5.2.3)

Figure 2.7 – Firm size as defined in terms of Dollar Amount of Net Capital

Firm Size	Net Capital
Large	Greater than $1 billion
Medium	$50 million to $1 billion
Small	Less than $50 million

According to the estimates that the DOL included in its Regulatory Impact Analysis[8] there were a total of 2,619 broker-dealers that serve ERISA accounts or IRAs and would thus be impacted by the proposed Rule. The DOL's estimate broke down this population as follows:

Figure 2.8 – Department of Labor Population and participants in SIFMA cost survey

Firm Size	Number of broker-dealers in industry, per DOL	Number of broker-dealers in SIFMA survey
Large	42	9
Medium	137	4
Small	2,440	5

The surveyed firms represent a diverse business mix; including both clearing and non-clearing firms and range from full-service broker-dealers to smaller retail oriented broker-dealers. Using the SIFMA survey, the surveyed firms indicated there would be significant costs for implementation and ongoing maintenance for operations to comply with the Rule. The surveyed firms were asked to consider the types of costs noted in Figure 2.9

Figure 2.9 – Key Cost Components Considered

Considerations for Start-up and annual on-going costs

- Information technology suppliers and vendors;
- Information technology systems, hardware and software, support and testing/audit;
- Outside legal counsel costs
- Outside compliance consultant costs
- Communications, marketing, business review and risk review;
- Training materials: creating, editing, and circulating new materials; reviewing, editing, finalizing, and publishing all impacted training materials;
- Training: providing training and communication to all impacted personnel, particularly sales and operations personnel;
- Reviewing and updating all existing client contracts and client disclosures (including documentation and delivery of disclosure);
- Reviewing and updating of sales surveillance tools, all impacted policies and procedures, including written supervisory procedures;
- Publishing and distributing revised policies and procedures;
- Reviewing, editing, finalizing and publishing all impacted marketing materials; and
- Updating exam test modules and instructions, training examiners, and executing additional testing procedures across all branch offices
- Other out-of-pocket costs
- Employee- and staff-related costs

The survey respondent firms noted that they would incur significant costs to understand the requirements and update systems, policies and processes in order to be ready to comply with the Rule Package. For global and complex firms who serve large portions of the IRA marketplace, this is expected to involve evaluating and updating potentially hundreds of different systems, policies and processes. As it relates to smaller and introducing firms many of these firms will be dependent on third party providers such as clearing firms and service vendors. Firms of all sizes will have to bear

[8] Source: http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf , Page 160

the burden of significant costs of adapting technology and operational frameworks. Smaller firms would likely be at a greater disadvantage, and some firms indicated that they may decide to exit the market due to the expense of complying with the Rule obligations.

Figure 2.10   Examples of the steps that firms may need to take to be ready for Rule implementation

Once the Rule is implemented, the survey respondent firms noted that they will incur additional costs for supporting the enhanced systems and processes designed to comply with the Rule's requirements for contracts, disclosures, recordkeeping and communications.

The SIFMA survey conducted with the SIFMA Working Group provides insight on how the Rule requirements are expected to impact operational expenses for implementing and maintaining the operational changes, processes and systems. In order to provide a closer approximation of costs that survey respondent firms will incur, Figure 2.11 contains the mean cost estimates from survey respondents by firm size[9]. The survey respondent firms estimated their start-up and ongoing maintenance costs to be the following:

Figure 2.11 –Mean Cost Estimates of Survey Respondents by Firm Size

Firm Size	Mean Start-up Costs per Respondent	Mean Ongoing Costs per Respondent
Large	**$38.1M**	**$9.5M**
Medium	**$23.1M**	**$5M**
Small	**$3.4M**	**$2.6M**

To understand what the range of the potential cost impact to the broader broker-dealer industry would be, the Working Group applied two methodologies to the SIFMA survey results: the DOL's cost estimate methodology for "Scenario A"[10] ("DOL Methodology") and by multiplying the mean cost estimate of each firm size category by the number of firms in the respective firm size category

[9] The cost survey was conducted by SIFMA. Deloitte did not audit or verify the underlying information and the extrapolation is provided as an illustrative example of what SIFMA in conjunction with the SIFMA Working Group believes to be the potential cost implications.
[10] The DOL Methodology is defined in the table below (source: Source: http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf , Page 164-166):

Firm Size Category	Scenario A	
	DOL's Per Firm Cost Calculation Methodology	DOL's Total Industry Cost Calculation Methodology
Large BD	Use SIFMA's large BD average cost estimate	Multiply DOL's Per Firm Cost Calculation by number of firms in industry in size same category
Medium BD	Multiply SIFMA's large BD average cost estimate by IAA ratio (0.133)	Multiply DOL's Per Firm Cost Calculation by number of firms in industry in size same category
Small BD	Multiply SIFMA's large BD average cost estimate by IAA ratio (0.048)	Multiply DOL's Per Firm Cost Calculation by number of firms in industry in size same category

("Alternative Methodology"). However, the Working Group chose to exclude small firms from this exercise because of the broad and diverse make-up of the industry's small firm population, which the SIFMA survey respondents may not have been representative of. In the view of the Working Group, while there would undoubtedly be substantial costs for small firms to come into compliance, their costs are difficult to assess, given the broad range of firm sizes and business models included in this category. Implementation for small firms would involve a mix of costs which are borne entirely by the firm itself, such as additional employees, customized legal advice, and system and process changes, as well changes made at the vendors and clearing firms who support many of their processes. The balance of these costs and whether costs undertaken by vendors would also be borne by small firms remains uncertain.

Figure 2.12 – Start-Up Cost Estimates for Broker-Dealer Industry for Large and Medium Firms

Firm Size Category	# of Firms	Start-Up Costs			
		DOL Methodology		Alternative Methodology	
		Per Firm Avg. Costs	Total Costs	Per Firm Avg. Costs	Total Costs
Large BD	42	$38.1M	$1.6B	$38.1M	$1.6B
Medium BD	137	$5M	$685M	$23.1M	$3.1B
		Total Cost	**$2.2B**		**$4.7B**

Figure 2.13 – On-Going Cost Estimates for Broker-Dealer Industry for Large and Medium Firms

Firm Size Category	# of Firms	On-Going Costs			
		DOL Methodology		Alternative Methodology	
		Per Firm Avg. Costs	Total Costs	Per Firm Avg. Costs	Total Costs
Large BD	42	$9.5M	$399M	$9.5M	$399M
Medium BD	137	$1.2M	$164M	$5M	$685M
		Total Cost	**$563M**		**$1.1B**

Figure 2.14 – Range of Cost Estimates for Broker-Dealer Industry for Large and Medium Firms

Range of Cost Estimates for Broker Dealer Industry for Large and Medium Firms
Start-up Costs: $2.2B - $4.7B
Annual On-Going Costs: $563M - $1.1B

The cost estimates provided by the respondent firms and Working Group are considerably greater than what the DOL in their Regulatory Impact Analysis estimated the start-up and ongoing costs would be for firms of similar size[11]. For the SIFMA Working Group this came as no surprise, since, in

[11] The DOL estimated the following ranges for total industry Start-Up and On-Going Costs:

	Scenario A	Scenario B
Start-Up Costs	$892M	$195M
On-Going Costs	$357M	$78M

Source: http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf , Page 166 their view, the DOL's estimate was based on a narrow dataset that was never intended to measure costs for complying with the Rule Package, which resulted in the DOL underestimating the projected costs. The cost estimates for the broker-dealer industry provided by the DOL in their Regulatory Impact Analysis relied on the results of a cost survey conducted by SIFMA in 2011 to understand the estimated costs of complying with prospective SEC fiduciary rules established under Dodd-Frank §913 ("913 Data"). The costs estimated in the 913 Data are fundamentally different than those anticipated for compliance with the Rule Package, given the comparatively narrow scope of Dodd-Frank §913 requirements and the focus on development of disclosure forms and customer relationship guides. Although the DOL conceded that "there will be substantive differences between the [DOL]'s new proposal and exemptions and any future SEC regulation that would establish a uniform fiduciary standard", the DOL nevertheless elected to rely on the 913 Data as the basis for their cost estimates, stating that the reason for doing so is that there are "some similarities between the cost components" in the 913 Data and the costs that would be required to comply with the Rule Package.

However, in the view of the Working Group, the results of the 2015 Cost Survey serve as a better guide to understand the estimated costs of complying with the Rule Package for the simple fact that the specific intent of the 2015 Cost Survey was to understand the broker-dealer industry's cost estimates of the Rule Package.

3. Certain Rule Package requirements will create disruptions to business operations and customer experience

Impediment to Business

The SIFMA Working Group identified components of the Best Interest Contract Exemption and Principal Transaction Exemption which will create obstacles for investment professionals, firms and customers to have efficient or even functional investment relations. The requirements of the Rule Package are expected to impede open dialogue on investment choices and education between investment professionals and their customers. The SIFMA Working Group identified several instances where the obligations of the proposed Rule Package may cause confusion amongst customers, loss of business and a decline in investments.

3.1 Potential negative impacts to customer experience

3.1.1 Customer confusion as a result of the Rule Package

Operationalizing the contract and disclosure requirements of the Best Interest Contract Exemption and Principal Transaction Exemption may inadvertently bring negative consequences to the customer.

The Best Interest Contract Exemption and Principal Transaction Exemption require investment professionals and firms to disclose the total cost of investing and “reasonable assumptions” about investment performance. Best Interest Contract Exemption and Principal Transaction Exemption requirements with respect to costs, calculations and performance assumptions may cause customer confusion as a result of non-standardized methodologies across firms.

- <u>Initial transaction disclosures focus heavily on costs which may mislead customers</u> - The Best Interest Contract Exemption disclosure will emphasize costs which may be misleading and harmful to customers. The disclosure would not require equal evaluation of risk and performance, and does not require that investment professionals provide a complete view of the investment. Firms will need to build out training for investment professionals on client relationship management and disclosures as well as an increased focus by investment professionals on documentation of conversations with clients to evidence compliance with the proposed rule.

- <u>Differing assumptions across firms in calculating performance for cost disclosures of products across firms will cause customer confusion</u> - The Rule Package provides limited guidance on determining performance assumptions to calculate future costs, which will lead to differing calculations across firms and therefore different information communicated to clients. The disclosure requirements also leave ambiguity on how future performance should be calculated. This will result in firms using different variables and assumptions from each other when calculating future performance, which will lead to instances where similar or the same products have different performance projections based on which firm performed the performance calculation.

- Firms may be required to bifurcate accounts to accommodate products that may not be permissible under the Rule Package, which could lead to confusion when advice is provided in one account but not another - Due to the number of products that will not be permissible under the proposed prohibited transaction exemptions, firms may be required to separate customer holdings into different account types for firms abide by the Rule Package requirements around advice. This may cause confusion to customers receiving advice from their investment professional in one account, but are suddenly no longer able to receive advice on other types of securities or in other non-fiduciary accounts. In this particular scenario, the DOL Rule Package would limit investment professionals from having complete transparency over customer assets, and may infringe on the ability of the customer to receive the best recommendations based on the customer's overall investment profile. Furthermore, firms would be required to identify permissible and non-permissible securities for products within customer accounts to determine what products can remain in IRAs and what assets may need to be sold or liquidated. Firms would be required to build out infrastructure oversight to ensure accounts are holding permissible investments, and customers are acting on advice in the applicable accounts. Establishing multiple IRAs may lead to an impact to IRA documentation requirements where the IRS may require separate IRA agreements for the fiduciary vs. non-fiduciary account types which could result in additional IRS reporting and potentially calculation of multiple required minimum distributions.

3.1.2 Impact of investment education limitations

The proposed Platform Provider and Investment Education carve-out requirements will limit information provided to investment professionals and customers. The Platform Provider carve-out restricts individualized information and allows firms to provide only general financial information such as the historical performance of asset classes, and platform investment options. Similarly, under the Investment Education carve-out, educational materials can no longer include information advice or specific recommendations with respect to specific investment products, managers or the value of particular securities. Restrictions proposed in these carve-outs limit education sources and the depth of information available upon which investment professionals and customers often base investment decisions.

- Restricting Platform Providers from answering specific questions will restrict the information available to customers – Currently, requests for proposals ("RFP") to platform providers from companies looking to sponsor a retirement plan for employees include questions around the specific products that could be offered on a platform to assist the potential plan sponsor in determining if the product choice is correct for their retirement plan needs. The exemption will preclude providers from addressing questions around specific product availability or options provided on the platform. The SIFMA Working Group indicated that this will limit the ability of potential plan sponsors to choose the platform provider that best serves their needs. This will make the process for choosing a plan provider operationally onerous and complicated due to a lack of information provided. Due to the limitations of the proposed Platform Provider carve-out, customers will be negatively impacted by a provider's inability to address information requests for specific information. Additionally, potential plan sponsors will likely be inundated with information that will not be relevant to them as a result of restricted information provisions

- Proposed limitations on information in educational material could lead to a lack of meaningful information available to investors upon which to base investment decisions - The proposed Investment Education carve-out allows exceptions if educational materials provided to a plan, fiduciaries or investors do not provide any specific recommendations to investment products, alternatives, or show value of a particular security or property investment. The narrow applicability of this carve-out will impede business and customer service due to the limitation of available information that can be provided without converting to fiduciary status. Customers will be prevented from utilizing investment analysis tools and call centers which will limit their understanding of investment options. Asset allocation models and interactive investment materials that refer to specific products available under a plan or IRA would be considered individualized recommendations rather than investment education. The proposed Investment Education carve-out could lead to an absence of educational tools that currently benefit customers. Additionally, firms would be required to update webpages or investment tools which will require new technology and operation builds and updates.

3.1.3 Investment option limitations and disadvantages

The complexities, costs and risks associated with non-compliance of the Rule Package may cause some firms to discontinue business with low balance accounts or retirement accounts altogether. Additionally, the Principal Transaction Exemption requirements will limit customer investment options if two price quotes from unaffiliated firms cannot be found.

- <u>Because of the associated complexities and costs required to transform operational and technological frameworks, firms may choose to no longer service low balance accounts</u> - Firms will consider the risk of taking on low balance accounts versus the potential for violating the strict requirements of the Rule Package. This may result in many firms closing small dollar value accounts, and limiting options for customers with low balance accounts.

- <u>Clients purchasing debt securities in principal transactions may be adversely impacted by investment limitations if two contemporaneous price quotes cannot be obtained</u> - The ability to gather price quotes based on the Principal Transaction Exemption requirements will vary depending on the debt security and available inventory. If the investment professional is unable to obtain the required two contemporaneous price quotes from non-affiliates, the investment professional will not be able to recommend the product to customers. This will lead to limitations on the products available to customers due to the constraints of the requirements and alternative recommendations that may not be best for the customer. Furthermore, it will be difficult for firms to operationalize retrieving two competing quote which could lead to latency in pricing comparison processes and trade executions. Once the price quotes are received, and regardless of whether the trade is completed or not, it will be operationally onerous to then track and store that data for 6 years.

4. Certain Rule Package requirements may conflict with existing regulatory obligations

Potential Regulatory Implications

Multiple requirements of the proposed Rule Package contradict current regulatory rules and guidelines to which firms are already held. It is unclear how firms will be expected to operationally comply with the proposed Rule Package within the current regulatory environment. Firms will need to understand where current regulations and the DOL conflict or overlap to identify operational processes that require enhancements to facilitate compliance across all regulations. Firms would be required to build out controls and oversight processes to document and evidence compliance with regulatory requirements and will need to store this massive amount of data.

4.1 Migration to multiple and various types of accounts that may not align with current expectations

Firms may find the requirements to comply with the Rule Package cost-prohibitive, and in some instances, these firms will choose to only offer a fixed-fee or wrap-fee model where suitable, or will terminate the account. In accounts with low or no activity, moving customers to this business model could result in increased regulatory scrutiny as this type of movement of these accounts has been noted as an SEC ("U.S. Securities and Exchange Commission") and FINRA focus[12]. These instances will require firms to implement additional recordkeeping and documentation of oversight to evidence reasoning or best interest to regulators.

Furthermore, complications can arise if customers with multiple types of accounts take advice related to a fiduciary account and act on it in a non-fiduciary account. Under the proposed Rule Package obligations, current customers would need to update account documentation for all applicable existing accounts to continue receiving advice. However, some customers may decide not to enter into contracts, or complete other necessary requirements for the firm to take advantage of an exemption (e.g., refusal to sign contracts required for Best Interest Contract of Principal Transaction Exemption, refusal to sell certain products out of their account for compliance with exemptions) which may result in customers entering into wrap accounts. These scenarios will lead to additional obligations for firms to monitor and supervise conversations to determine if advice was executed in an unintended account or if the investment professional violated regulations. Specifically, the following SIFMA Working Group concern was identified:

- Customers with multiple account types (both fiduciary and non-fiduciary) could act on advice in a different account than intended, potentially leading to regulatory violations – Customers could act on advice received in connection with their fiduciary account in a non-fiduciary account. Firms would be required to monitor and supervise conversations and to store the data to determine if advice was given and then executed in another type of account. The customer has the ability to act on a recommendation/advice in any account or capacity; however a customer may claim fiduciary duty and therefore puts firms and investment professionals at risk of violating the DOL Rule Package exemptions in accounts not aligned with the DOL requirements.

[12] Source: SEC 2014 Examination Priorities (http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2014.pdf)

4.2 Inconsistencies with other existing rules and guidance

The proposed Rule Package obligations pose concerns with firms being able to comply with both current regulatory rules and the DOL requirements. According to FINRA Rule Package 2510(d)(2), in the event of a mass account transfer FINRA would recognize negative consent letters as a notice of movement of accounts. However, the operationalization of the Multi-party Contract may result in a hindrance to opening customer accounts at the new brokerage firm and potential harm to the customer. This could lead to financial service firms not being able to utilize the exception under FINRA Rule Package 2510, which allows for negative consent forms to be used to process accounts involved in bulk exchanges.

In addition, under the Best Interest Contract and Principal Transaction Exemptions requirement for Initial transaction disclosures, the Rule Package requires "reasonable assumptions about investment performance," including assumptions related to future cost projections for 1-, 5-, and 10-year timeframe, which could potentially be in direct conflict with FINRA Rule Package 2210 depending on the nature of the assumptions which limits the ability of firms to provide assumptions on future performance. Further, factors that affect reasonable assumptions are dynamic and could change leading to potential questions around reasonable assumptions expressed. For example, changes in interest rates, specific earnings and other macro factors may impact the performance of an investment. These factors may not be captured in the framework to determine reasonable performance assumptions, which could create potential liability for financial service firms and investment professionals.

Additionally, the Investment Education and Financial Reporting and Valuation carve-outs both impose limitations on providing specific information with respect to valuations and potential investments. As a result of these limitations on non-fiduciaries, investment professionals will be restricted from providing customers with price quotes which may conflict with SEC guidance on providing greater valuation clarity[13].

- The Initial transaction disclosure requirement to make performance assumptions may result in a violation of FINRA Rule Package 2210 - Firms will be required to make performance assumptions/projections in order to calculate the total costs for the initial transaction disclosures that could result in violations of FINRA Rule Package 2210 depending on the nature of the assumptions and projections. There is limited guidance in how firms will calculate the reasonable assumptions and performance information and this may not be consistent from firm to firm, making it difficult for firms to implement processes for providing this information. Per discussion with SIFMA, FINRA would likely adjust its requirements for accounts covered by the Rule Package. This could lead to two standards depending on the type of account, requiring firms to implement additional controls and oversight to ensure assumptions are only provided for retirement accounts and that information provided is not utilized by customers in non-fiduciary type accounts.

- Introducing limitations on non-fiduciaries may conflict with SEC and MSRB ("Municipal Securities Rule Package making Board") guidance to provide greater clarity on valuations - As a result of the constraints the Rule Package would enact on a non-fiduciary, investment professionals will be prevented from providing price quotes to customers which is contrary to SEC and MSRB initiatives around increasing price transparency. This may lead to industry confusion across firms, investment professionals and customers. Additionally, firms would be required to update current controls and compliance frameworks, and provide training to investment professionals to ensure compliance with the Rule Package.

[13] Source: http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370542347679

5. The Rule Package is ambiguous and broad in certain areas, which challenges the operationalization of the Rule Package's requirements

Rule Package Ambiguity

Certain areas of the proposed Rule Package are broad or ambiguous and it may be impractical or impossible to operationalize the specific requirements as written. The SIFMA Working Group identified several instances where the Rule Package's requirements lack a definitive scope or enough specificity in wording and definitions to be fully understood and implemented. Without further clarification of certain terms and concepts, firms will not be able to build sufficient operational systems and processes to ensure compliance with the proposed requirements. Furthermore, the identified Rule Package ambiguities will lead firms and investment professional to become inadvertent fiduciaries and/or subject to excise taxes if controls and processes are not implemented. Without further clarification of certain areas of the Rule Package, the requirements for compliance are unclear or undefined and Firms are at a higher risk for unintentionally being subject to the penalty of the excise tax.

5.1 The definitions of certain terms are not clear

Certain terms within the proposed Principal Transaction Exemption are not clearly defined and will make it challenging for investment professionals and firms from complying with the obligations. To determine the Principal Transaction Exemption applicability and disclosure requirements, firms will require greater clarity and conclusive definitions of certain terms to fully operationalize the proposed Rule Package. Under the Principal Transaction Exemption, transactions must not involve debt securities with greater than "moderate credit risk" or that are not "sufficiently liquid" such that a sale at approximately "fair market" would not be possible in a reasonably short period. Without conclusive definition for the terms within the Principal Transaction Exemption requirements, there is a potential for inadvertent regulatory violations to occur. Specifically, concerns pertaining to ambiguous applicability and disclosures determination terms that will prevent the proposed Rule Package from being implemented as written include:

- <u>Lack of a clear definition for the term "moderate credit risk" will potentially create inadvertent regulatory violations</u> – The Rule Package requires that under the exemption a principal transaction must not involve debt securities with a greater than "moderate credit risk", this "moderate credit risk" is undefined and therefore it is unclear what debt securities can be involved in a principal transaction. This will make it unclear to investors and may be different from firm to firm as they use different standards.

- <u>Lack of clear definitions for the terms "sufficiently liquid" and "fair market value" will potentially create inadvertent regulatory violations</u> – The Rule Package requires that the debt security be "sufficiently liquid" so that it could be sold at or near its "fair market value" within a reasonably short space of time. This liquidity standard is undefined and it is therefore unclear which the debt securities can be involved in the transaction.

5.2 The scope of certain requirements is not clear

The SIFMA Working Group identified multiple instances where the scope of a proposed Rule Package requirement is not clearly defined, which will make it impossible or impractical to be fully operationalized. For example, while the Best Interest Contract Exemption and Principal Transaction

Exemptions obligations require that "material" conflicts of interest be aggregated and disclosed within a Multi-party Contract, the proposed Rule Package does not define the scope of what could be considered "material." Both exemptions also require that records be maintained to substantiate whether the conditions of the exemptions have been met, but do not appear to clarify if the scope of this requirement includes the historical records for existing accounts. Lastly, while the Rule Package and exemptions outline requirements for certain types of securities, there are a number of products that are not included (e.g., municipal bonds, options) and without further clarification it would be impossible to determine which securities are "non-permissible." Specifically, SIFMA Working Group concerns pertaining to instances where the scope of a proposed Rule Package requirement is not clearly defined and will prevent the proposed Rule Package from being fully implemented as written include:

- Without further clarification on the scope of what could be considered "material", it would be impossible for firms to gain comfort that they're controls and processes are designed to meet the expectations and requirements of the DOL for gathering conflicts of interest – The word "material" is not clearly defined and as it reads would require the firm to gather all conflicts of interest related to the transaction.

- Lack of clarity if the scope of the recordkeeping requirements to substantiate that exemption conditions have been met includes the historical records for existing accounts – The proposed Rule Package does not provide guidance as to whether firms are required to document historic data for existing accounts to evidence records of data for 6 years upon Rule Package implementation. It is not clear if the records will be grandfathered in or need to be created for exiting accounts.

- There is a lack of clarity around the scope of which securities would be considered "non-permissible" under the Rule Package and exemptions – The Rule Package and exemptions outline requirements for certain types of securities, however there are a number of products that are not included (e.g., municipal bonds, options). Without clarity on permissible and non-permissible products, firms would not be able to build adequate supervisory and operational systems to ensure proper controls frameworks and systems for these types of accounts.

5.3 Other areas of the Rule Package require clarification

Additionally, there were several instances identified by the SIFMA Working Group where further clarification would be needed to operationalize the Rule Package requirements. Specifically, concerns pertaining to ambiguous Rule Package requirements that will necessitate additional explanation to understand potential operational implications and prevent inadvertent non-compliance include:

- Lack of clarity around how certain mandatory requirements in the IRA life cycle (e.g., required minimum distributions) should be treated may lead to inadvertent non-compliance violations – The Rule Package does not delineate how providing advice aligned with requirements of an IRA would be treated in terms of contract and disclosure requirements. It is unclear whether providing this advice would be considered a recommendation, or the terms on when advice on a requirement is defined as a recommendation and compliance is required.

- Lack of clarity around presenting reasonable performance assumptions as it relates to debt securities – Due to the nature of debt securities, providing projections at 1-, 5- and 10-year intervals will prove difficult without the advisor making assumptions about future transactions. There are no standards or guidelines for the assumptions and variables to consider.

- It is unclear if an exemption (e.g., Sellers carve-out) can be applied to an existing fiduciary account that had previously not met the exemption requirements, but now due to changes would meet the exemption requirements – There is ambiguity around whether carve-outs apply for accounts that had previously fallen under other types of exemptions (e.g., Best Interest Contract Exemption, Principal Transaction Exemption) where the investment professional claimed a fiduciary status, and due to changes in the account would now otherwise qualify for an exception. For example, growth of a previously categorized “small” plan to a “large” plan as defined under the Seller carve-out requirements. The Rule Package notes that for the Sellers carve-out to apply, the investment professional may not identify as a fiduciary. It is unclear whether accounts that change in size after the implementation of the Rule Packages will be permitted to fall under the Sellers carve-out if the investment professional had previously been considered a fiduciary for the account but the “small” plan exemptions no longer apply.

- Failure to complete the contract with the appropriate customer party may result in failure to comply in accounts – Accounts may have multiple account owners (e.g., joint, trust), or a person granted trading authority (e.g., power of attorney), however it is unclear who is required to sign the contract and may require that multiple contracts be implemented for one account.

Conclusion

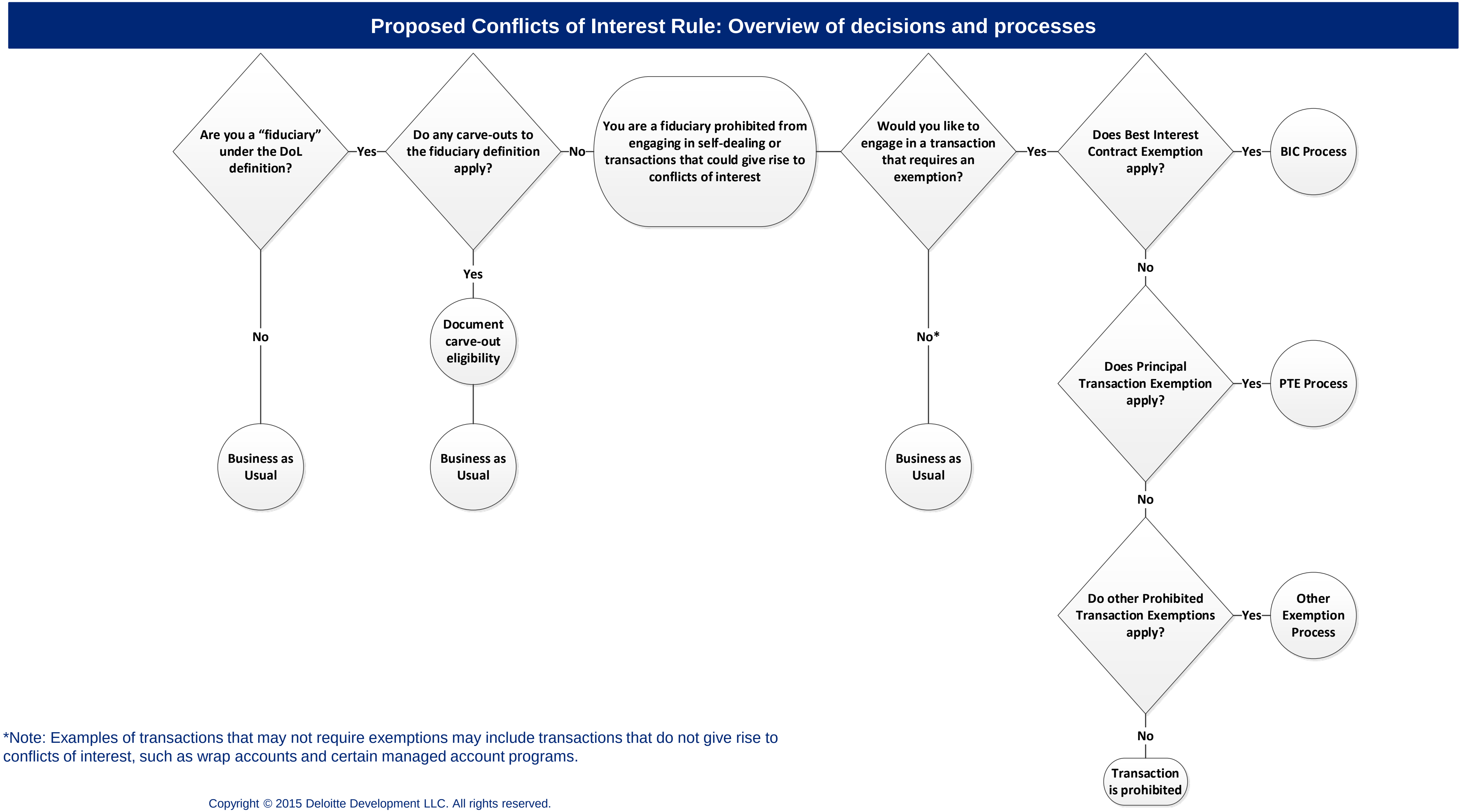
This points of view captured in this document indicate broad concerns from the broker-dealer community around the operationalization of the requirements of the Rule Package. The SIFMA Working Group identified multiple areas where the Rule Package, in their view, will require expansive and expensive changes to firm operations and infrastructure. The results of these changes will require considerably different training, compliance, systems, reporting, and recordkeeping than what is currently done by most broker-dealers. These transformational changes may fundamentally change the relationships and experiences between broker-dealers and their customers. While participants in the SIFMA Working Group indicated that they will make full and best efforts to comply with the letter and spirit of the rule, there remain concerns about the penalties in the form of excise taxes and transaction reversals they may have face in instances where there is even immaterial or inadvertent non-compliance with the Rule Package.

As the rulemaking process progresses, broker-dealers should continue to monitor and understand the different areas within their firms where changes or business decisions will need to be made. Accordingly, broker-dealers should continue to understand the potential investments that they may need to plan, the required timelines that it will take to become compliant and the residual effects for their people, processes, systems and customers.

Appendix: Rule Package Requirement Process Flows and Decision trees

Overview of the rule

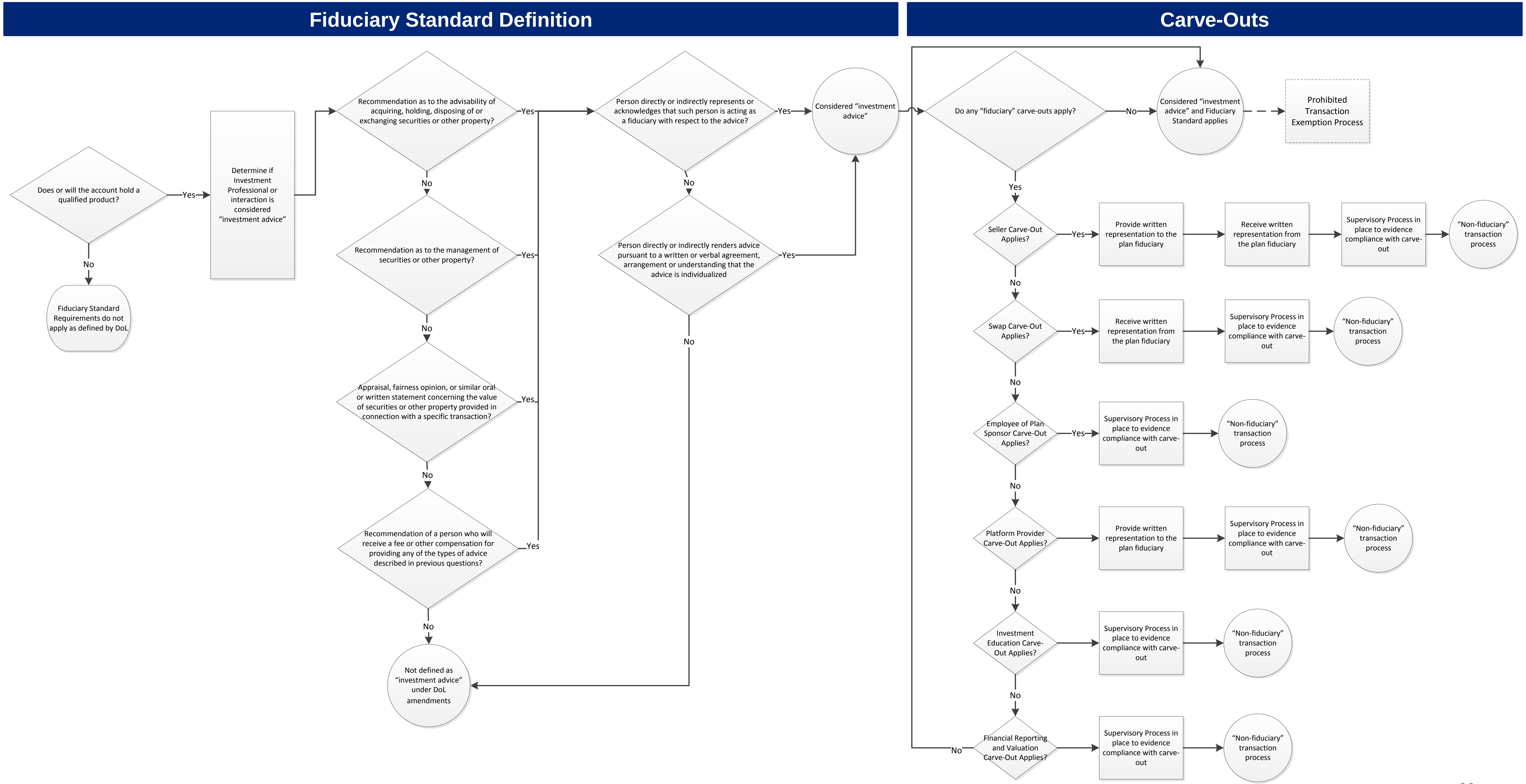
Overview of proposed rule



*Note: Examples of transactions that may not require exemptions may include transactions that do not give rise to conflicts of interest, such as wrap accounts and certain managed account programs.

Fiduciary Standard Definition and Carve Outs

Fiduciary Standard Definition and Carve Outs

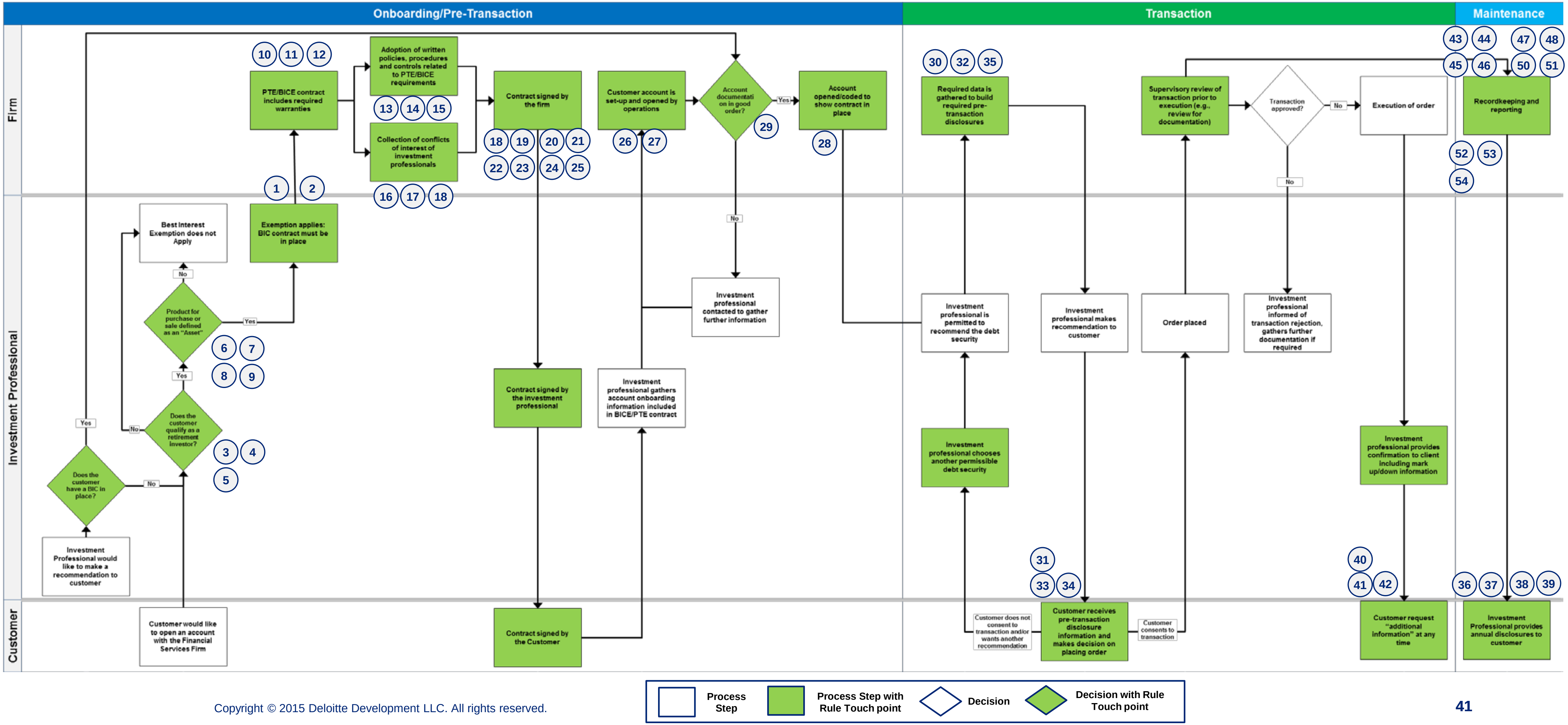


Best Interest Contract (“BIC”)

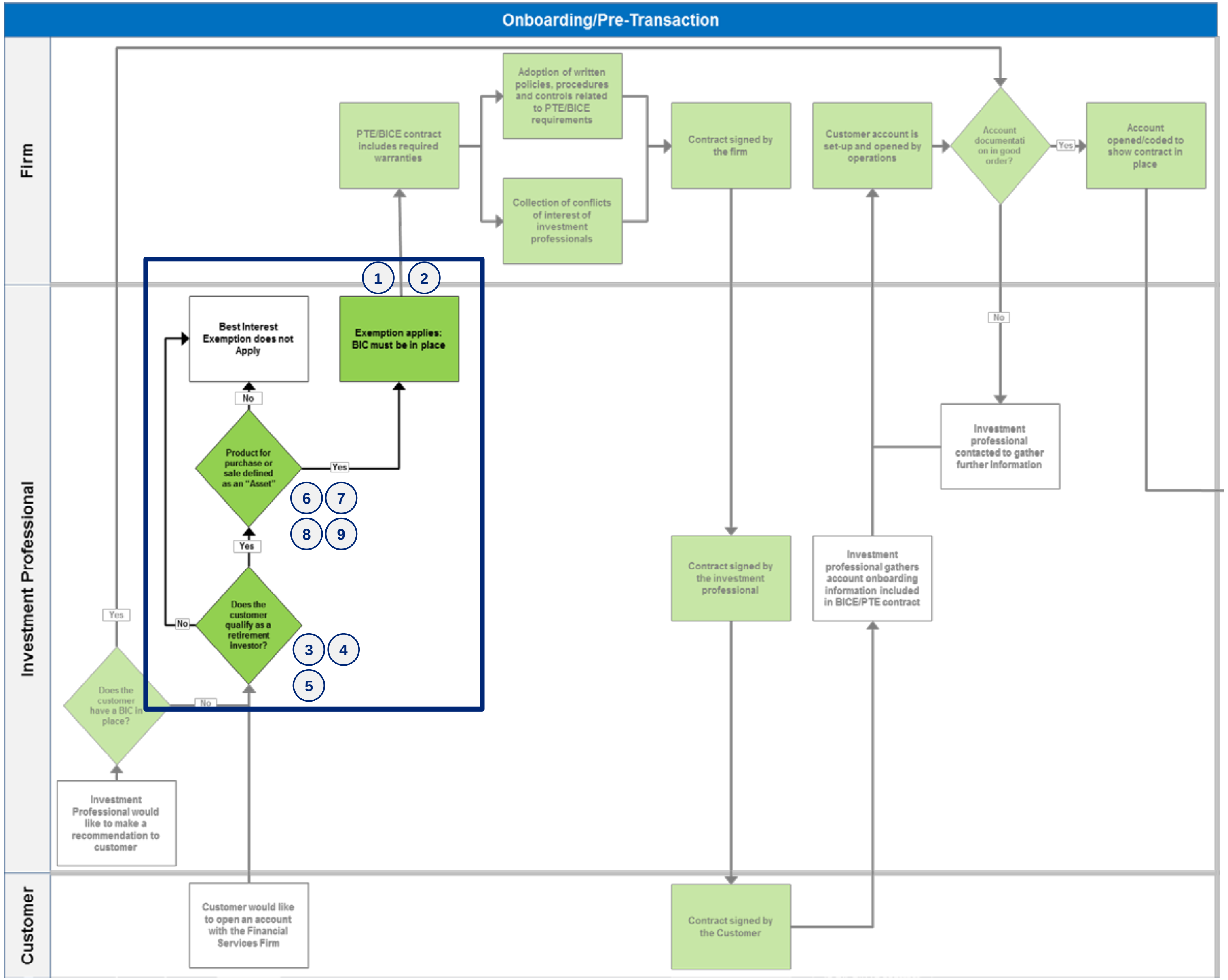
Process Flows and Operational Considerations

Best Interest Contract Exemption Process Flow

Illustrative high level overview of the proposed rule requirements associated with the Best Interest Contract Exemption through the phases of the customer life cycle. The (x) indicate where operational considerations exist for financial service firms and the detail is provided in the following pages in five sections: (1) Applicability and Permissibility Determination; (2) Contract Requirements; (3) Contract Implementation; (4) Disclosures and (5) Recordkeeping

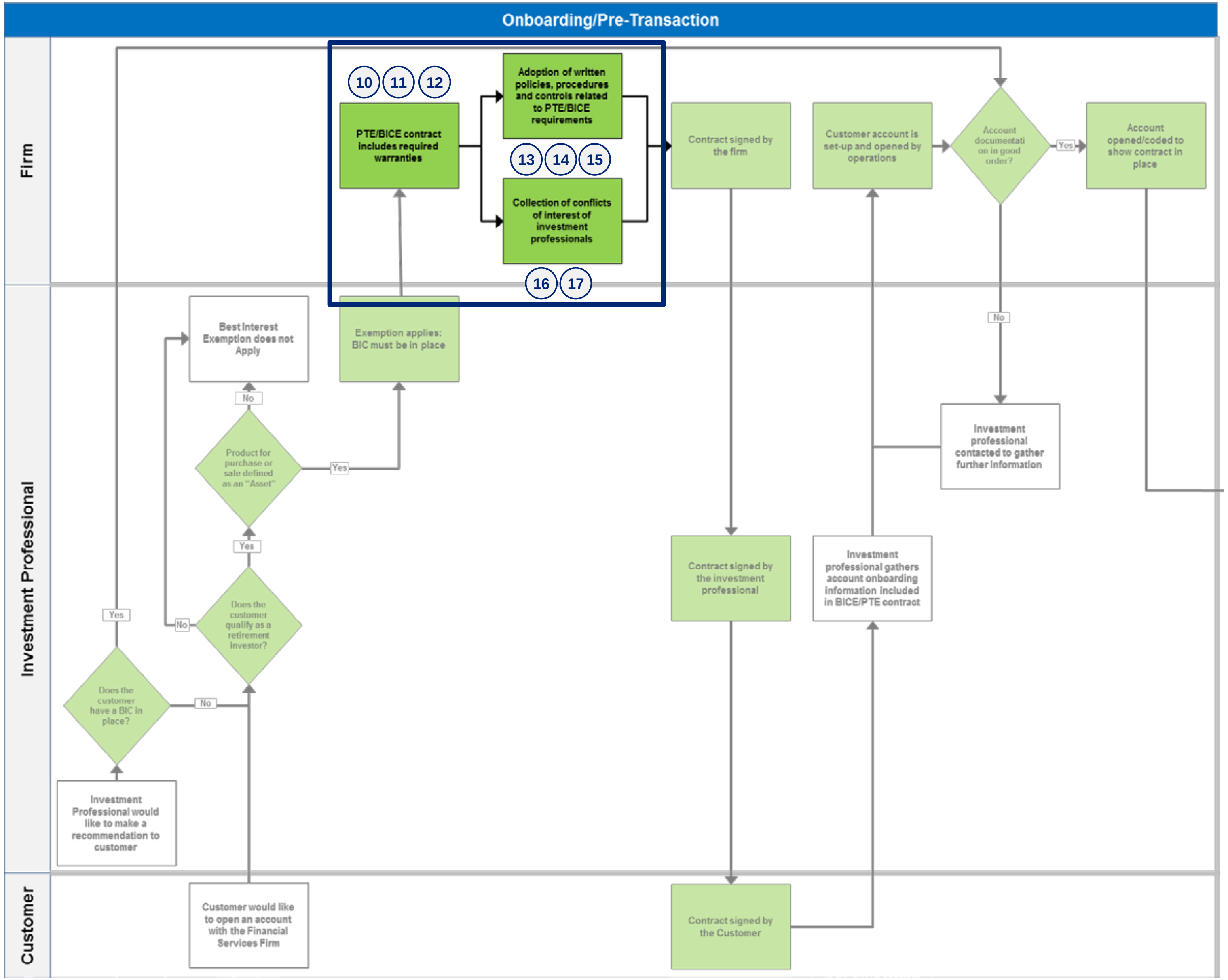


BIC - Applicability and Permissibility Determination



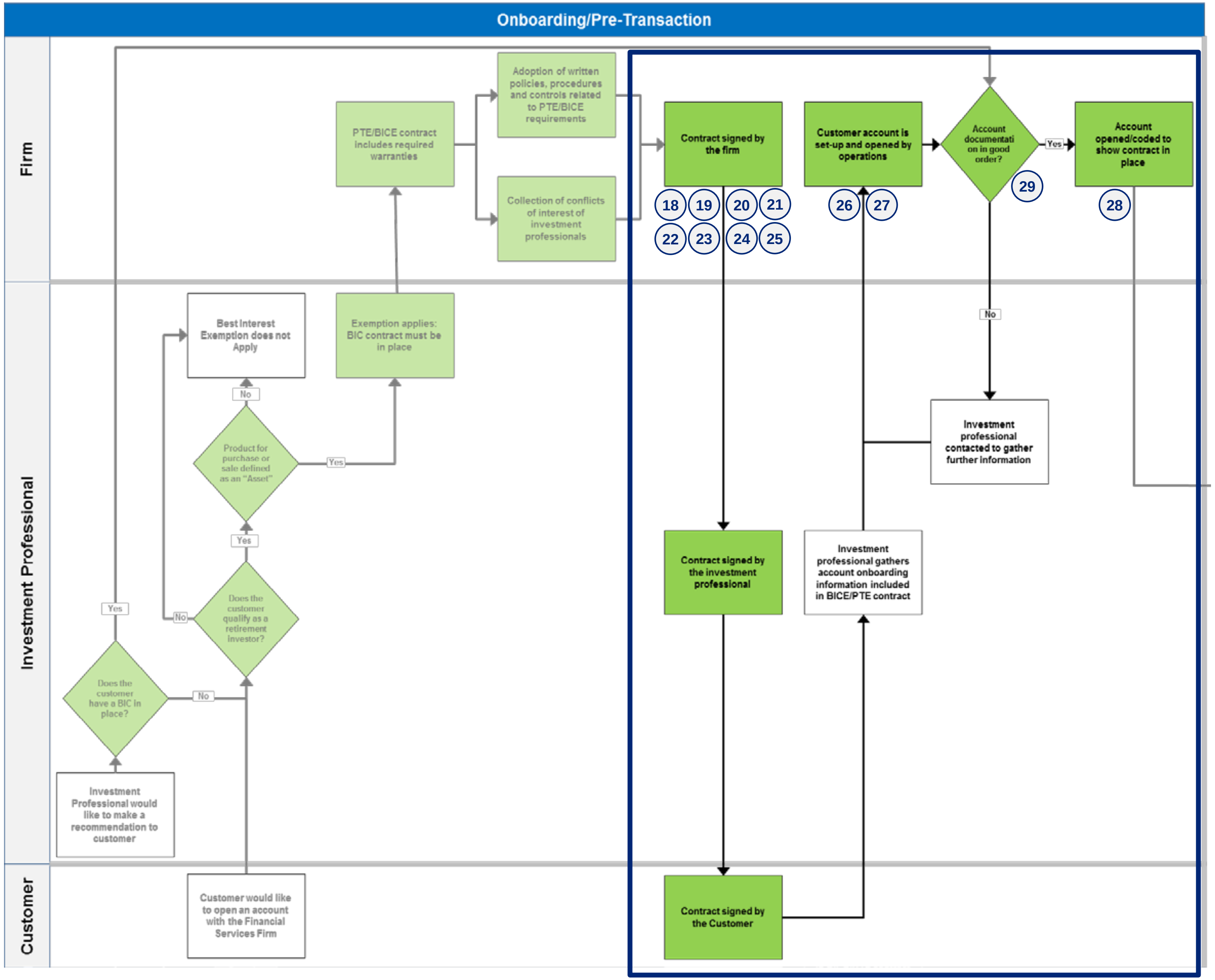
Process Steps	Operational Considerations for Compliance
Applicability and Permissibility Determination	
Determine if the investment professional will be providing investment advice	1 Systems processes developed to document conversations with customers to evidence where recommendations are given 2 Oversight systems and processes to monitor investment professionals conversations to ensure documentation and compliance with requirements
Determine if customer is "Retirement Investor"	3 Standardized methodology to identify and code accounts for Retirement Investors 4 Systems to capture customers identified as Retirement Investors to assist front, middle and back office in servicing this type of account within requirements 5 Oversight to monitor that Retirement Investors are properly identified and assisted in a manner prescribed by the Rule
Determine if the asset is permissible	6 Standardized methodology to identify what is a permissible assets 7 Systems and processes to block non-permissible assets from being recommended in retirement accounts 8 Oversight to monitor account activity is permissible within the specified account type 9 Opening and administration of non-retirement accounts or self-directed accounts to be used for non-permissible securities

BIC - Contract Requirements



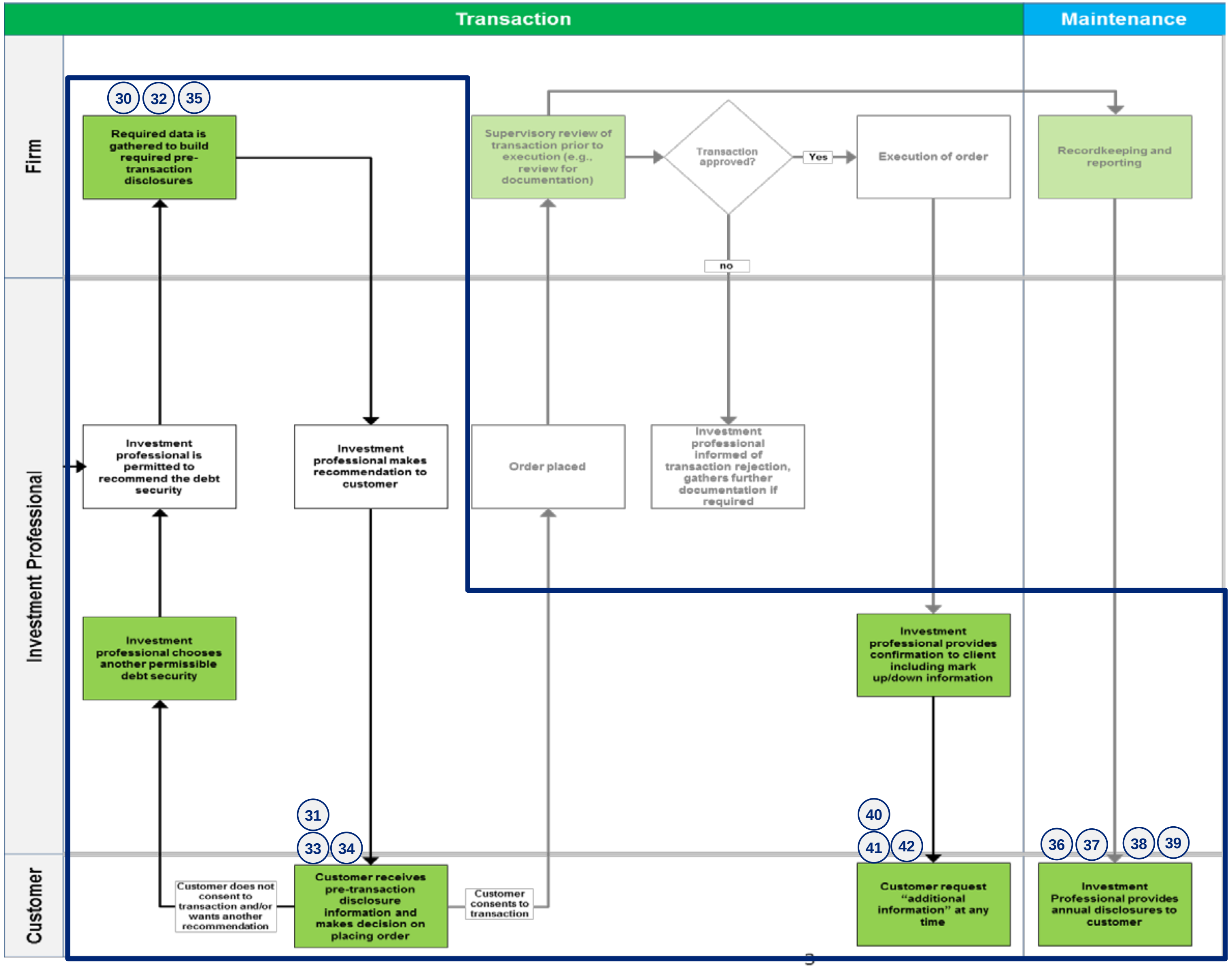
Process Steps	Operational Considerations for Compliance
Contract Requirements	
Create new contracts that meet the Rule conditions	10 Create new contracts and/or account documentation aligned with conditions and requirements outlined in Rule 11 Document direct and indirect fees associated with applicable retirement assets offered 12 Review all current policies and procedures to determine if gaps exist in meeting compliance
Collection of conflicts of interest of investment professionals	13 Design policies and procedures to address conflicts of interest requirements. 14 Standardized methodology to identify, report, document and catalog all investment professional conflicts of interest 15 Oversight systems, control framework and processes to monitor reporting, documenting and disclosure of conflicts of interest
Adoption of written policies, procedures and controls related to PTE/BICE requirements	16 Design policies and procedures to address requirements for PTE and BIC contracts 17 Oversight systems, control framework and processes interactions between investment professionals and customers to ensure advice not given before contract signed and all appropriate documentation is collected

BIC - Contract Implementation



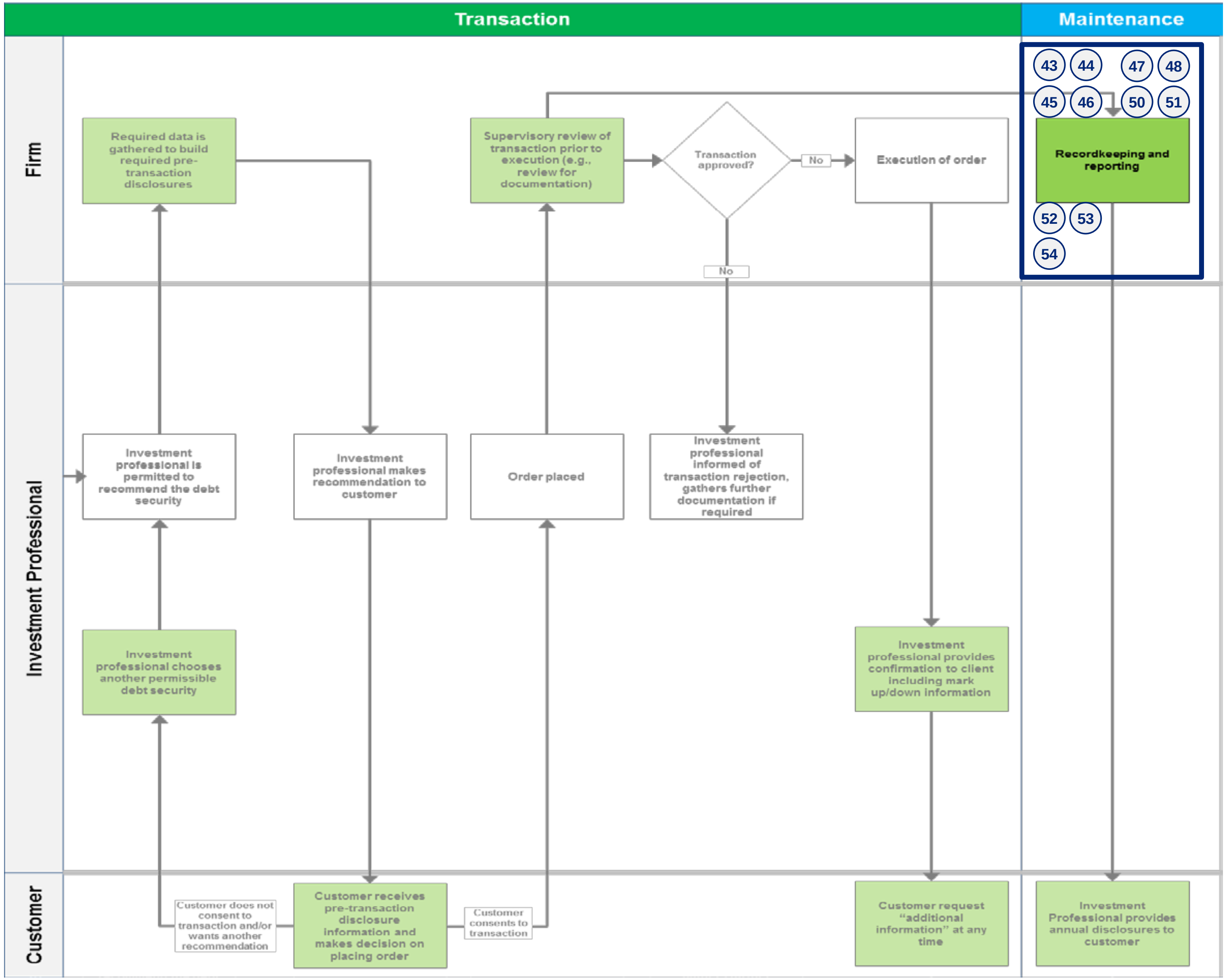
Process Steps	Operational Considerations for Compliance
Contract Implementation	
Identify if customer requires multi party contract for transaction/account	18 Standardized methodology to determine which customers and accounts require contracts 19 Identify existing customers and accounts requiring multi-party contracts 20 Oversight and control for systems to identify customers on an ongoing basis who require contracts and to ensure contracts are in place 21 Training to educate investment professionals regarding documentation and disclosure requirements
Require signature of firm, investment professional and customer prior to discussing securities	22 Oversight and control systems and processes to monitor investment professionals conversations with customers prior to signing Tri-party Contract 23 Standardized methodology for completing contracts and other relevant account documentation 24 Build or update systems and document repositories to accommodate new documentation and disclosure requirements 25 Training to educate investment professionals to provide updated information to customers on conflicts of interest, fees and compensation written in contract
Customer account is setup and opened	26 Standardized methodology for account onboarding incorporating new documentation, contract and disclosure requirements 27 Standardized methodology to identify all documentation necessary to setup customer account 28 Systems and processes updated and bifurcated to document and code accounts 29 Oversight and control systems and processes to monitor account documentation and investment professional dealings with retirement customers

BIC - Disclosures



Process Steps	Operational Considerations for Compliance
Disclosures	
Disclose total costs and reasonable assumptions of investing pre-transaction	30 Standardized methodology to identify and estimate total costs required for disclosure pre-transaction 31 Standardized methodology to ensure consistency in predicting performance on investments in retirement accounts 32 Systems to distribute disclosure information and relevant controls for distribution of information 33 Oversight systems and processes to monitor accuracy and consistency on investment performance prediction 34 Oversight and control systems and processes to monitor dissemination and accuracy of pre-transaction disclosures 35 Training for front, middle and back office on requirements, methodologies, policies and procedures for pre-transaction disclosures
Disclose annual transaction information	36 Standardized methodology for calculating direct and indirect fees and compensation attributable to the customer 37 Systems and processes to capture and maintain ongoing data collection identifying total dollar amount of: 1) assets purchased or sold, 2) expenses and fees and 3) indirect and direct compensation received by firms and investment professionals 38 Systems to distribute disclosure information and relevant controls for distribution of information 39 Oversight to monitor disclosure and accuracy of annual information within specified timeframe
Maintain a website with publicly disclosed information	40 Standardized methodology to create, update and maintain website with required data 41 Updates or changes to technology and cyber security to protect customer information 42 Oversight and controls systems and processes to monitor publicly disclosed information on website is current and accurate

BIC - Recordkeeping



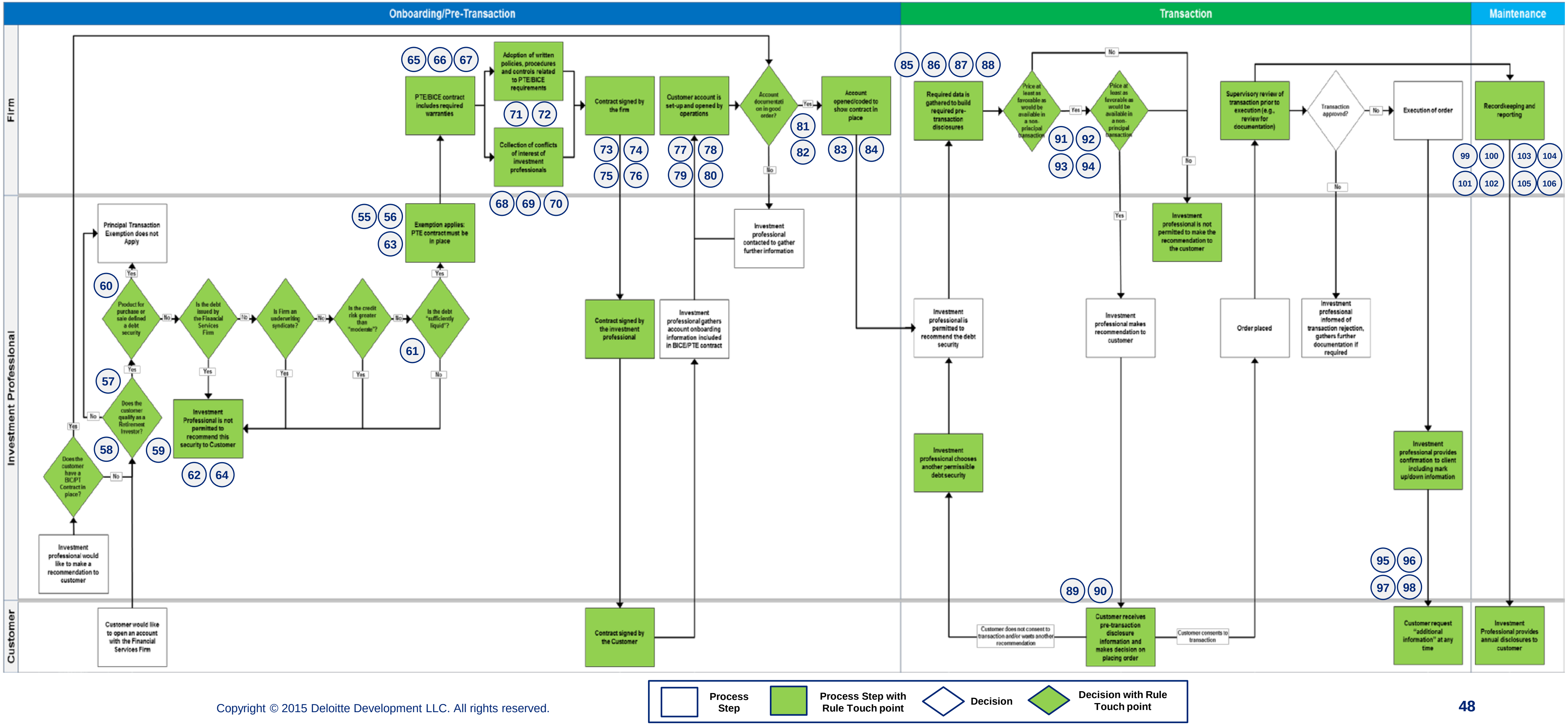
Process Steps	Operational Considerations for Compliance
Recordkeeping	
Notify DOL of intention to rely upon exemption	43 Standardized methodology to identify and convey accounts where an exemption is applicable 44 Systems and processes to document and code accounts 45 Controls to ensure firms notify the DOL of their intention to utilize the exemption 46 Oversight to monitor that Retirement Investors who rely upon the exemption meet the Rule requirements
Retain data in readily accessible form to substantiate the inflows; outflows; holdings; and returns for six years	47 Systems and processes developed to document data points pertaining to purchases, sales, holdings and performance of customers 48 Data repositories to acquire, store, and maintain data points for six years 50 Oversight systems and processes to monitor documentation and compliance with requirements
Retain necessary records, for six years, to substantiate whether exemption conditions have been met	51 Records inventory to identify applicable exemption requirements (e.g. contracts, disclosures) and corresponding documentation to be maintained across customer lifecycle 52 Systems and document repositories to capture, store, and retrieve applicable records 53 Controls to ensure compliance with exemption requirements 54 Oversight and surveillance processes to monitor that necessary records are being maintained

Principal Transaction Exemption (“PrTE”)

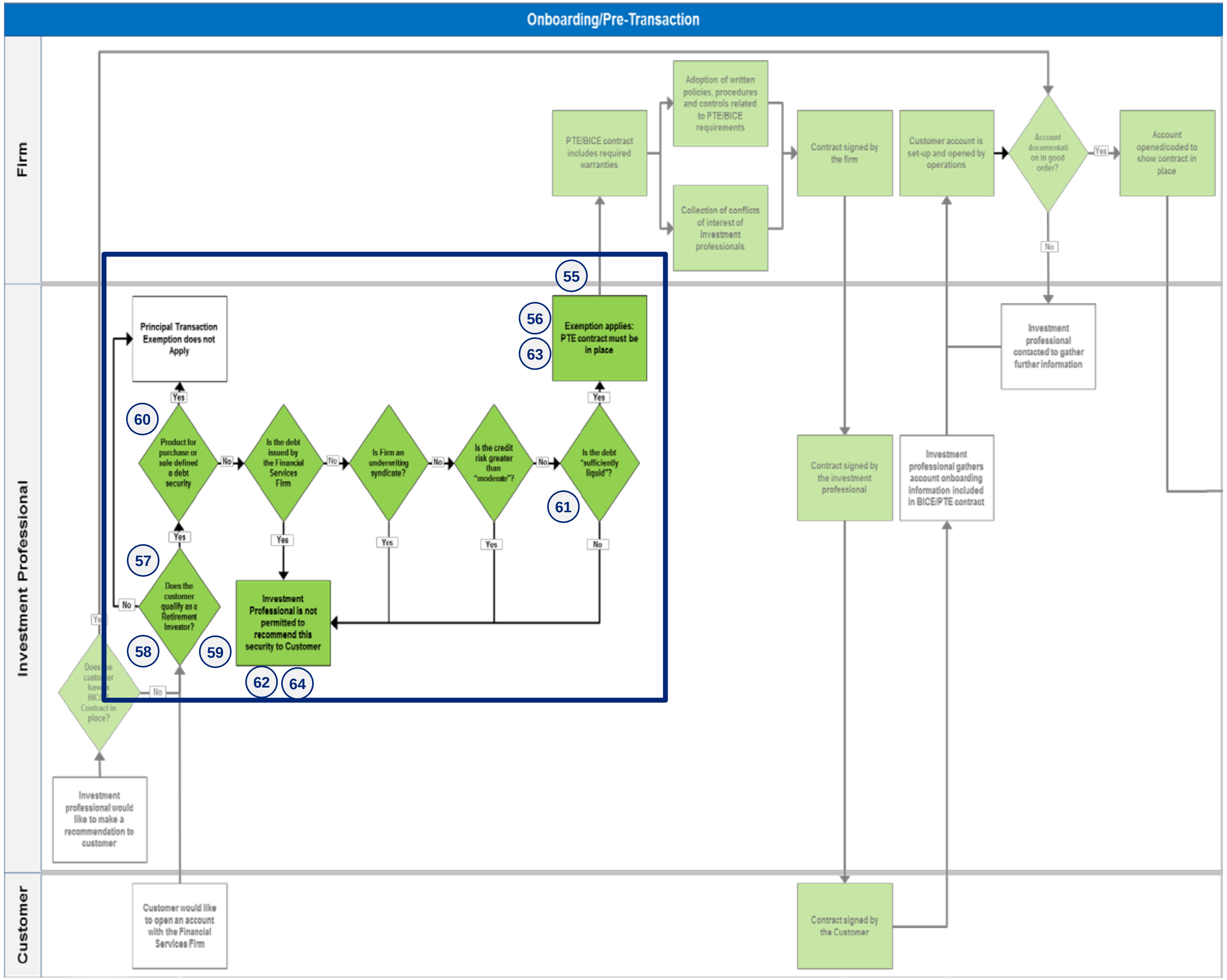
Process Flows and Operational Considerations

Principal Transaction Prohibited Transaction Exemption Process Flow

Illustrative high level overview of the proposed rule requirements associated with the Principal Transaction Prohibited Transaction Exemption through the phases of the customer life cycle. The (x) indicate where operational considerations exist for financial service firms and the detail is provided in the following pages in five sections: (1) Applicability and Permissibility Determination; (2) Contract Requirements; (3) Contract Implementation; (4) Disclosures and (5) Recordkeeping

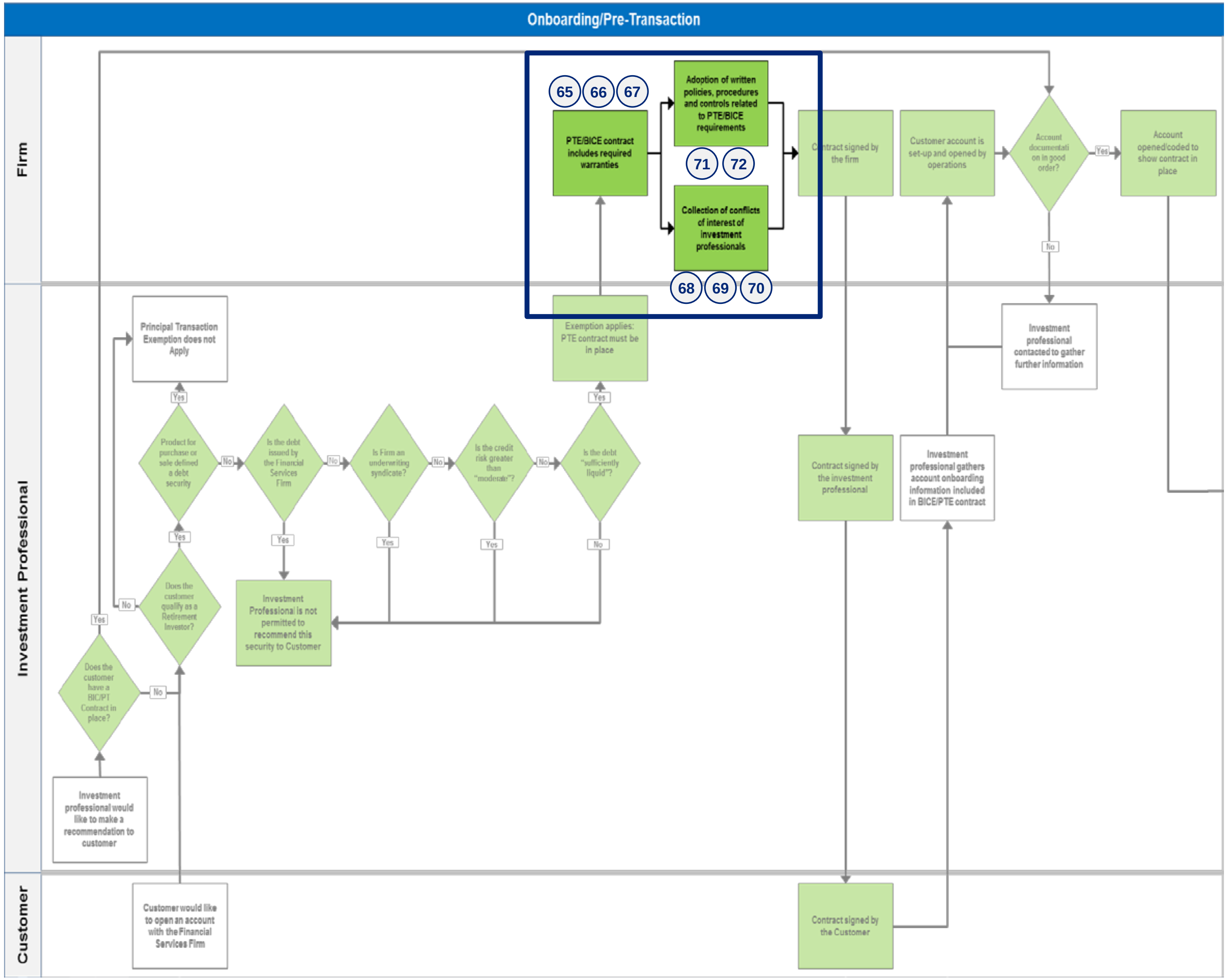


PrTE - Applicability and Permissibility Determination



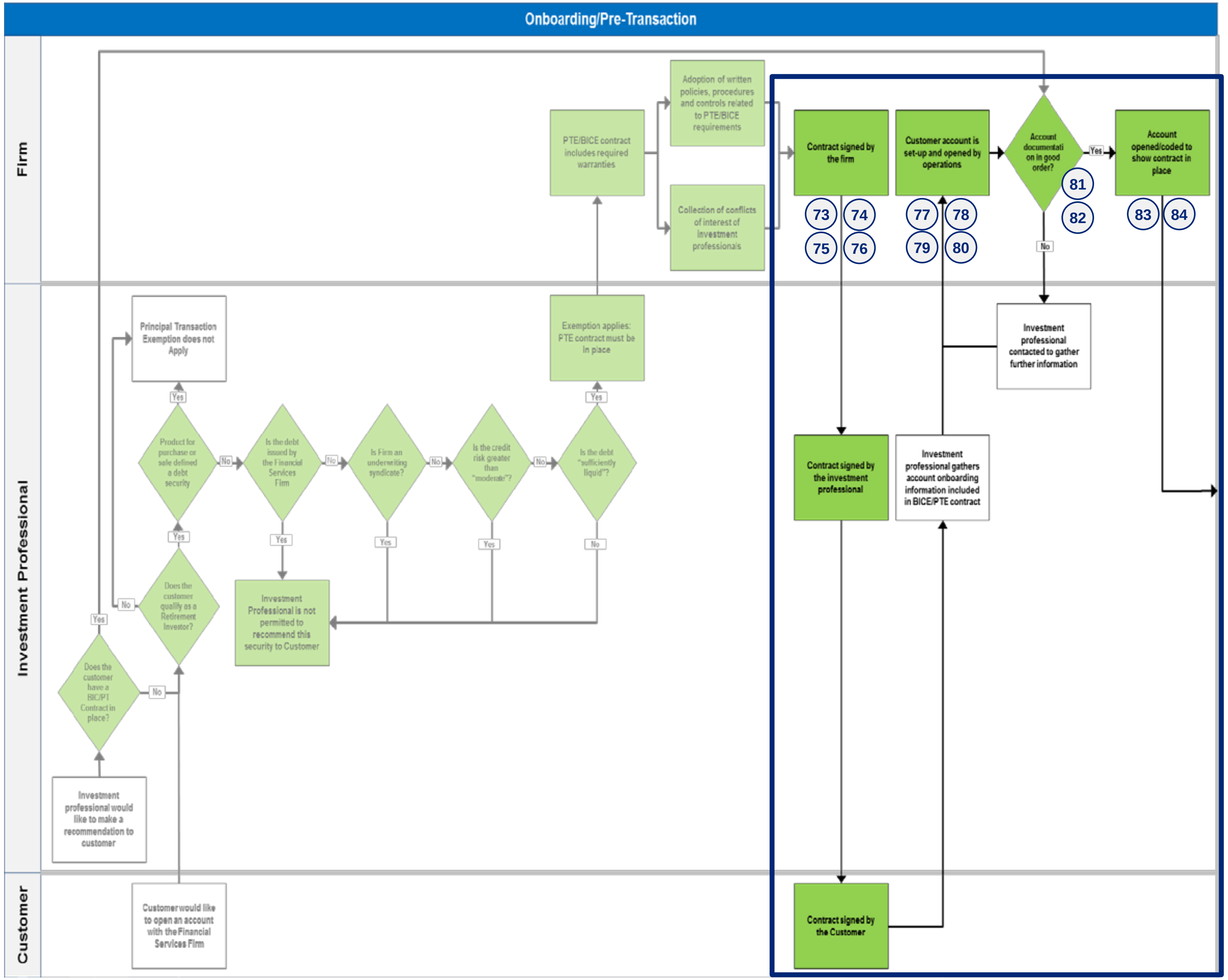
Process Steps	Operational Considerations for Compliance
Applicability and Permissibility Determination	
Determine if the investment professional will be providing investment advice	55 Systems processes developed to document conversations with customers to evidence where recommendations are given 56 Oversight systems and processes to monitor investment professionals conversations to ensure documentation and compliance with requirements
Determine if customer is "Retirement Investor"	57 Standardized methodology to identify and code accounts for Retirement Investors 58 Systems to capture customers identified as Retirement Investors to assist front, middle and back office in servicing this type of account within requirements 59 Oversight to monitor that Retirement Investors are properly identified and assisted in a manner prescribed by the Rule
Determine if the debt security is permissible	60 Standardized methodology to identify what is a permissible debt security 61 Systems to determine liquidity and credit rating for debt securities to identify permissible debt securities 62 Systems and processes to block non-permissible debt securities from being recommended in retirement accounts 63 Oversight to monitor account activity is permissible within the specified account type 64 Opening and administration of non-retirement accounts or self-directed accounts to be used for non-permissible securities

PrTE - Contract Requirements



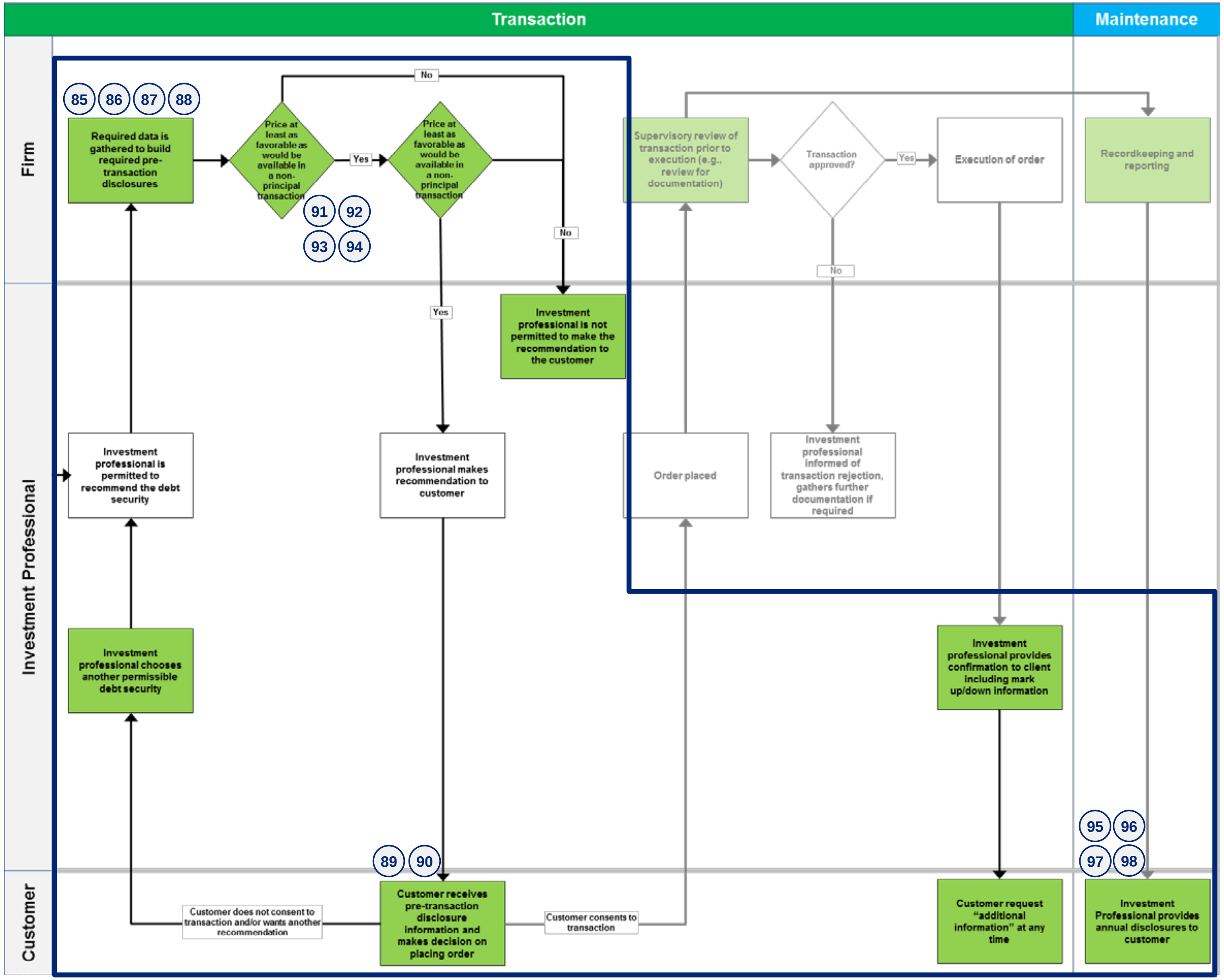
Process Steps	Operational Considerations for Compliance
Contract Requirements	
Create new contracts that meet the Rule conditions	65 Create new contracts and/or account documentation aligned with conditions and requirements outlined in Rule 66 Document direct and indirect fees associated with applicable retirement assets offered 67 Review all current policies and procedures to determine if gaps exist in meeting compliance
Collection of conflicts of interest of investment professionals	68 Design policies and procedures to address conflicts of interest requirements 69 Standardized methodology to identify, report, document and catalog all investment professional conflicts of interest 70 Oversight systems, control framework and processes to monitor reporting, documenting and disclosure of conflicts of interest
Adoption of written policies, procedures and controls related to PTE/BICE requirements	71 Design policies and procedures to address requirements for PTE and BIC contracts 72 Oversight systems, control framework and processes interactions between investment professionals and customers to ensure advice not given before contract signed and all appropriate documentation is collected

PrTE - Contract Implementation



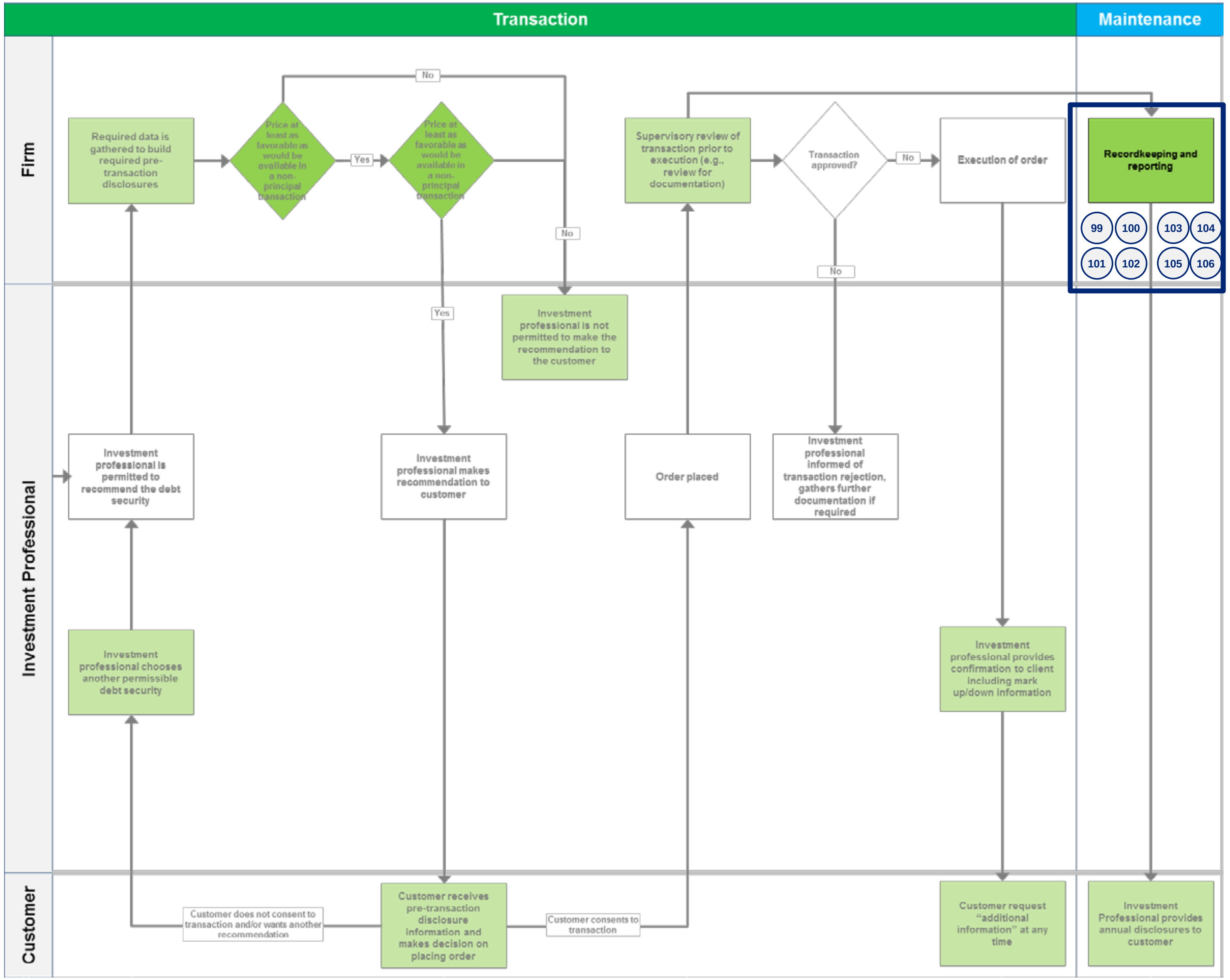
Process Steps	Operational Considerations for Compliance
Contract Implementation	
Identify if customer requires multi party contract for transaction/account	73 Standardized methodology to determine which customers and accounts require contracts 74 Identify existing customers and accounts requiring multi-party contracts 75 Oversight and control for systems to identify customers on an ongoing basis who require contracts and to ensure contracts are in place 76 Training to educate investment professionals regarding documentation and disclosure requirements
Require signature of firm, investment professional and customer prior to discussing securities	77 Oversight and control systems and processes to monitor investment professionals conversations with customers prior to signing Tri-party Contract 78 Standardized methodology for completing contracts and other relevant account documentation 79 Build or update systems and document repositories to accommodate new documentation and disclosure requirements 80 Training to educate investment professionals to provide updated information to customers on conflicts of interest, fees and compensation written in contract
Customer account is setup and opened	81 Standardized methodology for account onboarding incorporating new documentation, contract and disclosure requirements 82 Standardized methodology to identify all documentation necessary to setup customer account 83 Systems and processes updated and bifurcated to document and code accounts 84 Oversight and control systems and processes to monitor account documentation and investment professional dealings with retirement customers

PrTE - Disclosures



Process Steps	Operational Considerations for Compliance
Disclosures	
Disclose total costs and reasonable assumptions of investing pre-transaction	85 Standardized methodology to identify and estimate total costs required for disclosure pre-transaction 86 Standardized methodology to ensure consistency in predicting performance on investments in retirement accounts 87 Systems to distribute disclosure information and relevant controls for distribution of information 88 Oversight systems and processes to monitor accuracy and consistency on investment performance prediction 89 Oversight and control systems and processes to monitor dissemination and accuracy of pre-transaction disclosures 90 Training for front, middle and back office on requirements, methodologies, policies and procedures for pre-transaction disclosures
Disclose additional pricing information	91 Standardized methodology to obtain price quotes from two unaffiliated firms and the associated mark-up or mark-downs 92 Systems and processes to obtain price quotes from unaffiliated firms 93 Oversight and controls to monitor methodology and processes for obtaining and distributing pricing information to customers 94 Training for front, middle and back office on obtaining pricing information and systems
Disclose annual transaction information	95 Standardized methodology for calculating direct and indirect fees and compensation attributable to the customer 96 Systems and processes to capture and maintain ongoing data collection identifying total dollar amount of: 1) assets purchased or sold, 2) expenses and fees and 3) indirect and direct compensation received by firms and investment professionals 97 Systems to distribute disclosure information and relevant controls for distribution of information 98 Oversight to monitor disclosure and accuracy of annual information within specified timeframe

PrTE - Recordkeeping



Process Steps	Operational Considerations for Compliance
Recordkeeping	
Notify DOL of intention to rely upon exemption	99 Standardized methodology to identify and convey accounts where an exemption is applicable 100 Systems and processes to document and code accounts 101 Controls to ensure firms notify the DOL of their intention to utilize the exemption 102 Oversight to monitor that Retirement Investors who rely upon the exemption meet the Rule requirements
Retain necessary records, for six years, to substantiate whether exemption conditions have been met	103 Records inventory to identify applicable exemption requirements (e.g. contracts, pricing, disclosures) and corresponding documentation to be maintained across customer lifecycle 104 Systems and document repositories to capture, store, and retrieve applicable records 105 Controls to ensure compliance with exemption requirements 106 Oversight and surveillance processes to monitor that necessary records are being maintained

APPENDIX 3

July 20, 2015

By U.S. Mail and Email: e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11712
Suite 400
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: ZRIN: 1210-ZA25; PTE Application D-11712

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to provide comments regarding the Department of Labor's ("Department") Proposed Best Interest Contract Exemption[2] ("BIC Exemption") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). We appreciate the opportunity to comment and hope that our comments are helpful to the Department as it assesses whether the exemption, as written, can be accommodated into the broker-dealer model that exists today, or whether, as written, it will result in the loss of professional investment advice for small retirement accounts.[3] We respectfully request an opportunity to testify at the hearing on the proposed exemption.

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[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960 (April 20, 2015).

[3] 80 Fed. Reg. at 21961.

Attached hereto are SIFMA's submissions for the related rulemakings being undertaken by the Department. These attachments are an integral part of this submission.[4]

Although the preamble states that the proposed BIC Exemption "seeks to preserve beneficial business models by taking a standards-based approach that will broadly permit firms to continue to rely on common fee practices," the exemption as currently proposed raises significant and in many respects insurmountable obstacles for broker-dealers, including the ability to offer commission-based advice. For example, the contract requirements of the proposed exemption do not comport with the manner in which financial professionals enter into relationships with retail customers. SIFMA further believes that the written disclosures required under the proposed exemption will not only overwhelm customers with more information than they can possibly digest, but also seriously impede customer transactions and cause timing and opportunity losses for smaller retirement accounts.

Moreover, complying with the terms and conditions of the proposed exemption will impose significant additional costs on broker-dealers and other providers of financial services. That will make it extremely difficult, if not impossible, for smaller retirement accounts to receive financial advice from the professionals who currently serve them. As a result, many of these smaller retirement accounts may be terminated or maintained such that the investor receives no assistance and the broker is no more than an order taker. To the extent that the investment education currently provided by financial professionals ceases to be available, the result will be accelerated leakage of retirement savings out of tax-advantaged accounts, less people saving for retirement and widespread confusion on the part of retirement investors, none of which is in the best interest of these investors.

[4] See Appendices numbered 1-8.

SIFMA shares the Department's interest in ensuring that investors receive appropriate, informed assistance with decisions concerning retirement. However, SIFMA respectfully believes that this proposed exemption, and the package of proposals accompanying it, are not the proper way of proceeding. SIFMA also does not believe that the Department may use a new definition of "fiduciary," in combination with its exemptive authority, as a means of establishing a new regulatory and enforcement program for financial professionals, ERISA plans, and non-ERISA plans such as IRAs. SIFMA expresses this objection with regard to the BIC Exemption, and the other, related exemptive rules that have been proposed.

Comments on specific provision can be found on the pages indicated below:

Section I: Scope of the Proposed Best Interest Contract Exemption

SIFMA respectfully believes that the Department's new "fiduciary" definition, and this proposed exemption, exceed the Department's statutory authority. SIFMA offers the comments and recommended changes in this letter to assist the Department in improving this exemptive rule in the event the Department resolves to adopt this package of proposals in final form, despite the deep concerns they present. Nothing in these comments should be understood to mean that SIFMA concurs with the construction of ERISA and the Code underlying the Department's proposals, or with the policy views regarding the financial services industry that the Department has articulated in presenting its proposals.

Advice Recipients Covered by the BIC Exemption.

The proposed BIC Exemption permits an adviser to receive compensation for services provided to a "Retirement Investor" in connection with a purchase, sale or holding of an "Asset" by a plan, a plan participant or an IRA. "Retirement Investor" is defined to include a plan participant or beneficiary with the ability to self-direct his or her account or take a distribution, an IRA owner, or a plan sponsor of a plan with fewer than 100 participants that is not participant-directed. We urge the Department to include advice to sponsors of participant directed plans with fewer than 100 participants on the composition of the menu of investment options available under such plans. Without such relief, sponsors of such plans would have to enter into a fixed fee arrangement with an adviser to obtain advice regarding menu selection, which many small employers would be unwilling to do. We also note that the Department has omitted Keogh plans from the list of retirement investors, which we assume was inadvertent.

As a result of the Department's decision to limit the availability of the BIC exemption to the "retail" retirement marketplace, no financial professional can receive any third party fees on behalf of any plan with more than 100 participants. We urge the Department to permit receipt of mutual fund third party payments in connection with plans with more than 100 participants under PTE 86-128 (amended consistent with SIFMA's comment letter addressing the Department's proposed amendments to PTE 86-128), with full disclosure in the manner that has worked successfully under that exemption for the last 30 years.

We also believe that the 100 participant ceiling in the BIC exemption will be operationally unworkable from a compliance perspective. For example, how often would the financial professional need to confirm that the number of participants in the plan is at or below 100? It would not be possible to confirm the number of participants prior to every transaction or every recommendation. If the 100 participant cap is intended to protect less sophisticated plan sponsors, we suggest as an alternative that the Department use an asset based test in Section (b)(1)(i)(B) of the proposed regulation[5] that aggregates the assets of all plans sponsored by the employer and its affiliates. Many large employers sponsor multiple plans, some of which may be quite small. In such cases, the plan sponsor is not likely unsophisticated or in need of the protection of the BIC Exemption. Such employers can take advantage of other exemptions for any small plans that they sponsor and should not be forced into the BIC Exemption. If the Department determines to keep the 100 participant test, we urge the Department to amend the proposed exemption to provide that the test must be met as of the latest Form 5500 filed by the plan sponsor and publicly available from the Department at the time the account is opened.

Transactions Covered by the BIC Exemption.

The exemption covers only the receipt of compensation in connection with the *purchase, holding or sale* of a specified list of "Assets." We believe it also needs to cover the receipt of

[5] *See Definition of the Term "Fiduciary": Conflict of Interest Rule—Retirement Investment Advice*, 80 Fed. Reg. 21928, 21957 (Apr. 20, 2015).

compensation in connection with extensions of credit, since by its terms, the exemption covers debt instruments, bank deposits and certificates of deposit.[6]

We are troubled by the narrow scope of the permitted "Assets" and urge the Department to reconsider its approach to this concept. The term "Asset" is defined to include *only*: bank deposits; certificates of deposit; shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs, or exchange-traded funds; corporate bonds offered pursuant to a registration statement under the Securities Act of 1933; agency debt securities as defined in FINRA Rule 6710(l) or its successor; US Treasury securities as defined in FINRA Rule 6710(p) or its successor; insurance and annuity contracts; guaranteed investment contracts; and equity securities within the meaning of 17 C.F.R. § 230.405 that are exchange-traded securities within the meaning of 17 C.F.R. § 242.600.[7] The term "Asset" is expressly defined to exclude "any equity security that is a security future or a put, call, straddle, or other option or privilege of buying an equity security from or selling an equity security to another without being bound to do so."

The investments excluded from the Department's proposed list of permissible "Assets" include such transparent and liquid securities as municipal bonds, federal agency and government sponsored enterprise guaranteed mortgage-backed securities, foreign bonds, foreign equities, and foreign currency. It also omits other common investments such as over the counter equities, structured products (other than U.S. corporate bonds), hedge funds, private equity and other

[6] The BIC Exemption also provides no relief for principal transactions, which effectively denies relief under the exemption for the acquisition of shares of unit investments trusts. Although unit investment trusts are organized as registered investment companies, they are typically sold out of inventory. In a separate comment letter, SIFMA is recommending that the proposed exemption for principal transactions in debt securities be expanded in such a way that it would provide relief for the acquisition of unit investment trust shares.

[7] These "exchange" definitions make clear that only equities traded on a US exchange are covered under the exemption.

alternative investments, options, and futures contracts. In enacting ERISA, Congress chose not to prohibit these types of investments, and the Department has historically declined to create a "legal list" of investments for plan fiduciaries.[8]

The creation of an enumerated list of permissible asset types for small plans and IRAs is a marked departure from the Department's practice over the last 40 years. For the first time, the Department is proposing to create a "legal list" that substitutes its judgment for that of the plan fiduciary, IRA owner or plan participant. We question whether the Department has the legal authority to specify what retirement accounts can invest in. Had Congress wanted to place investment restrictions, it could have done so, as it did in IRC § 408(m) for IRA accounts. Because there are no such prohibitions in ERISA, we do not believe that the Department has the requisite authority to impose them now. We also question the Department's ability to expand the list of prohibited investments for IRAs given the language in IRC § 408(m) which does not include any of the securities prohibited under this proposed exemption.

We also believe that the "legal list" is fundamentally inconsistent with a fiduciary standard. An adviser may in good faith believe that an investment not on the list of "Assets" is in the best interest of the plan, plan participant or IRA owner. If an adviser so believes and fails to act on his or her belief, will adherence to the list be a defense? Limiting the ability of advisers to take action that they truly believe would be in the best interest of IRA owners, plans and their participants would substitute the Department's judgment for that of advisers, IRA owners, plans and their participants, and seems counter to the Department's stated goals.

[8] *See* Investment of Plan Assets under the "Prudence" Rule, 44 Fed. Reg. 31369 (June 1, 1979) ("the Department does not consider it appropriate to include in the regulation any list of investments, classes of investment, or investment techniques that might be permissible under the prudence rule"). We note that exchange traded funds did not exist in 1979 and thus could not have made any such list at the time.

Furthermore, limiting the types of permissible assets would create major operational challenges. As outlined in the Deloitte report submitted with this comment letter, SIFMA member firms would have to bifurcate accounts to accommodate products that would not be permissible under the exemption. Significant oversight would be required to ensure that advised retirement accounts are holding only permissible assets and that retirement investors are being advised only with respect to such assets. For pre-existing retirement accounts, SIFMA member firms will be barred from providing much needed advice to the account owners concerning the holding or sale of any assets that are not on the Department's proposed list. These negative consequences are discussed in greater detail below in SIFMA's comments regarding Section VII of the proposed exemption.

Although the Department suggests plans and IRAs can obtain exposure to impermissible assets through mutual funds, mutual funds does not have the risk, reward or fee structure of those assets (*e.g.*, sovereign bonds or foreign securities). It is not reasonable to suggest that a mutual fund is a substitute for an asset that the Department has excluded. We urge the Department to replace the term "Asset" in Section I(a) with the phrase "securities or other property." Given the impartial conduct standard required by the BIC Exemption, there should be no limit on the types of assets covered by the exemption. As proposed, the BIC Exemption purports to require brokers to act in the client's best interest, but then trumps the broker's judgment on what is or is not a suitable investment. Moreover, as the investment world constantly evolves, the sort of static list proposed in the BIC Exemption could impede investments in new vehicles that have the same level of transparency and liquidity cited by the Department as primary criteria in selecting "Assets." We believe that any such limitation is inappropriate.

The BIC Exemption also makes no provision for the receipt of compensation for two specific activities that the Department has included in the proposed definition of fiduciary investment advice: rollover advice and manager advice. Under the proposal, one becomes a fiduciary by recommending that a plan participant roll his or her account balance over to an IRA or by recommending a manager, but BIC Exemption provides no relief for the receipt of fees in connection with the rollover or the manager selection process.

In addition to substituting the phrase "securities or other property" for the term "Asset," SIFMA urges the Department to provide explicit relief for compensation received in connection with a recommendation to take a distribution of benefits or rollover into a plan or an IRA, as well as in connection with a recommendation concerning the selection of investment managers or advisers. We believe that these omissions must have been inadvertent, since it does not seem reasonable to make a person a fiduciary for a particular type of advice but provide no exemption for any compensation that may flow from that recommendation.

Because the proposed BIC Exemption is tailored to the recommendation of an "Asset," it is unworkable for recommendations of investment managers or advisers, including recommendations of separate managed account strategies or wrap fee programs (collectively, "advice programs"). These advice programs are for discretionary management services that, when provided for retirement accounts, are already subject to the full protections of ERISA today. A separate, modified BIC Exemption must be adopted that is more tailored and relevant to the recommendations of these advice programs. To address potential conflicts, such an exemption could incorporate the same impartial conduct standards and other requirements as contained in the BIC Exemption (subject to the necessary clarifications and modifications discussed below in this letter). To avoid encumbering unnecessarily the pre-investment conversation, and to leverage existing requirements and practices under the Advisers Act for discretionary management services, the exemption should allow the contractual requirements to be incorporated into an advice program agreement. It should be possible for that agreement to be executed after the adviser recommends the advice program, but prior to any actual investment through the advice program. For example, a required clause could state that an advice program recommendation was made in the best interest of the client. In lieu of the BIC Exemption disclosures, which are asset-based and therefore inapposite to the recommendation of advice programs, the Department should require 29 C.F.R. § 2550.408b-2 disclosures that could be incorporated into the advisory program's ADV Part 2 disclosure brochure that is already delivered to clients under the Advisers Act. The concept of leveraging § 2550.408b-2 disclosures is discussed in more detail below.

Section II: Contracts, Impartial Conduct and Other Requirements

Contract Requirement

The BIC Exemption requires that a contract be entered into *before* any recommendation is made to a retirement investor. There are several reasons why this requirement is simply incompatible with the markets and relationships it is intended to regulate. As a threshold matter, it is completely at odds with the manner in which brokers typically enter into relationships with retail customers. Given the uncertain scope of the term "recommendation" and the risk of non-compliance with the exemption, this proposed condition may leave brokers no choice but to ask retirement investors to enter into written contracts before any meaningful conversations have taken place. That could make retirement investors so uncomfortable that they simply decide not to proceed any further. Requiring a contract *before* any recommendation is made would also preclude reliance on the BIC Exemption for certain types of advice (such as rollover recommendations), because participants are not likely enter into a contract until they have considered the advice and made a decision.

There are other operational incompatibilities as well. The practical reality of the marketplace is that contracts are generally entered into between the financial institution and the IRA owner, plan fiduciary or participant acting on behalf of the IRA, plan or participant account. Advisers do not sign these contracts, and it would not be feasible for them to do so. Advisers are merely agents of the financial institution and they may leave that institution at any time. Having advisers sign the agreements would require the execution of a new contract whenever an adviser leaves the firm or an account is reassigned to another adviser. Likewise, if the adviser is not available, a recommendation could not be made by anyone else since the contract would be non-transferrable between advisers. Similarly, where an IRA or small plan account is serviced by a team of advisers, all of the advisers would have to sign the agreement, and a new contract would be required whenever an adviser leaves the team, or a new adviser joins the team.

Requiring advisers to sign a written contract would also create problems for financial institutions that have call centers and a rotating team of employees who may be permitted to provide advice. The Department declined to provide a "carve out" for call centers in the proposed definition of fiduciary advice. Can IRAs be allowed to use the call center if *no one* in the call center has signed the contract? If call center staff are fiduciaries, does each staff person in the call center have to sign the contract if an IRA owner could get a different person every time the IRA owner calls? These are just two examples of why this requirement is impractical.

Furthermore, there are close to fifty million IRAs and plans with *current* brokerage contracts. To amend, reprice, and resign all of those current contracts in the eight month period between the effective date and the applicability date would be an impossible undertaking. The Department has noted the impracticality of obtaining signatures on revised contracts in more than twenty prohibited transaction exemptions permitting deemed consent or negative consent. We respectfully request that any contract requirement be replaced by a written undertaking on the part of the financial institution; if the plan fiduciary, participant or IRA owner continues the relationship after being provided with the written undertaking, he or she will be deemed to have consented to it. At a minimum, the BIC Exemption should be revised to make clear that either negative consent or an electronic signature is sufficient, and that the written undertaking can be delivered either by mail or by electronic means.

Finally, we note that the proposed exemption for principal transactions targets the plan or IRA account as the counterparty to the agreement by requiring that the retirement investor enter into the contract "acting on behalf of the Plan, participant or beneficiary account, or IRA." This language makes clear that any advice provided by the adviser is being provided only with respect to the retirement account covered by the agreement. Although we have commented separately that the contract requirement of the proposed principal transaction exemption should likewise be replaced by an undertaking, we think treating the retirement account as the counterparty is more workable than the approach taken in the proposed BIC Exemption, which views the retirement investor as the counterparty.

Voluntary Assumption of Fiduciary Status

The BIC Exemption requires the adviser and the financial institution to affirmatively state that they are "fiduciaries under ERISA or the Code, or both, with respect to any investment recommendations to the Retirement Investor." The "Retirement Investor," as that term is defined in the exemption, will be a person or entity who may have more than one account with the adviser or the financial institution or both. At the very least, this language should be revised to clarify that the affirmative statement applies only with respect to recommendations provided with respect to the specific retirement account covered by the undertaking.

The required acknowledgement of fiduciary status creates other complications as well. For example, the preamble states that the requirement to adhere to a best interest standard "does not mandate an ongoing or long-term advisory relationship."[9] Section (c) of the proposed regulation[10] appears to limit the scope of any fiduciary duty to those assets for which a person exercises discretionary authority or renders investment advice. However, the Department should

[9] 80 Fed. Reg. at 21969.

[10] *See Definition of the Term "Fiduciary": Conflict of Interest Rule—Retirement Investment Advice*, 80 Fed. Reg. at 21959.

make clear in the BIC Exemption that advisers and financial institutions can limit any acknowledgment of fiduciary status and the requirements of the exemption to the *specific* assets for which investment advice has in fact been rendered, and if the investment advice is non-discretionary, that they can also limit the scope of any fiduciary obligation so that it does not extend to ongoing monitoring of that asset position. To do otherwise would require a financial institution to provide an additional investment advisory service (account monitoring) that neither the financial institution nor the plan, participant, or IRA owner may want or be willing to pay for. The Department should not imply that the adviser and/or financial institution will be acting in a fiduciary capacity *any* time they discuss investments for an account that holds an asset that was subject to non-discretionary investment advice. To do so would in fact preclude the adviser and financial institution from relying on the carve-outs to fiduciary status, including the ability to provide investment education, for any trade executed in the account.

In conjunction with the BIC Exemption's narrow definition of "Asset," the acknowledgement of fiduciary status must not result in self-directed IRA owners and plan participants being denied the ability to invest in assets of their choice. If a client with an advised IRA instructs the custodian to acquire a non-recommended investment that is excluded from the list of permissible "Assets," the broker should be able to execute the trade for a commission because the broker did not provide investment advice on that asset. The Department should make this clear. Otherwise, broker-dealers may be unwilling to risk dual-role accounts, where recommendations are made as to some but not all investments. This is a very common model for some broker-dealers whose advisers may provide occasional advice but not all the time and not with respect to all assets in the account, and it is consistent with Section (c) of the proposed regulation. If broker-dealers are instead forced to restrict advisory accounts to the acquisition, holding or sales of "Assets" as defined in the BIC Exemption, the result will be to deny clients the ability to invest their accounts in the assets of their choice. This does not seem to be the Department's intent, and in the final adoption the Department should make this clear.

Even if the above situation is addressed, dividing IRAs into advised and non-advised IRAs will create its own set of problems, not unlike the situation where a client has both a personal brokerage account and a plan or an IRA account.   Assume that the broker recommends an investment for the client's personal account that would not be on the BIC Exemption's list of permitted "Assets," and that the client then instructs the broker to purchase the same investment for the IRA. The broker has not made a recommendation for the IRA and should be permitted to execute the transaction in the non-advised IRA as a non-fiduciary broker. However, the broker may risk being sued for a prohibited transaction by following the client's instruction with respect to the IRA. If the broker does not follow the client's instruction, the broker risks losing the client's business.

These types of risks are likely to drive many broker-dealers away from commission-based compensation arrangements entirely, contrary to the Department's stated goal of "flexibly accommodate[ing] a wide variety of business practices" through use of the BIC Exemption. [11] The broad undertaking of fiduciary responsibility, the prevalence of individuals having multiple accounts with the same financial institution and broker, and the severely constrained list of permitted "Assets" make the BIC Exemption an ineffective solution for the modern investment marketplace.

Impartial Conduct Standards

The BIC Exemption requires that the adviser and the financial institution affirmatively agree to comply with, and then in fact comply with, impartial conduct standards. The impartial conduct standards require the adviser to provide advice that is "in the Best Interest of the Retirement Investor (*i.e.*, advice that reflects the care, skill, prudence and diligence under the circumstances

[11] 80 Fed. Reg. at 21961.

then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, without regard to the interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party)." The Department has thus taken ERISA's prudence standard and turned it into a prohibited transaction applicable to both plans and IRAs.

Congress saw no reason to impose a prudence standard for IRAs and believed that a violation of the prudence standard for ERISA plans should be remedied through litigation in federal court. Nonetheless, the proposal purports to condition relief under Section 4975 of the Code on the *contractual* assumption of a prudence standard that would be enforceable by IRA owners in state court through class action litigation or in arbitration on an individual claim basis. We do not believe that Congress intended a breach of the duty of prudence to violate the prohibited transaction provisions of ERISA and the Code.

We also do not believe the Department has a basis to apply its best interest standard to ERISA plans. The Department acknowledges in the preamble that the best interest standard "is based on longstanding concepts derived from ERISA and the law of trusts"; in particular, the duties of prudence and loyalty imposed by ERISA § 404(a). Requiring advisers to ERISA plans or plan participants to agree to, and comply with, a best interest standard separate and apart from their existing ERISA fiduciary duty is redundant and unnecessary to achieve the Department's stated goals. For ERISA plans, requiring advisers and financial institutions to adhere to a best interest standard as a condition for relief under the BIC Exemption ramps up the consequences of any fiduciary breach by imposing an excise tax on a prudence violation. We believe that is both inappropriate and contrary to the statutory framework and Congress's intent.

In our view, the Department lacks statutory authority to require compliance with a prudence rule as a condition of a prohibited transaction exemption. Congress has issued more than 20 statutory exemptions. Not one of those exemptions has imposed a vague "reasonable person" standard or a subjective "misleading disclosure" standard as a condition punishable by transaction reversal and an excise tax, regardless of whether there is a loss on the trade and regardless of whether the disclosure is entirely correct but simply unclear. Nor has any exemption previously issued by the Department contained such vague and subjective conditions. These conditions simply are not administrable and therefore do not meet the standards for issuance of an exemption under ERISA § 408(a). If the Department insists on retaining compliance with a non-misleading disclosure condition in the exemption, we suggest instead that the Department explicitly adopt FINRA guidance relating to Rule 2210 regarding the term "misleading."[12] In addition, we ask that the provision be clarified to require only that the financial institution and any adviser acting for the financial institution reasonably believe that the statements are not misleading. Because the failure to comply with a prohibited transaction exemption has such dire consequences, we do not believe that an inadvertent, immaterial statement taken in the wrong way by a client should result in reversal of the transaction, a guarantee of losses and the imposition of an excise tax.

We also question the language purporting to require advisers and financial institutions to prove that advice was given "without regard to the financial *or other interests of* the … Related Entity or *any other party*." We have several concerns with respect to this formulation. First, we believe the requirement that advice be "without regard" for the financial interests of the adviser sets up a standard that an adviser will fail any time a plaintiff can prove that the adviser did not recommend the investment that paid him the least. In guidance regarding the suitability rule, FINRA uses a much more common sense approach that does not contain this flaw: that the adviser provide recommendations that are in the best interest of his client and put his client's interest before his own.[13] We urge the Department to use this formulation.

[12] *See, e.g.*, FINRA Frequently Asked Questions regarding Rule 2210, *currently available at* www.finra.org/industry/finra-rule-2210-questions-and-answers.

[13] *See, e.g,* FINRA Regulatory Notice 12-25, Q1 at p.3 (May 2012) (citing FINRA rules that adhere to this formulation).

In addition, the proposed exemption in the language quoted above refers to “other interests” of “any other party,” with no apparent limitation. We do not know what these “other interests” and “other parties” are intended to address; nor does the preamble explain them. We request that this language be deleted from the definition of “best interests” in the exemption.

The impartial conduct standards also prohibit the adviser, financial institution and their affiliates and related parties from receiving unreasonable compensation “in relation to the total services they provide to the Retirement Investor.” This new formulation of reasonable compensation is unexplained. Nor does the Department attempt to justify the differences between this formulation and Congress’s view of reasonable compensation, which does not require all compensation received by a financial institution to be justified by a particular set of services to a particular account. We believe that this language is troublesome and we urge the Department to use the language it has used since the enactment of ERISA and as recently as 2012, when it entirely revised its regulations under ERISA § 408(b)(2).[14]

The impartial conduct standards also prohibit misleading statements about the recommended asset, fees, material conflicts of interest and other matters pertinent to the retirement investor’s investment decisions. While SIFMA generally agrees that misleading statements about such matters should be prohibited, we do not believe that such statements should be remedied by a prohibited transaction excise tax and rescission of related trades. We also note that the definition of “Material Conflicts of Interest” in Section VIII(h) of the proposed exemption provides no

[14] *See* 29 C.F.R. § 2550.408b-2(d) (“Section 2550.408c-2 of these regulations contains provisions relating to what constitutes reasonable compensation for the provision of services.”); 29 C.F.R. § 2550.408c-2(b)(1) (“In general, whether compensation is ‘reasonable’ under sections 408(b)(2) and (c)(2) depends on the particular facts and circumstances of each case.”).

explanation of the term "Material."[15] The proposed definition in Section VIII(h) is so broad that it will be virtually impossible for financial institutions to enumerate every conceivable existing or potential conflict of interest. A materiality standard should be added to the proposed exemption by amending the definition of "Material Conflict of Interest" to state as follows: "A 'Material Conflict of Interest' exists when an Adviser or Financial Institution has a financial interest that, from the perspective of a reasonable person, could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor regarding an Asset."

Warranties

The proposed BIC Exemption requires that the adviser and the financial institution warrant that: (i) they and their affiliates will comply with all applicable federal and state laws regarding investment advice and securities transactions; (ii) the financial institution has adopted written policies and procedures reasonably designed to mitigate the impact of material conflicts of interest and "ensure" that its advisers adhere to the impartial conduct standards; (iii) in formulating its policies and procedures, the financial institution specifically identified material conflicts of interest and has adopted measures to prevent material conflicts from causing violations of the impartial conduct standards; and (iv) the financial institution and its affiliates and related entities do not use "quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation or other actions or incentives to the extent that they would tend to encourage individual Advisers to make recommendations that are not in the Best Interest of the Retirement Investor." Although differential compensation encouraging the adviser to act in a manner that is not in the client's best interest would breach that warranty, differential compensation received by the financial institution itself would be permitted.

[15] The term "Material Conflicts of Interest" appears throughout the proposed exemption, and our comment on that term should be deemed restated each time the term appears. The repeated use of the term makes it even more important that the definition in Section VIII(h) be clarified.

These warranties are extremely troublesome, particularly in light of the resulting exposure to class action litigation. SIFMA requests that the first warranty be modified to warrant that the advisor, the financial institution and their affiliates have adopted policies that are *reasonably designed* to achieve compliance with all applicable law, not that they "will comply" with all applicable law. This is the regulatory standard that FINRA uses, and which the SEC approved.[16] We hope that the Department will recognize that this warranty would be provided in the context of the safeguards established by the SEC and FINRA and not require an absolute, strict liability declaration.

SIFMA also requests clarification regarding the second and third warranties. The Department should make clear that the second warranty requires the financial institution to warrant that it has adopted written policies and procedure that are *reasonably designed* to ensure that its advisers adhere to the impartial conduct standards, not that policies and procedures "ensure" such adherence. Similarly, the third warranty should be modified to warrant that the financial institution has adopted measures that are *reasonably designed to mitigate* material conflicts of interest, not that the financial institution has adopted measures "to prevent" such conflicts from causing violations of the impartial conduct standards. The financial institution cannot possibly adopt measures that will "prevent" material conflicts of interest.

SIFMA urges the Department to eliminate the fourth warranty regarding compensation practices entirely. Contrary to the Department's statement that the BIC Exemption "will broadly permit firms to continue to rely on common fee practices,"[17] we believe that this warranty will require a

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[16] Rule 3110(a) provides that: "Each member shall establish and maintain a system to supervise the activities of each associated person that is reasonably designed to achieve compliance with the applicable securities laws and regulations, and with applicable FINRA rules."

[17] 80 Fed. Reg. at 21961.

substantial, if not a complete, overhaul of broker compensation arrangements. Indeed, as far as we can tell, it will require the elimination of commission-based advice. Although the preamble indicates that the failure to comply with the mandated warranties would not result in a loss of the exemption, any breach of these warranties in the IRA setting, including the warranty regarding compensation policies and procedures, would be actionable under state contract law.[18] Thus, any warranty that differentiated commissions, sales loads, trail commissions,12b-1 fees and other payments from third parties do not "tend to encourage" violations of the best interest standard would expose financial institutions to the risk of class action litigation. To avoid that risk, financial institutions would be forced to eliminate differential and third party compensation arrangements with advisers (including attendance at training or other seminars to which advisers may be invited), as well as any bonus or incentive programs for advisers, in the provision of investment products and services to small plans and IRAs.

The preamble suggests several methods of satisfying the "policies and procedures" warranty, including the use of computer models to generate advice delivered by advisers, asset-based compensation, fee offsets, compensation systems based on the financial institution's determination of what products take more time or effort to sell, and compensation arrangements that are designed to align the interests of the adviser with the interests of the investor. None of these examples would reasonably permit the continuation of commission-based advice. Thus, contrary to what the Department says in the preamble, commission-based advice would be eliminated in brokerage accounts for IRAs, and an important choice for retirement investors about how to pay for advice would be gone.

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[18] *See* 80 Fed. Reg. at 21970 ("Failure to comply with the [policies and procedures] warranty could result in contractual liability for breach of warranty."); *id*. at 21972 ("The Department intends that all the contractual obligations (the Impartial Conduct Standards *and the warranties*) will be actionable by IRA owners.") (emphasis added).

Given their resulting exposure to class actions for breach of warranty, SIFMA believes that its members will either terminate their relationships with smaller plans and IRAs or offer only fee-based compensation arrangements. As the head of FINRA noted quite recently:

> … I have practical concerns with the Labor proposal in a number of areas. First, the warranty and contractual mechanism employed by Labor used to address their limited IRA enforcement jurisdiction, appears to me to be problematic. In one sweeping step, this moves enforcement of these provisions to civil class action lawsuits or arbitrations where the legal focus must be on a contractual interpretation. I am not certain how a judicial arbiter would analyze whether a recommendation was in the best interests of the customer "without regard to the financial or other interests" of the service provider. I'm not sure, but I suspect, a judicial arbiter might draw a sharp line prohibiting most products with higher financial incentives no matter how sound the recommendation might be. Similarly, I'm not sure how a judicial arbiter would evaluate which compensation practices "tend to encourage" violations of the exemption. It would appear likely, however, that firms would be required to demonstrate, at least, that any higher compensation was directly related to the time and expertise necessary to provide advice on the product, as specifically suggested by DOL. To say the least, making that case is not a simple proof standard.
>
> This all leads to my second concern that there is insufficient workable guidance provided either to the firm or the judicial arbiter on how to manage conflicts in most firms' present business models other than moving to pure asset-based fees, or a completely fee-neutral environment...I fear that the uncertainties stemming from contractual analysis and the shortage of useful guidance will lead many firms to close their IRA business entirely or substantially constrain the clients that they will serve. Put another way, the subjective language of the PTE, coupled

with a shortage of realistic guidance, may lead to few providers of these critical investor services.[19]

We believe that these concerns are well founded. Full and prominent disclosure, brought to the client's attention with some frequency, will do far more to shed light on fee differences, and educate clients regarding these differences, than arbitrarily banning fee differences in a business model that treats agency transaction compensation, principal transaction spreads, mutual fund fees and insurance company commissions differently. It is a not a "principles based" change to require this kind of massive overhaul in the way all brokers are compensated. In 2010, the Department suggested that it wanted a change in the law to make its enforcement program easier. We are very concerned that this exemption has the same aim, but at a huge cost to the financial services industry and those saving for retirement. We strongly urge the Department to reconsider this requirement.

If the Department determines to proceed with this approach, we ask the Department to delay the differential compensation rules for thirty six months. As the Department is well aware, the compensation paid to brokers differs *within asset types* and *across asset types*. It is simply unrealistic to require a change of this magnitude in eight months. Financial professionals with IRA or other plan clients would have to be excluded from firm-wide bonus pools that reflect the profitability of the entire firm, including retirement clients. Financial professionals also would have to be excluded from training programs if such programs are sponsored or supported by a mutual fund complex or similar provider of investment offerings. Changes like this will take years to plan and implement. Financial institutions cannot renegotiate the contractual arrangements with third parties and venders to alter the pay practices of every adviser within the eight month period provided in the proposed exemption. Delaying the differential compensation

[19] http://www.finra.org/newsroom/speeches/052715-remarks-2015-finra-annual-conference

rules by thirty six months should give financial institutions the time to redesign their programs, review all bonus and incentive programs, set new policies and procedures, retrain all necessary compliance, audit and risk teams, and put in new systems to accommodate these rules.

Contract Disclosures

Under the proposed BIC Exemption, the written contract must disclose all material conflicts of interest, and inform the investor of the right to obtain complete information about all fees associated with the assets in which the plan or IRA is invested, including "all of the direct and indirect fees paid [sic] *payable to* the Adviser, Financial Institution, and any Affiliates." (Emphasis added). It must also disclose the existence of proprietary investment products, any fees that the adviser will receive from third parties in connection with the purchase, holding or sale of any asset, and the address of the website required by the exemption. Failure to include any of these disclosures would preclude reliance on the exemption, and advisers and financial institutions will be exposed class action lawsuits challenging the completeness of any such disclosures.

Again, the use of the prohibited transaction framework here is troublesome. For example, many indirect fees cannot be attributed to specific transactions or customers due to the nature of the compensation arrangements utilized by investment providers and do not affect the customer's bottom line. For example, a mutual fund company may agree to pay a broker a flat fee that is unaffected by sales volume. The payment would be made regardless of whether the broker provides services to retirement investors and the payment may be insignificant when attributed to individual investors. Yet the smallest omission would require reversal of the transaction and payment of an excise tax, even where the omission had no effect on the transaction.

We urge the Department to incorporate the materiality standard described above in the definition of "Material Conflicts of Interest." Otherwise, even the most inconsequential omission would require reversal of the transaction and payment of an excise tax and expose advisers and financial institutions to class action litigation. For purposes of assessing the disclosures, we recommend, and assume that the Department intends, that the terms “direct” and “indirect” have the same meanings ascribed to them in the recent amendments to the regulation under ERISA § 408(b)(2).

Prohibited Contract Provisions

As an initial matter, we note that the Department does not have the authority to create a new private right of action, which is what is done with the BIC requirement. Beyond this, SIFMA has concerns with a number of the contractual prohibitions in the BIC Exemption. The Exemption provides that the written contract may not limit the liability of the adviser or the financial institution for violations of the contract, nor may it waive or limit the retirement investor’s right to participate in class actions against the adviser and the financial institution. The Department states in the preamble that “[t]he right of a Retirement Investor to bring a class-action claim in court (and the corresponding limitation on fiduciaries’ ability to mandate class-action arbitration) is consistent with FINRA’s position that its arbitral forum is not the correct venue for class-action claims.” The Department also states, however, that “this section would not affect the ability of a Financial Institution or Adviser, and a Retirement Investor, to enter into a pre-dispute binding arbitration agreement with respect to individual contract claims.”

We believe that the BIC Exemption should allow advisers and financial institutions to exclude liability for actions and omissions outside of their control. If an adviser recommends a transaction, the investor approves it, but the transaction fails or is cancelled for lack of funding by the client, then the *client* should be responsible for the failure to settle the trade and any compensation received by the adviser should not be at risk under the BIC Exemption. Similarly, the acts or omissions of a third party, such as a custodial error in recording assets or trades, or impossibility due to an occurrence outside the control of the financial institution (a force majeure) should not cause liability on the part of a broker.

We also ask the Department to confirm in any final rule that, consistent with existing law, the contract with the retirement investor may exclude liability for punitive and consequential damages. In addition, we ask the Department to clarify that the contract may require the use of FINRA's securities dispute resolution forum as the venue for arbitrating claims under the contract. Finally, we urge the Department to eliminate the proposed prohibition of provisions waiving the right to bring a class or other representative action in court. The Department has no authority to prohibit such agreements under the Federal Arbitration Act.

Section III: Disclosure Requirements

As a general matter, SIFMA agrees that appropriate cost disclosure may enhance a retirement investor's ability to assess prospective transactions, whether in a plan or in an IRA. However, SIFMA is very disappointed that the Department chose not to rely on the detailed disclosures required by the 2012 amendments to its regulation under ERISA § 408(b)(2).[20] SIFMA's members opposed many of the requirements of that disclosure regime, largely on the ground that the costs of implementing the new requirements would greatly outweigh any benefits to be gained from them. But the entire industry complied with those requirements just three years ago. Now, after SIFMA's members have spent millions of dollars building the systems necessary to implement that disclosure regime, the Department is proposing to require a new disclosure framework, different from the first, which would be far more costly to design and implement.

Rather than continue down this path, SIFMA suggests that the Department incorporate the fee disclosure requirements of 29 C.F.R. § 2550.408b-2(c) into the BIC Exemption. Following

[20] *See* Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure, 77 Fed. Reg. 6632 (Feb. 3, 2012).

adoption, the Department could take the appropriate time to judge whether those disclosures provide plan fiduciaries, participants and IRA owners with sufficient information to assess conflicts of interest, and then determine based on actual experience with those disclosures whether it is still necessary to mandate the additional disclosures set forth in the proposal. This would allow SIFMA's members to rely on the systems already in place to make disclosures to IRA owners. With this approach the Department should make clear that it is permissible for financial institutions that are operating under the Advisers Act (*e.g.*, when recommending discretionary investment management services or advice programs as discussed above) to include the 408b-2 disclosures in their Form ADV disclosure brochures, as this will be more manageable for both advisers and their clients.

SIFMA offers the following additional comments with respect to the disclosure requirements of Section III of the proposed BIC Exemption:

Cost Disclosure at Time of Purchase

Under the proposed BIC Exemption, whenever an adviser executes a purchase of an asset for a retirement investor, the investor must be given a chart showing the "total cost" of the acquired asset over periods of one, five, and ten years. "Total cost" includes the acquisition cost (*e.g.*, loads, commissions, mark-ups on assets bought from dealers, and account opening fees), ongoing fees and expenses of pooled investment funds (*e.g.*, annualized mutual fund expenses), and costs of disposition (*e.g.*, surrender fees and back-end loads). The Department states that its proposal is designed to direct attention to fee information "in a time frame that would enable the Retirement Investor to discuss other (possibly less costly) alternatives with the Adviser prior to executing the transaction" and invites comment on all aspects of the provision of data both at the time of the transaction and annually.

We believe that this chart is unworkable. Providing an investment's "total cost" over one, five and ten year periods will require return assumptions, which no financial professional will be prepared to speculate about. The SEC and FINRA have for years taken the position that projected return information is unreliable and misleading to investors. Indeed, a communication to a retirement investor that purports to predict or project performance would violate FINRA Rule 2210(d)(1)(F). The Department lacks any special expertise in this area and should not attempt to override the judgment of the agencies that have that expertise,

We firmly believe that this disclosure requirement should be eliminated. Differing assumptions across firms to calculate future performance of products could mislead retirement investors. Forward-looking cost estimates, based on future performance speculation, is simply unsubstantiated speculation. Will the 1-, 5- and 10-year data be deemed to satisfy the requirement if they are calculated using FINRA rules? To the extent that an investment is not subject to FINRA's oversight (*e.g.*, GIPS standards or state insurance regulations), what assumptions would advisers be required to make in order to comply? Do the 1, 5 and 10 year calculations apply to stocks and bonds and bank deposits, and if so, how? No financial professional could operationalize these requirements and they should be dropped.

The chart would also slow trading to the disadvantage of retirement investors alone. While the financial professional creates the chart, provides it by mail or electronically, and waits for the retirement investor to see and approve it, the market moves, pricing changes, and valuable opportunities are lost. By focusing on cost to the exclusion of other investment characteristics such as historical performance, the chart also provides a distorted picture of the relative merits of a particular investment. In short, we believe that the chart envisioned by the Department would help no one, and at worst, would seriously undermine the financial institution's duty of best execution.

Practical issues surrounding the timing and mode of delivery of this chart provide yet another reason why it should be eliminated. How long would the adviser have to wait after mailing,

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emailing or other means of delivery to the investor before the adviser could reasonably assume the investor has reviewed the information? If the disclosure is provided in a compliant form, will the investor be precluded from later claiming that the adviser failed to explain the information sufficiently or that the investor did not find the disclosure to be adequate to assess a course of action? In all cases, an investor must instruct the adviser to make a trade only after having the full disclosure in hand. Will the adviser be required to furnish the disclosure, even if by postal mail, before the transaction can be placed? If so, the disclosure requirement might actually impede best execution or affect the advisability of the particular transaction.

Furthermore, many substantive elements of the disclosure make no sense given the narrow definition of permissible "Assets." We are confused by the reference to mark-ups in the costs of acquisition. Mark-ups are charged only on principal transactions, which are not covered by the exemption. Even if a fixed income security is sold on an agency basis, the adviser would have no way of knowing what the mark-up is, since it is charged by an unrelated dealer that has no legal duty to disclose the mark-up. If mark-up includes spread revenue on annuities, then the proposed disclosure requirement is inconsistent with the disclosures required by 29 C.F.R. § 2550.404a-5. The reference to account opening fees is also puzzling. Accounts do not seem to be covered as an Asset. What is contemplated by the required disclosure of mark-downs on assets sold to dealers? That information will not be available to the financial professional or the financial institution; if required, the third party dealer will not engage in the trade.

Various types of accounts impose fees at the time of opening, and some may have fees if the account is materially changed – such as transitioning an account from a pure investment vehicle to an annuitized account without liquidating any investments. Unless the definition of "Asset" under the BIC Exemption is revised to include a rollover account, the fees associated with opening a rollover account are not costs of acquiring an "Asset." More importantly, while we recognize that the Department's goal is to provide the investor with a sound basis to assess costs, we do not believe that including this type of account fee in the disclosure makes sense in the overall context of the regulation. Similarly, fees imposed to close an account do not have a connection to any "Asset." In our view, these disclosure items need to be rethought and better tailored to reflect the narrow list of assets permitted under this exemption.

Annual Fee and Compensation Disclosure

Under the BIC Exemption, within 45 days after the end of each year, the adviser must give the retirement investor a list of each asset purchased, sold, or held for his account during the preceding year, as well as a statement of all fees and expenses paid by the investor, directly or indirectly, during the year with respect to each asset. A statement of the total compensation received by the adviser and financial institution directly or indirectly from any party, as a result of each asset purchased, sold or held for the investor's account during the year also must be included.

We believe that this requirement should be eliminated. Requiring annual disclosure of all fees and expenses paid by the investor during the year would be duplicative of disclosures made at the time of sale (*e.g.*, through prospectuses and trade confirmations) and would only impose unnecessary costs on financial institutions that would ultimately be passed on to retirement investors. It would also be extremely difficult for advisers and financial institutions to identify all of the indirect compensation that they may receive. As stated previously, many indirect fees cannot be attributed to specific transactions or customers due to the nature of the compensation arrangements utilized by investment providers. By the same token, the amount of any indirect compensation attributable to a specific transaction or customer may be insignificant, and the failure to disclose even an immaterial amount of indirect compensation could result in a complete loss of the exemption.

If the Department insists on retaining this annual disclosure requirement, it should be expressly limited to assets *for which investment advice was provided* during the preceding year. We assume that is the Department's intent, and request that the Department make that limitation clear. We also respectfully request that the timing of the annual disclosure be revised to match the timing requirements for the annual Form 5500. We do not believe any meaningful purpose is served by requiring the disclosure within forty-five days after each year end. Further, our members believe that this time frame is not reasonable and should, at the very least, be extended to ninety days. Also, for fees and expenses paid by the investor, estimates should permitted, as they are in the Department's current regulation under ERISA § 408(b)(2) – for example, fees for pooled investment vehicles are estimated based on the average annual fee rates of those vehicles. The Department should also permit estimates for indirect compensation and require only that material amounts be disclosed.

Web Disclosure

The BIC Exemption requires the financial institution to maintain a web page that lists all "direct or indirect material compensation" payable to the adviser for services in connection with each asset (or, if uniform across a class of assets, the class of assets) that an investor is able to purchase, hold or sell through the adviser and that has been purchased, held or sold in the last 365 days, along with the source of the compensation and how it varies within and among assets. The information also must be accessible in a machine readable format. This presumably requires the detailing of every insurance company separate account, every collective trust by unit class, every mutual fund by share class, every annuity contract and every GIC.

SIFMA views the web page disclosure requirement as overly broad, very impractical, and extremely costly and cumbersome to build, administer and maintain. SIFMA's members have had the experience of modeling disclosure for plans and participants in the last five years. They do not believe that such an undertaking would achieve the Department's stated goal of providing “a broad base of information about the various pricing and compensation structures adopted by Financial Institutions and Advisers.”[21] In addition, although the Department states that a related goal is to provide information that enables “financial information companies” to analyze and compare fee and compensation practices of advisers and financial institutions, this is a massive undertaking, requiring daily review for product and fee changes, and would cost millions of dollars for every single financial institution. We simply do not see how establishing a publicly available web page would serve the interests of the public and it certainly could not be cost justified. Even if the Department’s goal is to condense information that would then be aggregated and disseminated by “financial service companies,” the varying degrees of payments that could be attributed across the many types of institutions would be meaningless. In addition to these steep challenges, the information would not have any use for members of the public, even for participants of plans that invest in privately managed accounts.

We urge the Department to abandon the proposed web page disclosure requirement as a condition for relief under the BIC Exemption. This requirement, coming so close on the heels of the massive section 408(b)(2) project, is simply impossible to justify. On its own, it will result in brokers refusing to use the exemption, which in turn will result in more leakage of retirement savings from tax-advantaged accounts and widespread confusion on the part of retirement investors, neither of which is in their interest.

Section IV: Range of Investment Options

Under the BIC Exemption, the financial institution must offer and the adviser must make available a range of assets that is broad enough for the adviser to make recommendations with respect to every asset class necessary to serve the retirement investor’s best interests. The

[21] 80 Fed. Reg. at 21973.

exemption permits the financial institution to offer only proprietary products, only those that generate third party fees or only those of a particular asset class or product type, if it makes a written finding that the limitations do not prevent the adviser from providing advice that is in the investor's best interest, if the compensation received for the services provided to the investor is reasonable, and if the investor is given written notice of the limitations placed on assets that may be offered to the investor. The adviser must notify the investor if the adviser does not in fact recommend a sufficiently broad range of assets to meet the investor's needs.

The precise language in Section IV(a) of the exemption states that the financial institution and adviser must offer "a range of Assets that is broad enough to enable the Adviser to make recommendations with respect to all of the asset classes reasonably necessary to serve the Best Interests of the Retirement Investor in light of its investment objectives, risk tolerance, and specific financial circumstances." The Department should make clear that the term "asset classes" refers to the broad categories of equity, debt and cash instruments, rather than subcategories or other classifications that are less easily categorized. Any other intended meaning would be unworkable and lead to confusion.

The Department's use of the phrase "range of Assets" in Section IV(a) is also confusing. Could a financial institution that offers only mutual funds have a "range of Assets" that is broad enough to satisfy the requirements of Section IV(a)? What about a financial institution that offers bank deposits, CDs and money market funds? How would the requirement of a "broad enough" array of "Assets" apply in cases where a financial institution specializes in a limited range of asset classes? Could a specialist in fixed income satisfy the broad "range of Assets" requirement of Section IV(a) if the specialist recommends a broad range of corporate bonds, agency debt and U.S. Treasury securities that meet the definition of an "Asset" under the BIC Exemption, or would the specialist have to advise on an entire range of asset classes? Could such a fixed income specialist satisfy the broad "range of Assets" requirement in Section IV(a) with respect to some retirement investors but not others? The Department acknowledges that some firms “specialize in particular asset classes or product types” and suggests that such firms may still be able to use the exemption;[22] however, it is unclear how the “range of Assets” requirement could be satisfied outside the context of mutual funds. We urge the Department to limit this requirement to recommendations to purchase, hold or sell mutual funds.

Section IV(b) focuses on financial firms that exclusively offer specialized and/or proprietary products, which may or may not cross an array of asset classes. Many of the above questions about Section IV(a) reflect confusion about the interplay between Sections IV(a) and (b). We believe that Section IV(b)’s “Section (a) notwithstanding” language should be clarified to delineate the scope of the general rule and the exceptions and conditions.

We are also unclear about how the conditions of Section IV(b) would be applied in operation. The conditions of Section IV(b) specify that the firm and adviser must satisfy the best interest, impartial conduct and reasonable compensation standards contemplated by the proposal and notify the retirement investor of the limitations placed on the Assets offered to the investor. These requirements of Section IV(b) raise a number of questions.

- To the extent that a financial institution offers a limited range of investment options, does Section IV(b)(1) require the financial institution to make a separate written finding for each retirement investor that the limitations on Assets available for purchase do not prevent the advisor from acting in the best interest of the retirement investor or otherwise adhering to the impartial conduct standards? Can this requirement be satisfied by a written finding that applies to all of the financial institution’s retirement investor clients?

[22] *See* 80 Fed. Reg. at 21975.

- How would the adviser address questions from a client in a case where Section IV(b)(4) requires the adviser to provide notice that it is not recommending a sufficiently broad range of investment options to meet that client's needs? For example, assume a financial institution's business model is to sell only funds with agreements for compensation, and it and the adviser make the finding required under (b)(1). Further narrowing the range of investments, the individual adviser advises only on bond funds regardless of whether other advisers may recommend a broader range. Does Section IV(b)(4) require the adviser to provide the investor with a notice stating literally that "the Adviser does not recommend a sufficiently broad range of Assets to meet the Retirement Investor's needs"? Section IV(b)(4) should be revised to make clear that the notice can be phrased in less pejorative terms that are more tailored to fit the circumstances – *e.g.*, "Please understand that the adviser provides recommendations only on bond funds and that the adviser's recommendations are not intended to encompass the entire range of assets that might be necessary to meet your needs."

In addition to the questions noted above, it is unclear whether the notice required by Sections IV(b)(3) must be repeated every time a recommendation is made, updated or changed. Similarly, under what circumstances would a change in the limitations on Assets offered to retirement investors render a notice provided under IV(b)(3) insufficiently specific? For example, what if the financial institution changes the amount or percentage of revenue sharing it expects to receive? Would it be sufficient in all such cases to state in a notice that the firm expects to receive payment from the investment providers whose products are being offered, or is more specific disclosure required as to the relative amounts of such compensation?

The requirements of Section IV(b)(1), (3) and (4) are vague and confusing. We urge the Department to eliminate these sections, or repropose them with more clarity and objective requirements. Failure to meet this exemption requires reversal of the transactions done under it, and payment of a significant excise tax. It is quite unfair to impose a vague, internally inconsistent, and ill-defined requirement with these severe penalties.

Finally, we request that Section IV(b)(2) be deleted. That condition requires that any compensation be "reasonable in relation to the value of the specific services provided to the Retirement Investor in exchange for the payments and not in excess of the services' fair market value." Because the impartial conduct standards already prohibit the receipt of compensation in excess of what is reasonable, Section IV(b)(2) should be unnecessary.

To the extent that Section IV(b)(2) purports to establish a different standard of "reasonable compensation," we believe that it is too prescriptive and narrow to be workable. A standard requiring that compensation be no more than "fair market value" for the specific services provided to plan investors and individual investors alike would be extremely difficult to apply. How would a financial institution prove reasonableness in relation to the specific services provided to the retirement investor if the firm has only omnibus expenses that are based on services and profitability across a large retirement plan book of business? Would it be reasonable to allow an adviser to recommend one mutual fund over another where the adviser knows that the recommended fund's investment manager pays the adviser's firm more than another fund manager? Would the firm be prepared to show that the adviser's only economic benefit would be greater fees paid to his firm, or would the firm be better advised to recommend only funds with the lowest third party payments? Third party fees vary widely. If a financial institution accepts a low fee from one fund, would all other fund fees in excess of that level be unreasonable on the ground that the benefit to the firm is indirectly compensating the individual adviser?

In short, the "reasonable compensation" standard articulated in Section IV(b)(2) is unreasonable, and appears to be drafted as an impossibility: unless a financial professional can trace every dollar to a particular service to a particular account in connection with a particular transaction and demonstrate that others charge the same way, he is destined to fail. We suggest that this has never been the law, nor even the Department's position with respect to the reasonable compensation requirements of the statutory exemption for services.

Sections V and IX: Disclosure to the Department, Recordkeeping and Data Requests

Section IX of the BIC Exemption requires financial institutions to maintain information at the financial institution level by quarter, concerning investment inflows, outflows and holdings for each asset purchased, sold or held under the exemption, including: the identity and quantity of each asset purchased, held or sold; the aggregate dollar amount invested or received and the cost to the investor for each asset purchased or sold; the cost incurred by the investor for each asset held; all revenue received by the financial institution or its affiliate in connection with the purchase, holding or sale of each asset, disaggregated by source; the identify of each revenue source and the reason for the payment. In addition, financial institutions must maintain information at the investor level concerning the identity of the adviser, the beginning- and end-of-quarter value of each investor's portfolio, and each external cash flow to or from the investor's portfolio during the quarter.

Section V(b) of the BIC Exemption further requires that this data be maintained for a period of six years from the date of the transaction for which relief is sought under the exemption and that it be made available to the Department upon request *within six months from the date of the request*. In addition, Section V(c) requires the financial institution to maintain for a period of six years records demonstrating that the conditions of the exemption have been satisfied. Such records must be made available to the Department, the Internal Revenue Service (IRS), any retirement investor and any contributing employer or employee organization whose members are covered by a plan that engaged in a transaction under the exemption.

The preamble states that the purpose of the Section V(b) data request requirement is to "assist the

Department in evaluating the effectiveness of the exemption." The effect of that requirement, however, would be to invalidate past and future compensation covered under the exemption if the Department's data request cannot be met within the six month period. Creating a system that would be able to respond to such a data request will be extremely costly and time consuming. The cost implications of these data request requirements are described in greater detail in the Deloitte report submitted with this comment letter. We do not believe that these costs are justified by the benefit the Department suggests would be obtained. We urge the Department to eliminate the data request requirements of Sections V(b) and IX entirely.

If the Department decides to move forward with the data request requirements of Sections V(b) and IX, it should extend the effective date of these requirements by at least thirty-six months to give the industry adequate time to develop the systems necessary to capture the data and perform the calculations contemplated by the requirements. We also ask the Department to eliminate the Section IX(e) public disclosure provision. We believe it is entirely inappropriate to disclose portfolio return information alongside the identity of the individual advisor in a public filing. It appears that the entire purpose of this disclosure is to embarrass or otherwise call out advisors whose clients have lower returns, regardless of whether the clients' returns are determined by their own choice of strategies, and not by their advisor's skill or expertise. It is a blunt instrument, without any differentiation between asset classes, age or risk tolerance of the investor, or any other parameter that would actually be relevant to a comparison.

In addition, we ask that the data request requirement in Section V(b) be modified to parallel the exception in the proposed recordkeeping requirement of Section V(c) for records that are lost or destroyed due to circumstances beyond the control of the financial institution. We also request clarification that, to the extent a financial institution cannot rely on the exemption due to a failure to maintain or provide information that complies with a data request under Section V(b), that the inability to rely on the exemption will apply only prospectively from the date the BIC Exemption becomes unavailable to that institution, and that there will be no retroactive consequences.

In contrast, we believe that the comprehensive disclosure framework administered by the SEC and FINRA is far more targeted and nuanced in an appropriate manner. Particularly in light of the privacy risks highlighted by the widely-publicized hacking of confidential personal information concerning millions of federal employees, we believe that sensitive information about individual investors should either be excluded from the data request requirements of Sections V(b) and IX, or at the very least subject to a right on the part of the investor to "opt out" of having their sensitive financial information scrutinized, or even inadvertently disclosed, by federal regulators. At the very least, we believe this section should require all retirement investors to be warned that every transaction they engage in will be reported to the federal government.

Section VII: Exemption for Pre-Existing Transactions

The supplemental relief for pre-existing transactions would provide relief from the prohibitions of ERISA §§ 406(a)(1)(D) and 406(b) and Code §§ 4975(c)(1)(D), (E) and (F) for the receipt by advisers of prohibited compensation in connection with transactions that were entered into prior to the applicability date of the proposed regulation. The supplemental relief for pre-existing transactions applies to the receipt of compensation for services in connection with the purchase, holding or sale of an "Asset" by IRAs, participant accounts and *all* ERISA plans, regardless of size and whether or not the plan is participant-directed. The supplemental relief would cover advisers who did not consider themselves fiduciaries prior to the applicability date, as well as advisers who considered themselves fiduciaries but relied on an exemption that has since been amended. The proposed conditions for supplemental relief would require that the compensation be received under an arrangement that was entered into prior to the applicability date. The proposed conditions also would require that the adviser not provide any "additional advice" regarding the purchase, holding or sale of the asset after the applicability date. The proposed conditions would also exclude transition relief for any compensation received in connection with a purchase or sale that was a non-exempt prohibited transaction when it occurred.

SIFMA does not believe that it would be in the best interests of retirement investors to deny transition relief for advice to hold or sell or otherwise dispose of assets already held in such accounts. Not providing advice to a retirement investor on assets that the advisor previously recommended will only confuse the investor. Advisers should be able to continue to receive compensation for any asset in the retirement investor's account prior to the effective date of the rule as long as the adviser does in fact continue to give advice to the investor. That is a common sense approach and is in the retirement investor's best interest.

We also would ask that any acquisitions or dispositions that are effected after the applicability date of the regulation pursuant to any standing or automatic investment instructions effected before the applicability date (*e.g.*, investment instructions to rebalance back to the original investment allocation) be afforded protection under the BIC Exemption. These modifications would allow investors and advisers to continue on previously agreed courses of action, with the relief to end immediately upon any new recommendation or transaction that otherwise would trigger the contractual and other requirements of the BIC Exemption.

We believe that investors are best served by transition guidance that enables them to dispose of assets that they or their advisers no longer wish to own. The adoption of a new set of rules should not make it more cumbersome to advise, recommend or process an order to liquidate a pre-existing position, particularly given the time it will undoubtedly take to bring pre-existing accounts into compliance with the new rules. Rather, the disposition of a pre-existing position for cash should be grandfathered under existing rules, although any recommendation to re-invest that cash would, appropriately, be subject to the new fiduciary definition. Any other approach would be, at best, confusing to explain and apply, and at worst, inhibit communications between advisers and clients about poorly performing assets. In the event there is no relief for advice regarding pre-existing holdings, however, we recommend that prohibited transaction relief for such advice be conditioned only on compliance with the "best interests" standard proposed by FINRA. In this way, firms will be able to limit sales or other dispositions of assets that may generate extra compensation for the adviser, such as a back-end load or surrender charge.

We believe that it is equally important to extend transition relief to acquisitions of investments that are part of an automatic savings and investment program. For example, if a plan participant elects automatic salary deferrals into the plan after receiving advice from an adviser prior to the applicability date, we do not believe it serves the interests of anyone involved to require that such advice be revisited and, most likely, given again subject to the fiduciary standard, with or without the BIC Exemption. It would create an enormous burden for financial firms, and it is difficult to understand how it would benefit the participant. If, of course, the adviser recommends any increase in the investment amount, or changes the recommended asset mix after the applicability date, the new fiduciary framework would apply. Similarly, standing asset allocation (and rebalancing) instructions and automatic dividend reinvestment should not be an inadvertent compliance trap, so long as it is not changed or advised to be changed. Mutual fund and annuity "dollar-cost averaging," where an individual purchases a highly liquid interest, usually a money market fund, and has the money fund account automatically fund other investments at pre-set intervals, also should be unaffected if the dollar-cost averaging advice and investment program were set before the applicability date.

SIFMA is also concerned that the narrow definition of the term "Asset" could have serious adverse consequences if the exemption for pre-existing transactions is adopted in its proposed form. As we understand the proposed transition relief in Section VII, if a pre-existing holding is not an "Asset" within the meaning of the BIC Exemption, Section VII will provide no relief for any compensation received with respect to that holding going forward, and Section I likewise will provide no relief for any advice or recommendations with respect to that holding going forward. Denying transition relief for compensation received with respect to pre-existing holdings that are not "Assets" not only defeats legitimate expectations of the contracting parties, but will create a huge compliance burden from the instant the rules become applicable. Advisers and financial institutions will have to determine promptly which pre-existing accounts hold investments that meet the definition of an “Asset,” which hold investments that do not meet that definition, and which hold both types of investments. For any pre-existing accounts that hold investments that are *not* “Assets,” advisers and financial institutions will have to immediately suspend the receipt of any compensation attributable to such assets and cease to provide any advice or recommendations with respect to such non-“Assets” going forward. For accounts that hold both “Assets” and non-“Assets,” segregating any ongoing compensation associated with “Assets” covered by the transition rule will present its own technical challenges, and advisers and financial institutions may have no choice from a compliance perspective but to split the “Assets” and non-“Assets” into separate accounts. Such splitting into separate accounts would not only increase recordkeeping and other costs, but also make it more difficult for the account owner to monitor his accounts with the financial institution.

Furthermore, because of the time it would take to identify every account holding non-“Assets,” advisers and financial institutions may have to place all of their retirement accounts into a “no advice” category until all of these issues can be sorted out. The process of identifying all pre-existing account holdings that are not “Assets” will be extremely costly and time consuming, and the account owners themselves are likely to be bewildered and upset by the entire experience. We do not believe this is workable and we urge the Department to broaden the scope of transition relief.

The transition relief also suffers from the concerns we have previously raised regarding multiple accounts, such as an IRA and a non-retirement account, and the limited scope of the “Asset” definition. We will not reiterate all of those concerns in this section of our comments, but we wish to point out that, apart from the fiduciary requirements and proposed exemptions, there is no history in account construction or composition that differentiated among assets as the Department now proposes. Therefore, while the issues we raised above certainly apply in the context of future accounts, assets and recommended transactions, the complications are multiplied where financial firms are maintaining multiple pre-existing accounts for clients. It will be next to impossible to succinctly explain to clients or advisers how the rule regarding "Assets" is to be applied, particularly with long-standing investment accounts.

The Request for Comment on a Low Fee Streamlined Exemption

The preamble to the proposed exemption seeks comments on whether the Department should issue a separate class exemption, with fewer conditions, for advice concerning low-fee index funds. Examples mentioned in the preamble are "a long-term recommendation to buy and hold a low-priced (often passively managed) target date fund that is consistent with the investor's future risk appetite trajectory" and "a medium-term recommendation to buy and hold (for 5 or perhaps 10 years) an inexpensive, risk-matched balanced fund or combination of funds, and afterward to review the investor's circumstances and formulate a new recommendation."

This contemplated exemption appears, similar to the "Asset" definition, to indicate a policy preference by the Department for passively managed target date funds. Neither ERISA nor the Code authorizes the Department to implement such policy changes. Further, we disagree with this approach because there is no good evidence that passively managed investments are "safer" than actively managed investments. An investment in an S&P 500 index fund reflects an affirmative decision to invest in large U.S. equities (and incidental futures used to smooth rebalancing transactions, or large inflows and outflows). The fund's investment strategy is quite simple to explain, but its underlying assets are subject to all of the market volatility and to some extent sector volatility that underlie all equity investing. We do not believe that any element of such vehicles, in and of itself, lends itself to a different fiduciary analysis, and we reiterate our view that the Department's desire to simplify the investment advice for retirement investors should not result in the Department lending favored status to any particular investment type. We recommend even-handed treatment of investments in the BIC Exemption and in the fiduciary regulation overall absent specific features that demand special precautions.

Section VIII: Definitions

Many of SIFMA's questions and comments regarding the proposed definitions in the BIC Exemption are addressed as they arise in the proposal itself. What follows is a list of additional comments and questions concerning the definitions, not specific to any particular functional part of the exemption.

Adviser – Under the proposed fiduciary regulation, there is no carve out for call centers or their personnel. SIFMA has separately commented on that proposal. For purposes of the BIC Exemption, call center employees may be compensated in a way that puts them in a position that requires relief. However, to meet the definition of an "Advisor" under Section VIII(a) of the BIC Exemption, call center employees would have to "[s]atisfy the applicable federal and state regulatory and licensing requirements of insurance, banking, and securities laws with respect to the transaction." We are concerned that this language may require call center employees to register with the SEC as "advisers" under the Investment Advisers Act of 1940 ("Advisers Act"). Unless the Department decides to include a specific carve out in the fiduciary regulation for call centers, we urge the Department to clarify that call center employees do not have to register as "advisers" under the Advisers Act to qualify for relief under the BIC Exemption.

The Department, in the proposed fiduciary regulation, has cited its extensive coordination with securities regulators. We are hopeful that the SEC and the Department are aligned on the "Adviser" definition, and that invoking the relief provided by the BIC Exemption will not, by itself, trigger a separate registration requirement with the SEC under the Advisers Act to the extent there was no other need to register under that statutory framework.

Affiliate – We urge the Department to revise this definition to provide greater consistency with the federal securities laws, particularly with respect to the individuals covered in paragraph VIII(b)(2). The ERISA and Code definitions cited in that section will introduce an additional compliance hurdle to the extent those definitions do not align with the common definitions applied in the securities law context.[23] We recommend using the existing framework of broker-dealers' compliance programs, which are predicated not only on an "affiliate" definition but also on an "associated person" definition.

Best Interest – The proposed best interest standard requires advisers and financial institutions to prove that their recommendation was made "without regard to the financial *or other interests* of the Adviser, Financial Institution or any Affiliate, Related Entity *or other party*." We recommend that this clause be replaced with the phrase "and place the interests of the Retirement Investor ahead of their own." At a minimum, for the reasons explained in our comments on the impartial conduct standards, we urge the Department to delete the phrases "other interests" and "or other party" from the current formulation of the standard.

Financial Institution – Section VIII(e)(2) defines the term "Financial Institution" to include a bank or similar financial institution supervised by the United States or a state, or a savings association, "but only if the advice resulting in the compensation is provided through a trust department of the bank or similar financial institution or savings association which is subject to periodic examination and review by federal or state banking authorities." We see no reason to

[23] Rule 12b-2 under the Securities Exchange Act of 1934 defines "Affiliate" as a "person that directly, or indirectly through one or more intermediaries, controls, or is controlled by, or is under common control with, the person specified." That Rule contains a separate definition for an "associate": "(1) any corporation or organization ...of which [a] person is an officer or partner or is, directly or indirectly, the beneficial owner of 10 percent or more of any class of equity securities, (2) any trust ..., and (3) any relative or spouse of such person, or any relative of such spouse, who has the same home as such person or who is a director or officer of the registrant or any of its parents or subsidiaries."

limit this definition to advice provided through a bank's trust department. Advice to IRA owners may emanate from any department of a bank and all areas are subject to federal or state supervision.[24] Accordingly, we request that the entire "but only if" clause be dropped.

Independent – As written, the definition of "independent" would disqualify any company that provides services to the financial institution, such as its accounting firm, lawyers, cleaning services, food services, security services, parking services, window washing services, etc. To the extent any of those companies sponsors a plan, the plan sponsor would not be "independent," regardless of how small the amount of income received from the financial institution. Historically, the Department has recognized this fact in virtually every exemption it has granted and we assume its failure to do so here was inadvertent. Accordingly, we suggest that subsection (2) of the definition of "independent" in Section VIII(f) should be replaced with the following: "Receives less than 5% of its gross income from the Adviser, Financial Institution or Affiliate." In addition, subsection (3) should be revised to make clear that an IRA owner will not be deemed to fail the independence requirement simply because he or she is an employee of the financial institution.

Individual Retirement Account – We believe that health savings accounts (HSAs) should not be included in the definition. HSAs by their terms are not intended for retirement income but rather health care expenses. To be clear, we argue the same is true for other tax favored savings vehicles that are not intended to provide retirement security, such as college or other educational savings accounts that may be offered through broker-dealers.

[24] The bank regulators at the federal level include the Office of the Comptroller of the Currency, the Consumer Financial Protection Board and the Securities and Exchange Commission.

Material Conflict of Interest – This definition should be revised to incorporate the standard of materiality described above in our comments concerning the impartial conduct standards. Without more, the Department's proposed definition could be interpreted to cover even the most remote financial interest that could possibly affect one's best judgment, regardless of whether the effect of the financial interest would be material.

Proprietary Product – Section VIII(j) defines a "proprietary product" as one that is "managed by" the financial institution or any of its affiliates. However, investment products are generally considered "proprietary" to a firm when they are issued or sponsored by the firm or an affiliate. We recommend a definition more in line with these concepts and believe that the term "managed by" is not a meaningful indicator of "proprietary" status.

SIFMA and its members appreciate the opportunity to comment and look forward to meeting with the Department to discuss our concerns. For further discussion, please contact the undersigned at 202-962-7329.

Sincerely,

Lisa J Bleier

Lisa J. Bleier
Managing Director, Federal Government Relations
and Associate General Counsel

APPENDIX 4

July 20, 2015

By U.S. Mail and Email: e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11713
Suite 400
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: ZRIN 1210-ZA25

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to provide comments regarding the Department of Labor's ("Department") proposed exemption under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and section 4975 of the Internal Revenue Code ("Code") for certain principal transactions in debt securities between a plan or an IRA (and other individual accounts) and its investment advice fiduciary. SIFMA appreciates the opportunity to comment and hope that our comments are helpful to the Department as it assesses the impact of the proposed exemption on IRAs, plans and their participants. SIFMA shares the Department's interest in making sure that plans and IRAs are treated fairly in the market place and have the ability to trade effectively and efficiently in all markets. SIFMA respectfully requests an opportunity to testify at the Department's August 10-13, 2015 hearing.

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

Attached hereto are SIFMA's submissions for the related rulemakings being undertaken by the Department. These attachments are an integral part of this submission.[2]

The proposed exemption, as drafted, covers all plans and IRAs where the fiduciary financial institution is providing investment advice, and does not have discretionary control. SIFMA believes it is appropriate that the exemption covers all plans and IRAs, and we believe that the limitation on discretionary fiduciaries is consistent with the other proposals made by the Department.

SIFMA is concerned however, that the proposed exemption will have a deleterious effect on prices in the bond market for plans and IRAs. The delays, the lack of liquidity from taking large dealers out of the market, the costs of agency transactions, and the work-arounds to avoid riskless principal transactions all add to pricing inefficiencies. SIFMA does not understand how such a strikingly bad result could be in the interest of participants. Nor do we believe that the Department's cost analysis has identified or correctly analyzed these costs. In addition, the proposal permits only a very limited list of investments that may be purchased and sold on a principal basis by plans and IRAs. It denies exemptive relief for many types of securities, for currencies and for other investment products commonly held (and currently held) by retirement accounts. New issues of equity and debt securities where one's own financial institution is part of the underwriting syndicate will be prohibited in plans and IRAs. Moreover, municipal securities, certain agency debt securities, unit investment trusts, highly rated debt of the client's own financial institution, all noninvestment grade debt, brokered certificates of deposit, private placements, preferred shares, structured notes such as principal protected notes, securities issued by charitable institutions, agency mortgage backed securities will only be able to be purchased on an agency basis which we believe will be significantly more expensive for retail investors. We think the Department has not articulated a sensible rationale for the proposed exemption's

[2] See Appendices numbered 1-8.

limitations on the assets that can be transacted on a principal basis, and these limitations are not in the best interest of retirement investors. We also believe the Department exceeds its statutory authority in undertaking to dictate the securities that properly may be held by retirement investors.

In addition, as described more fully below, the proposed exemption seems completely focused on what securities a plan or IRA can *purchase* in a principal transaction and does not reflect the important role of a retirement investor's financial institution in providing facilitation trades when the client wants to sell a security and cannot obtain a reasonable price from a third party.

The Department also appears to have overlooked, or failed to adequately considered, the existing oversight of securities and banking regulators with respect to principal transactions, including the attendant extensive rules and guidance. Significantly, the policies, procedures, training, supervisory and compliance programs and surveillance systems of financial institutions have been long—established based on these rules and guidance; now, it appears that all of that will need to be revised to create different rules for plans and IRAs than the rules generally applicable to the institution's other customers. This is improper, and it also is improper for the Department to craft this exemption and attempt to assess its benefits and costs without taking into account existing regulatory requirements.

The proposed exemption assumes that principal transactions in the securities listed above are complex, and they are not. It assumes that principal transactions in these securities are riskier than in the three "approved" bonds, and they are not. It assumes that the conflicts of interest with respect to principal transactions are of a different, more troublesome sort than any other conflict addressed by this exemption and they are not. It assumes that the impartial conduct standards, including the best interest standard, are a nullity, and they are not. Finally, it appears to ignore a financial institution's duty to comply with FINRA rules and guidance, including the duty of best execution, which overarches all of these requirements. These are well-known and well-regarded regulatory standards with teeth, and it should not be dismissed in favor of flat prohibitions on the best and most efficient, economic way to trade these instruments.

The proposed exemption may impair a broker-dealer's ability to exercise reasonable diligence under FINRA and MSRB rules by adding a significant hurdle for dealers to act in a principal capacity. FINRA's Best Execution rule and MSRB's Best Execution rule (effective December 7, 2015) require that dealers exercise reasonable diligence to ascertain the best market for the subject security and to buy or sell in that market so that the resultant price to the customer is as favorable as possible under prevailing market conditions. FINRA and MSRB provide a list of factors that will be considered when determining whether a dealer exercised reasonable diligence. The duty of best execution applies whether a broker-dealer is acting as an agent or a principal and applies across retirement and non-retirement accounts. The Department's proposed pricing information requirements conflict with a dealer's best execution obligations, in that if a dealer has used reasonable diligence and has determined that its own principal inventory is the best available market under prevailing market conditions, under FINRA and MSRB rules it must execute in that market.

In the 40 years since ERISA was enacted, the Department has never suggested that it has superior knowledge of what types of investments are in the best interest of retirement investors. Nor has the Department attempted to upend the way these investments are traded in the markets. But once the Department amends its regulation defining investment advice fiduciaries, unless it provides appropriate relief, IRAs, plans and participants will be demonstrably disadvantaged. When buying the securities they want, their costs of execution will be higher and their pricing will be less favorable. SIFMA disagrees with this unprecedented view that the Department should be the final arbiter of the types of securities permitted to be held by retirement investors, or the way securities should be traded, as the Department has done with this proposed exemption and the proposed BIC exemption. "Legal lists" of securities for retirement accounts, crafted by the Department, is just the wrong path. SIFMA respectfully urges the Department to consider how these limitations undercut the viability of the best execution standard in the securities laws, the best interest standard required under the exemption, as well as the standards embodied in section 404 of ERISA for employer sponsored plans.

This proposed exemption covers IRAs as well as the largest most sophisticated plans in the country. SIFMA believes that these restrictions will substantially injure plans of all sizes. We are concerned that these restrictions will create the very incentive the Department seeks to avoid: clients doing everything in their power to make sure that their financial representative is not a fiduciary, so they can buy the investments they choose to buy, and trade them in the most advantageous way for their plan. To us, the proposal seems to substitute the Department's judgment for that of a participant, plan fiduciary or IRA. And the proposed exemption appears to substitute the Department's judgment for that of the primary securities and banking regulators, who understand and regulate these markets on a daily basis and have done so for years, who have far more experience than the Department does in these markets, and who have rules and regulations in place that carefully assess the conflicts and the risks of principal transactions.

SIFMA is concerned that financial professionals will be obligated to warn their retirement plan clients that other securities may be in the best interest of the account but the Department has prohibited their purchase entirely or permitted the purchase only in a manner that is demonstrably more expensive and less efficient. The exemption will have the effect of removing liquidity from the market and increasing the cost of all securities because of the need to create new mechanisms to accommodate agency trades in securities that are virtually always traded as principal. This is such a departure for the Department that we respectfully request that it reconsider this course. There is nothing inherently different about the trading of other debt instruments, or other products sold on a principal basis that should, as a policy matter, eliminate a dealer's ability to sell them to their retirement plan clients in the most efficient manner that the market can provide. It is unreasonable to make the purchase and sale of principally traded products more expensive and more burdensome because the Department is uncomfortable with those products and the way they have been sold. Neither the SEC nor FINRA, whose job it is to regulate these markets, has prohibited the purchase and sale of these publicly traded products, even for the smallest retail account nor required them to be traded as agent. We strongly urge the Department to engage with us in rethinking this proposed exemption, not only with its central theme of a very limited list of securities that can be traded on a principal basis, but on some of the conditions in this proposal, which do not achieve the Department's goals but merely substitute the Department's judgment for the expertise and experience of the SEC, FINRA and the MSRB on efficient and protective securities trading.[3]

We are also concerned that these instruments will not even be functionally available to plans. It is most typical for dealers to facilitate investor transactions with third parties on a riskless principal basis rather than a pure agency basis because third parties are typically unwilling to assume settlement risk with the investor. The dealer thus assumes this settlement risk by stepping in as principal to facilitate the trade. In this case, the dealer moves the asset through its inventory but only as a pass through to or from that third party. Given the unwillingness of most third party dealers to trade directly with an unknown investor, there will be no place else for these transactions to settle, or way for third party trades to settle, when the account is custodied at the broker-dealer.[4] Thus, the Department's restrictions on principal transactions in anything other than the few types of securities it has "approved" will be tantamount to a ban on holding

[3] The MSRB rule set has a number of customer protection rules that operate similarly, but not identically to FINRA rules, including MSRB Rule G-17 (Fair Dealing), G-18 (Best Execution), G-19 (Suitability of Recommendations and Transactions), Rule G-30 (Prices and Commissions). The MSRB's Electronic Municipal Market Access (EMMA) website was designed to provide market transparency specifically to retail investors. Discussions herein referring to FINRA rules are equally applicable to the municipal securities market, but have been truncated for ease of readability (including the discussion of FINRA Notice 14-52 on matched trades).

[4] To the extent that the assets of a plan are held at a bank trustee, securities purchased or sold by a plan are settled to the bank trustee's account at the Federal Reserve or a depository.

such other securities altogether. It is critical to permit any transaction to be traded as riskless principal so that clients retain the ability to purchase and sell any assets that trades in a principal market and at a lower cost.

Finally, many firms provide market access for self-directed investors and their brokers that combine screeners and other research tools and available aggregated inventory from the dealer and other third-party dealers. As noted throughout this letter, the ability of firms to deal with their clients on a principal basis is necessary to maintain inventory, provide access to a range of investments and deliver best execution. In these instances, the client or broker on behalf of a client is unaware of whether the bond is coming from the dealer or a third party dealer until executed. The final rule should make clear that the proposed exemption for principal transactions is not needed for such services, provided that the service does not provide an individualized recommendation to a particular plan, participant or IRA account owner.

The Contract Requirement

We urge the Department to recognize several operational difficulties with the contract requirement in this exemption. First, today, contracts, when they are signed, are signed by the client, and the individual financial adviser is not a party to the agreement for a variety of employment reasons. Second, it is unlikely in an employer sponsored plan that a contract exists between the participant and the financial institution, because the owner of the account is the trustee, and the trustee is the only entity that can bind the plan in this regard. Finally, an action to enforce a contractual agreement between a plan and a financial institution is duplicative of, and actually less valuable than, the cause of action that exists under ERISA, and in all likelihood would be preempted. Accordingly, SIFMA urges the Department to change the proposed exemption to require only a written undertaking by the financial institution, as part of the account opening process, and encompassing the impartial conduct standards as revised in the manner suggested below, and only for plans not subject to Title I of ERISA. For plans covered by Title I of ERISA, SIFMA suggests that the exemption require only a written undertaking to the plan to encompass the impartial conduct standards, revised as we suggest below, but *excluding* the best interest standard, which is already found in ERISA section 404. SIFMA also suggests that these provisions may be contained in separate documents, so that every change in a disclosed conflict of interest or change in fees does not require the contract or written undertaking to be amended.

SIFMA members are concerned that the Department has not fully considered the extraordinary amount of time that it will take, and the significant costs that will be incurred, including the renegotiation of virtually all fees, to re-document the more than 50 million accounts now held at broker-dealers. If client "wet" signatures are required, there will be no way for all of these contracts to be amended regardless of how much lead time the proposed exemption provides. Even with new IRA and plan accounts, delays in obtaining signatures may result in lost trading opportunities and market movements against the client.

In addition, the systems build to provide the data required by the proposed exemption, which is discussed more fully below, is likely to take years, not the eight month compliance period offered by the Department. In the meantime, retirement clients will be unable to trade on a principal basis for the large majority of securities, and their interests will be harmed.

- Consider, for example, a retirement client holding a relatively small, illiquid bond on the effective date, who wants to sell that bond. That client would ordinarily look to its financial institution to provide that investor with liquidity and purchase that illiquid bond; generally, the financial institution would do so. If there are no other bids, or only bids at unreasonable prices, the client will be unable to sell the bond at all. We are certain that this is not a result the Department would favor.

- Similarly, consider a retirement client with bonds or NASDAQ securities that do not meet the Department's "legal list"; how are they to be sold?

SIFMA urges the Department to craft a rule that allows the financial institution to purchase *from* a client any asset that is generally bought and sold on a principal basis for any asset held in a retirement account.

The proposed exemption, like virtually all of the new and amended exemptions in this fiduciary package, requires both the adviser and the financial institution to enter into a written contract with the retirement investor acting on behalf of a plan or IRA. In the BIC exemption, the contract must be entered into *before a recommendation is made*, which, as we note in SIFMA's comment on that exemption, is unworkable as a timing matter. In the proposed principal transaction exemption, the contract must be entered into *before engaging in the transaction*. This formulation is more workable than that used in the BIC exemption. We also believe the language is clearer in the principal transaction exemption that the contract relates not to the retirement investor, and any account it holds, but to a particular plan or IRA of the retirement investor. We are concerned that recommendations made to an individual specifically for a nonretirement account may be used instead, by that individual, to direct the financial professional to purchase or sell that asset in his retirement account, and cause that recommendation, which was clearly intended for a nonretirement account, to become fiduciary advice in a retirement account. Accordingly, we believe that all of these exemptions, and the rule itself, need to acknowledge the fact that clients may have several accounts, and ensure that advice given to a nonretirement account does not become fiduciary advice in a retirement account. Because of the significant penalties associated with prohibited transactions, our members seek bright lines so that they can build reasonably designed compliance, surveillance and supervisory systems reasonably designed to ensure compliance with the final rule.

<u>The Impartial Conduct Standards</u>

Under the proposed exemption's contract requirement, the adviser and the financial institution must affirmatively agree, and comply with the following provisions: that they are fiduciaries; that they will comply with a best interest standard that incorporates the prudent person standard of section 404 of ERISA; that they will not enter into a principal transaction with the plan, participant or beneficiary account, or IRA if the purchase or sales price of the debt security (including the mark-up or mark-down) is unreasonable under the circumstances; and that the adviser's and financial institution's statements about the debt security, fees, conflicts of interest and the principal transaction, and any other matters relevant to a retirement investor's investment decision in the debt security, are not misleading. These standards are entirely inappropriate for plans covered by Title I and are simply an effort to add an excise tax penalty to ERISA's statutory scheme. The Department does not have the authority to do so. In addition, the disclosure conditions are not reasonable and not administrable, within the meaning of section 408 of ERISA.

Congress saw no reason to have a prudence standard for IRAs and believed that a violation of the prudence standard for ERISA plans should be remedied through litigation in federal court. Nonetheless, the proposal purports to condition relief under Section 4975 of the Code on the *contractual* assumption of a prudence standard that would be enforceable by IRA owners in state court. We do not believe that Congress intended a breach of the duty of prudence to violate the prohibited transaction provisions of ERISA and the Code. Our specific comments follow.

First, SIFMA strongly objects to these standards for plans covered under Title I of ERISA. The Department acknowledges in the preamble that the best interest standard "is based on longstanding concepts derived from ERISA and the law of trusts"; in particular, the duties of prudence and loyalty imposed by ERISA section 404(a). Requiring advisers to ERISA plans or plan participants to agree to, and comply with, a best interest standard separate and apart from their existing ERISA fiduciary duty is redundant and unnecessary to achieve the Department's stated goals. For ERISA plans, requiring advisers and financial institutions to adhere to a best interest standard as a condition for relief under the principal transaction exemption ramps up the consequences of any fiduciary breach by imposing an excise tax on a prudence violation. We believe that is both inappropriate and contrary to Congress's intent. Title I has its own remedy scheme that Congress carefully crafted to be based on losses, not on foot faults. These plans are already covered by a comprehensive disclosure scheme and a regulation issued just three years ago. We urge the Department to remove this requirement from the exemption, and if the Department declines to do so, to make it applicable only to plans not covered under Title I of ERISA, but as modified below.

Second, the Department does not have the statutory authority to require compliance with a prudence rule as a condition of a prohibited transaction exemption. Congress has issued more than 20 statutory exemptions; not a single one has, as a condition, a subjective and "reasonable person" standard or a subjective "misleading disclosure" standard which is punishable by transaction reversal and an excise tax, regardless of whether there is a loss on the trade and regardless of whether the disclosure is entirely correct but simply unclear. Nor has any exemption previously issued by the Department contained such a vague and subjective condition. These conditions are not administrable and therefore do not meet the standards for issuance of an exemption under section 408 of ERISA. If the Department insists on retaining compliance with a non-misleading disclosure condition in the exemption, we suggest instead that the Department explicitly adopt FINRA guidance relating to Rule 2210 regarding the term "misleading.[5] Because violation of a prohibited transaction exemption has such dire consequences, we do not believe that an inadvertent, immaterial statement taken in the wrong way by a client should result in a reversal of the transaction, a guarantee of losses and an excise tax on the entire principal amount. We ask that the provision be clarified to require that the financial institution and any adviser acting for that institution reasonably believe that their statements are not misleading.

Third, in section II(b), the financial institution and the adviser are required to affirmatively agree that they are fiduciaries with respect to any recommendations made to a retirement investor. That language is overbroad. It suggests that it can be *any* recommendation, not simply those

[5] See e.g, FINRA Frequently Asked Questions regarding Rule 2210. http://www.finra.org/industry/finra-rule-2210-questions-and-answers

which make a person a fiduciary under the proposed regulation, and regardless of whether the recommendation is made with respect to this account *or any other account of that person*. We would revise that section to read as follows:

> (b) Fiduciary. The written undertaking affirmatively states that the Financial Institution and any adviser acting for the financial institution are fiduciaries under ERISA or the Code, or both, with respect to any recommendation regarding Principal Transactions that meets the requirements of 29 CFR 2510.3-21 with respect to the specific account of the Retirement Investor to which the written undertaking is expressly applicable.

Fourth, we believe the language in the best interest standard for Title II plans needs to be changed. The proposed exemption requires advisers and financial institutions to prove that advice was given "without regard to the financial *or other interests of* the … [financial institution] or *any other party*." We do not know what these references to other interests and other parties mean and the preamble does not explain them. Given the risks of penalties for prohibited transactions and the threat of class action litigation for getting this wrong, we request that this language be deleted from the exemption.

Fifth, the standard requires that the advice be "without regard" to the financial interests of the adviser.[6] We are concerned that under this standard as written, an adviser will fail any time a plaintiff can prove that the adviser did not recommend the investment that paid him the least. FINRA uses a much more common sense test that does not contain this flaw: that the adviser make suitable recommendations based on the client's financial circumstances and needs and that the adviser put his client's interest before his own. We urge the Department to use this formulation. This formulation is found in supplementary guidance to FINRA Rule 2111 and we respectfully request that the Department use it here.[7]

[6] We note that FINRA's markup/markdown rules expressly include consideration of the cost to the financial institution of obtaining and carrying the security. . Rule 2121.01(b)(2)("in the case of an inactive security the effort and cost of buying or selling the security";) Does the Department's formulation make the FINRA requirement impossible?

[7] FINRA RN 12-25, A1 (December 2012).

Finally, we do not believe that the price formulation in this section of the proposed exemption has a common meaning that courts and arbitrators will be able to discern. Broker-dealers acting on a principal basis are required to establish policies, procedures and supervisory systems to meet the detailed, clear and unambiguous FINRA rules on pricing. Moreover, FINRA surveils prices regularly to be certain that its rules are being met. We recommend that the Department explicitly incorporate Rule 2121 into this exemption.

> FINRA Rule 2121. Fair Prices and Commissions
>
> In securities transactions, whether in "listed" or "unlisted" securities, if a member buys for his own account from his customer, or sells for his own account to his customer, he shall buy or sell at a price which is fair, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense involved, and the fact that he is entitled to a profit; and if he acts as agent for his customer in any such transaction, he shall not charge his customer more than a fair commission or service charge, taking into consideration all relevant circumstances, including market conditions with respect to such security at the time of the transaction, the expense of executing the order and the value of any service he may have rendered by reason of his experience in and knowledge of such security and the market therefor.

We believe that FINRA Rule 2121 is the appropriate standard for the market in general. Plans and IRAs should not be subject to a different and potentially inconsistent standard than nonretirement investors. Thus, we suggest that section II(c) should read as follows:

> (1) When providing investment advice within the meaning of 29 CFR 2510.3-21 to an account of a Retirement Investor that is subject to Title I of ERISA regarding the Principal Transaction, the Adviser will act in accordance with section 404 of ERISA. When providing investment advice within the meaning of 29 CFR 2510.3-21 to an account of a Retirement Investor that is not subject to Title I of ERISA regarding the Principal Transaction, the Adviser will provide investment advice that is in the Best Interest of the Retirement Investor (i.e., advice that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, and put the interests of the account before the interest of the Financial Institution, its Affiliates and the Adviser);

(2) The Adviser and Financial Institution will not enter into a Principal Transaction with the Plan, participant or beneficiary account, or IRA if the purchase or sales price of the Debt Security (including the mark-up or mark-down) is not a fair price within the meaning of FINRA Rule 2121; and

(3) The Adviser and Financial Institution reasonably believe that their statements about the Debt Security, fees, Material Conflicts of Interest, the Principal Transaction, and any other matters relevant to a Retirement Investor's investment decision in the Debt Security, are not misleading.[8]

The Four Contractual Warranties Are Not Workable

The proposed exemption also requires that the adviser and financial institution provide four warranties in the contract, each one enforceable in arbitration or in court through a class action, but not themselves a cause for denial of relief under the exemption if violated. We do not think it is possible to reasonably design a supervisory system or establish a set of policies and procedures which assures that, in every case, each warranty will be met. The Department has never, to our knowledge, created a set of conditions that requires no errors, no mistakes, and no violations.

The first warranty is problematic. It states that the adviser, financial institution and its affiliates will comply with all applicable federal and state laws regarding the rendering of the investment advice and the purchase and sale of the debt security. Fairly read, if the institution violates any FINRA rule, regardless of prompt correction, and regardless of how inconsequential the violation, it will violate this warranty, and be subject to potential class action litigation.[9] The existence of the warranty, and the threat of class action litigation, may well cause financial institutions to refuse to settle any allegation of wrongdoing for fear of violating this warranty. We believe a flat compliance standard with all federal and state laws is an inappropriate standard for an exemption with such harsh consequences for an inadvertent violation. We urge the

[8] See also the analogous MSRB rules found in Rules G-18 and G-30.

[9] All of the Department's exemption proposals are a stark departure from the administrable exemptions issued in the past, where the conditions were objective, and achievable, and did not create the possibility of missteps such as confirmation errors which could invalidate all relief under the exemption. This new approach of the Department makes all the exemptions impossible to comply with as a practical matter.

Department to clarify this provision by requiring policies and procedures that are "reasonably designed to achieve compliance with applicable law", which is the standard that FINRA uses in its Rule 3110. We also ask the Department to clarify that the affiliates' compliance is only required to the extent that the affiliate takes part in the transaction. We also note the Department lacks authority to restrict parties' agreement to arbitrate on a non-class basis.

The second warranty is that the financial institution has adopted written policies and procedures reasonably designed to mitigate the impact of Material Conflicts of Interest and to *ensure* that its individual Advisers adhere to the Impartial Conduct Standards. We note that the definition of Material Conflict of Interest has no materiality standard at all. Many firms would be compelled to try to cover every single potential conflict, no matter how small due to the risk of a claim later that an insignificant omission caused a breach of the warranty.[10] We urge the Department to add a materiality standard to the definition by amending the definition of "Material Conflict of Interest" to include the following underlined text: "A 'Material Conflict of Interest' exists when an Adviser or Financial Institution has a financial interest that, from the perspective of a reasonable person, could affect the exercise of its best judgment as a fiduciary in rendering advice to a Retirement Investor." In addition, the Department should make explicit that the phrase "reasonably designed to" modifies both mitigation of conflicts and adviser adherence. Otherwise, the financial institution's policies have to be perfect, which is not a real world concept and not used in any other DOL exemption. We also believe that a standard that the written policies and procedures will "ensure" individual advisors' adherence is impossible to meet. No policy and procedures can possibly be written to "ensure" adherence. We urge the Department to strike that requirement, or replace it with an achievable standard, such as "reasonably designed to meet the requirements of these warranties".

[10] We are concerned that a breach of warranty could entitle a plaintiff to void the transaction, effectively giving that individual a put back to the dealer for any transaction where the account suffered a loss, regardless of whether the loss is related to a perceived disclosure failure.

The third warranty requires that the financial institution has specifically identified Material Conflicts of Interest and adopted measures to prevent the Material Conflicts of Interest from causing violations of the Impartial Conduct Standards. We do not see how the second and third warranty differ and if they are not different, one should be deleted. In addition, the financial institution cannot possibly adopt measures that will "prevent" material conflicts of interest. These transactions are principal transactions between a plan or IRA and a fiduciary and by definition, a principal transaction is a counterparty transaction, which inherently contains a conflict of interest; thus the goal must be mitigation, not prevention of all conflicts. We urge the Department to change the term "prevent" to "mitigate".

The fourth and last warranty, common to all of the exemptions, provides that:

> Neither the Financial Institution nor (to the best of its knowledge) any Affiliate uses quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differentiated compensation[11] or other actions or incentives to the extent they would tend to encourage individual Advisers to make recommendations regarding Principal Transactions that are not in the Best Interest of the Retirement Investor.

While we appreciate that the Department believes that this language does not *necessarily* require level compensation, we respectfully disagree. That is the plain meaning of "differentiated compensation". Four out of the five examples in the preamble that are provided in order to illustrate this requirement provide for level compensation. The courts will look at the words "differential compensation" and will give those words their common sense meaning. We understand that the Department believes and hopes that the industry can come up with an alternative that neither requires level compensation or time billed by the hour, but this would be extremely difficult given the compensation model that has existed for decades in the industry. We do not believe that a flat compensation structure across all products is achievable and we do not believe that the Department has correctly assessed the costs of this requirement.

[11] We note that the BIC exemption uses the term "differential compensation" and this exemption uses the term "differentiated compensation". It is unclear whether there is a distinction intended by these word differences, and if so, what that distinction might be. As more fully explained in the body of the comment, SIFMA strongly objects to the level fee requirement of this warranty.

Compliance with this warranty will require financial institutions to entirely overhaul broker compensation practices to eliminate any financial professionals with IRA or other plan clients from a firm-wide bonus pool that reflects profitability of the entire firm, including retirement clients, and to exclude financial professionals from training programs if such training programs are sponsored or supported by a mutual fund complex or similar provider of investment offerings. Changes like these will take years to plan and implement. Financial institutions cannot renegotiate the contractual arrangements with third parties and vendors and alter the pay practices of every adviser in the 8 month period provided in the proposed exemption. Although the preamble indicates that the failure to comply with these warranties will not result in a loss of the exemption, the Department warns that it may well also breach the best interest standard which will result in loss of the exemption and excise taxes, as well as reversal of the trade.

In addition, any purported breach of any aspect of these four warranties in the IRA setting, no matter how insignificant, including the warranty regarding compensation policies and procedures, would be actionable under state contract law.[12] Given their resulting exposure to state court class actions for breach of warranty, SIFMA believes that its members may either terminate their relationships with smaller plans and IRAs, restrict their roles to order takers only, or offer only fee-based compensation arrangements to plans and IRAs where it is suitable to do so, simply to avoid the risks of litigation. As the head of FINRA noted quite recently:

> …I have practical concerns with the Labor proposal in a number of areas. First, the warranty and contractual mechanism employed by Labor used to address their limited IRA enforcement jurisdiction, appears to me to be problematic. In one sweeping step, this moves enforcement of these provisions to civil class action lawsuits or arbitrations where the legal focus must be on a contractual interpretation. I am not certain how a judicial arbiter would analyze whether a recommendation was in the best interests of the customer "without regard to the financial or other interests" of the service provider. I'm not sure, but I suspect, a

[12] *See* 80 Fed. Reg. at 21970 ("Failure to comply with the [policies and procedures] warranty could result in contractual liability for breach of warranty."); *id*. at 21972 ("The Department intends that all the contractual obligations (the Impartial Conduct Standards *and the warranties*) will be actionable by IRA owners.") (emphasis added).

> judicial arbiter might draw a sharp line prohibiting most products with higher financial incentives no matter how sound the recommendation might be. Similarly, I'm not sure how a judicial arbiter would evaluate which compensation practices "tend to encourage" violations of the exemption. It would appear likely, however, that firms would be required to demonstrate, at least, that any higher compensation was directly related to the time and expertise necessary to provide advice on the product, as specifically suggested by DOL. To say the least, making that case is not a simple proof standard.
>
> This all leads to my second concern that there is insufficient workable guidance provided either to the firm or the judicial arbiter on how to manage conflicts in most firms' present business models other than moving to pure asset-based fees, or a completely fee-neutral environment…. I fear that the uncertainties stemming from contractual analysis and the shortage of useful guidance will lead many firms to close their IRA business entirely or substantially constrain the clients that they will serve. Put another way, the subjective language of the PTE, coupled with a shortage of realistic guidance, may lead to few providers of these critical investor services.[13]

We believe that these concerns are well founded. Full and prominent disclosure, brought to the client's attention with some frequency, will do far more to shed light on fee differences, and educate clients regarding these differences, than arbitrarily banning fee differences in a business model that treats agency transaction compensation, principal transaction spreads, mutual fund fees and insurance company commissions differently. It is a not a "principles based" change to require this kind of massive overhaul in the way all brokers are compensated. In 2010, the Department suggested that it wanted a change in the law to make its enforcement program easier. We are worried that this proposed exemption has the same aim at a huge cost to the financial services industry, accomplished in a manner that is disruptive and will ultimately have a negative effect on retirement savings.

As the Department is well aware, the compensation paid to brokers differs *within asset types* and *across asset types*. It is not realistic to require a change of this magnitude in 8 months. We urge the Department to eliminate this provision. Failure to make some accommodation in this area

[13] https://www.finra.org/newsroom/speeches/052715-remarks-2015-finra-annual-conference

will cause dealers to refuse to use the exemption and to allow only third party transactions if they can be appropriately structured to be settled without going through a dealer's inventory. That cannot be in the interest of retirement investors. We urge the Department to recognize an even more fundamental consequence of these provisions. The sheer enormity of operationalizing these rules will likely cause financial professionals and the institutions who employ them to use wrap fees for these accounts, set high enough to be able to offset all transaction fees, and effect a dollar for dollar offset on third party payments. Principal transactions will be done with third party dealers who will charge a higher markup that likely reflects the fact that the trade is small, and the customer is not the third party dealer's own customer. Thus, the mark up inevitably will be higher than if the transaction had been done with the plan's own financial institution and the wrap fee will cover the additional transaction fees that the client would otherwise not have been required to pay. All in all, this will be a worse result for plans and neither protective of them nor in their interest. We strongly urge the Department to reconsider this requirement.

If the Department determines to proceed with this approach, we also ask the Department to delay the differential compensation rules for 36 months, which should give financial institutions the time to redesign their compensation programs, review all bonus and incentive programs, set new policies and procedures, retrain all necessary compliance, audit and risk teams, and put in new systems to accommodate these new rules.

Other Contract Disclosures

The contract must also contain disclosures regarding principal transactions in general, the client's consent to principal transactions, and the fact that the consent can be revoked. SIFMA has no comments on these requirements. The contract cannot contain (a) any exculpatory language or (b) any provision under which the plan, IRA or the retirement investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution. While we have no comment on the latter prohibited contract provision, the former is too broad. All contracts with customers disclaim liability for client-caused losses, losses caused by reliance on a client's misrepresentation, or losses caused by forces outside the financial institution's control such as force majeure, market failures, communication failures and the like. These are reasonable and standard contractual provisions found in commercial contracts. Without them, financial institutions will not do business with plans. We suggest that the Department revise this language to provide as follows:

> Exculpatory provisions disclaiming or otherwise limiting liability of the Adviser or Financial Institution for a breach of fiduciary duty under ERISA by the Adviser or the Financial Institution or a violation of the Best Interest Standard for plans not covered by Title I of ERISA.

<u>General Conditions</u>

The proposed rule covers only certain debt securities and fails to cover many other products transacted on a principal basis. The proposed exemption's "legal list" only permits debt securities and then only: (1) U.S. dollar denominated debt, issued by a U.S. corporation and offered pursuant to a registration statement under the Securities Act of 1933; (2) an "Agency Debt Security" as defined in FINRA Rule 6710(l) or its successor; or (3) a "U.S. Treasury Security" as defined in FINRA Rule 6710(p) or its successor. This list omits a vast array of securities which are commonly held by plans, including:

- equities,
- municipal bonds
- agency and GSE mortgage-backed securities guaranteed by Ginnie Mae, Fannie Mae or Freddie Mac,
- foreign corporate securities,
- preferred securities,
- unit investment trusts,
- debt issued by a charitable organization,
- foreign sovereign debt,
- certificates of deposit, and
- all equity or debt new issues where the financial institution is the underwriter or is a manager of the syndicate.

The Department's reason for this limitation is as follows:

> Under this rationale, however, the Department is not persuaded at this point that additional exemptive relief for principal transactions involving other types of assets would be in the interests of, and protective of, plans, their participants and beneficiaries and IRA owners. Equity securities, for example, are widely available through agency transactions that do not involve the particular conflicts of interest associated with principal transactions. Other assets such as futures, derivatives and currencies, may possess a level of complexity and risk that would require a retirement investor to rely heavily on a fiduciary's advice. In such cases, the Department is concerned that the class exemption proposed here would be insufficiently protective of plans, participants and beneficiaries, and IRA owners.
>
> The Department requests comment on the limitation of the proposed exemption to debt securities. Public input is requested on whether there are additional assets that are commonly held by plans, participant or beneficiary accounts, and IRAs that are sold primarily in principal transactions. Commenters should provide specifics about the characteristics of such assets and the proposed safeguards that would apply to an exemption permitting their sale in a principal transaction.

The reference to futures in the preamble is disconcerting, in that futures are not traded as principal. The Department, in dismissing the need for principal transactions in the equity markets, overlooks the NASDAQ requirement that market makers stand ready to trade for their own account to maintain a fair and orderly market. The Department does not address the fact that many of these investments are already held in plans and IRAs, nor the cost of the rule when those existing investments cannot be sold on a principal basis to one's financial institution.

We urge the Department, especially with respect to an exemption that does not merely apply to retail investors but to the largest institutional accounts, to provide leeway on securities that can be purchased from a plan or IRA's financial institution. In the absence of this flexibility, plans will not be able to purchase these securities at all, or will have to purchase and sell these assets on an agency basis, and pay significantly more for them. They surely will not be able to participate in any block trades to obtain maximum price efficiency because the Department's rules are so inconsistent with the FINRA requirements and will require that plan and IRA trades be executed by themselves. The Department, and the Secretary on the Department's behalf, have consistently argued that the purpose of these rules is to make sure that service providers to plans and IRAs put their clients' interests first, and to make sure that this fiduciary standard is enforceable. Nowhere has the Department or the Secretary said that the purpose of the rule is to make sure that plans either do not hold particular securities, or do not buy them in the most efficient way. Nor do we think that is the Department's goal. But it surely will be the result here.

Municipal Bonds

Municipal securities are debt obligations issued by states, cities, counties, and other public entities that use the loans to fund public projects, such as the construction of schools, hospitals, highways, sewers, and universities. Municipal securities can be bought either as new issues that are sold by underwriters to investors or can be purchased in the secondary market where they are traded over-the-counter. Municipal securities are heavily regulated by the SEC, FINRA and the MSRB, which is charged under the Securities and Exchange Act to propose rules governing the municipal securities markets[14]. The MSRB also maintains a data base to provide transparency on bond prices.

The absence of municipal securities from the list of "Assets" is troublesome. Taxable and tax exempt municipal bonds are held by many retirement investors because they provide relatively high returns with moderate risk.   The preamble is silent on why municipal bonds may not be purchased in a principal transaction from the financial institution. We do not believe that anyone would suggest that they possess a level of complexity or risk that would require heavy reliance of

[14] The MSRB protects investors, state and local governments and other municipal entities, and the public interest by promoting a fair and efficient municipal securities market. The MSRB fulfills this mission by regulating the municipal securities firms, banks and municipal advisors that engage in municipal securities and advisory activities. To further protect market participants, the MSRB provides market transparency through its Electronic Municipal Market Access (EMMA®) website, the official repository for information on all municipal bonds. The MSRB also serves as an objective resource on the municipal market, conducts extensive education and outreach to market stakeholders, and provides market leadership on key issues. The MSRB is a Congressionally-chartered, self-regulatory organization governed by a 21-member board of directors that has a majority of public members, in addition to representatives of regulated entities. The MSRB is subject to oversight by the Securities and Exchange Commission.

an investment professional similar to derivatives. Thus, the Department's limitation on municipal bonds is unexplained.

The municipal bond market is a dealer market. The bulk of the bonds offered for sale via any online bond search are typically owned by dealers. Municipal securities can play an important role in retirement accounts, both on a taxable and non-taxable basis. Taxable municipal bonds, such as the Build America Bonds, are not exempt from federal, state or local taxes. Depending on a number of factors including, the interest rate environment, offered yield, potential need for diversification of credit, and individual tax situation, it may be in the retirement investor's best interest to hold a taxable municipal bond in their IRA. We acknowledge that taxable municipal bonds are more typically purchased in retirement accounts as compared to tax-exempt bonds, which are exempt from federal, state or local taxes. However, on an absolute yield basis, tax-exempt municipal bonds may be appropriate for retirement investors during certain time periods in the market. We do not believe that substitution of the Department's investment judgment on this issue is appropriate and we believe that requiring these bonds to be purchased and sold in agency transactions can only hurt plans. Rather than effectively limiting retirement investors' access to these securities, we recommend that the determination of whether an investment in a municipal security is in a retirement investors' best interest be left to financial institutions and advisers who have a better understanding of the individual needs of the retirement investors they serve. We recommend the Department include municipal securities in the definition of debt security in the proposed exemption, subject to the existing section 404 standards for ERISA plans and a fiduciary best interest standard in the proposed exemption for IRAs.

Currencies

The reference to currencies as possessing a level of complexity and risk that would require a plan to rely heavily on a fiduciary's advice is perplexing. Currency prices are broadly quoted, and transparent. We do not understand any perception of complexity and risk for currencies. Even retail accounts buy and sell foreign securities daily and buy and sell the currencies necessary to settle these trades. These are not investment trades or speculative trades. They simply accommodate the client's interest in investing in a foreign market. Even the largest plans and the most sophisticated accounts will be unable to purchase currency from their own financial institution, leaving them to attempt to purchase odd lots from a third party dealer at rates potentially less favorable than the rates they can receive from their own financial institution. We do not think this restriction is in the interest of any plan.

Foreign Securities

In addition, the proposed exemption, taken together with the BIC exemption, effectively bans all foreign securities from IRAs and 401(k) accounts since they cannot be bought as agent in a retail account under the BIC exemption and they cannot be bought as principal under this exemption. It is an extraordinary restriction. In SIFMA's comments on the BIC exemption, we are urging the Department to permit foreign securities. We hope that whatever bias the Department has against global investing can be overcome. Assuming it can, this exemption absolutely must cover currency or plans and IRAs will be left to purchase currency in odd lots from third party dealers.

Brokered Certificates of Deposit

We also urge the Department to add brokered certificates of deposit to the list of assets, assuming the Department is unwilling to eliminate its "legal list" construct. Brokered CDs (CDs from third party financial institutions) are most often sold as principal and without this relief, this safe and appropriate investment generally will not be available to IRAs and plans. This omission is particularly glaring because the Department has chosen to include CDs in the list of permitted "Assets" for the Best Interest Contract Exemption. There is no rational basis for the Department to conclude that CDs are appropriate for the Best Interest Contract Exemption but not appropriate for the Principal Transactions Exemption.

Unit Investment Trusts

We urge the Department to permit unit investment trusts to be sold to plans under this exemption. Unit investment trusts are transparent investment vehicles that maintain the same investment mix for their term, allowing investors to understand exactly what the investment mix in the trust will be for the entire holding period. Thus, in a way they are like an actively managed product in that the security mix need not track an index but like a passive investment in that there is very little trading activity and transaction cost within the trust. The unit investment trusts are regulated by the SEC under the Securities Act of 1933 and the Investment Advisors Act and are accompanied by a prospectus clearly setting out all fees, both internal to the trusts and payable to financial intermediaries. They are generally sponsored by large investment managers. While these unit investment trusts can be purchased in an agency transaction, there are several cost savings inherent in the principal process. We would be happy to talk to the Department further about these vehicles.

Equities and Debt New Issues

The Department, in dismissing the need for principal transactions in the equity markets, overlooks the NASDAQ requirement that market makers stand ready to trade for their own account to maintain a fair and orderly market.

In addition, although equities may be available on an agency basis, it is not true for new issues. And of course, new issues of debt will also be prohibited in this exemption for any broker whose own financial institution is in the underwriting syndicate. Excluding these equity and debt securities from the exemption denies access to these securities altogether. For most IRA and small plan clients, their only ability to purchase these newly issued securities is from their financial institution. No other institution is likely to share these limited securities with a small account that is not a client. It will be a significant enough effort to explain to existing clients the new rules, the new fees, and the new disclosures. It will be virtually impossible to make clients understand that these products they have always been able to buy because of their relationship with a financial professional, are suddenly unavailable to them. They will not see this regulation as protective; they will see it as the Department substituting its judgment for that of retirement investors who have chosen to seek out these new issues for good investment reasons. The risks are fully disclosed to the investor prior to the time that the order is placed. We disagree with the Department that retirement accounts should not buy new issues. Had this rule been in effect over the last 10 years, IRAs and plan participants who maintain accounts at large broker-dealers would not have been able to purchase shares of Apple, Amazon, Google, GoPro, or the biotech issues in the initial public offering and the only explanation for the limitation on their investment gain is that they are no longer permitted to have a brokerage account. The result of these limitations is that retirement accounts will be forced to sit out some of the most successful equity and debt offerings over the last several years because the Department appears to think these issues are speculative.

The preamble gives no reason at all for this restriction and the reasons for it are not evident. With disclosure of the risks, the conflicts of interests and the fees to be earned by the underwriters, we do not understand the reason for the prohibition. It is disheartening that with all of the disclosure of direct and indirect fees, the requirements to identify and disclose conflicts of interest, and with the best interest standard in place, the Department is still unprepared to allow retirement investors to make their own investment choices, regardless of the size of the account or the sophistication of the fiduciary. We do not believe the Department has the statutory or legal authority to specify what retirement accounts can invest in.[15] Had Congress wanted to place investment restrictions on plans, it would have done so, as it did in Code Section 408 for IRAs. Because there are no such prohibitions in ERISA, we question the Department's ability to

[15] We do not believe that the Department has the authority to limit investments of plans and IRAs through the exemption process when Congress clearly intended these products to be available in the market place to these retirement accounts on the same footing as other investors. Section 408 permits the Department to grant an exemption if it is in the interest of plans and protective of them. The "protective" standard does not assume that retirement investors are so unfamiliar with the markets that anything other than highly rated, liquid bonds can be sold as principal.

impose them now through the exemption process. We also question the Department's ability to expand the list of prohibited investments for IRAs given the language in Code Section 408 which does not restrict any of the securities prohibited under this proposed exemption.

Financial Institution Debt

Within the limited list permitted by the Department, financial institution debt is specifically excluded. We urge the Department to reconsider financial institution debt. These debt instruments are generally highly rated, and in some cases, even provide principal protection. There is absolutely no evidence that we know of that would suggest that financial institutions imprudently cause plans to purchase their own debt. Many retirement accounts have long held these instruments, and they will not understand why they will no longer be able to do so. As noted earlier, they will see this as the Government restricting what they can own in their retirement account. Financial institutions also often offer their debt that has been developed as solutions to meet their clients' investment objectives. For example a financial institution might provide limited exposure to an equity index through the coupon on the debt while also protecting the principal of the investment. These valued products and solutions will now be off limits to retirement accounts, because it can neither be purchased under this exemption or under the BIC exemption. Nor has the Department considered in its cost estimates the effect on the capital markets when IRAs and plan participants have to sell all these debt instruments precipitously and immediately. The effect on these institutions and the capital markets would be significant. Finally, we reiterate our concern that this exemption covers all retirement plans, not just retail investors. We see no reason why financial institution debt of one's own financial institution cannot be sold as principal by a financial institution, or purchased at all by IRAs and participants in 401(k) plans. Even for the largest plans, this restriction leaves retirement accounts to buy these instruments from third party dealers at higher prices with commissions.

Agency and GSE Guaranteed Mortgage-Backed Securities (Agency MBS)

The proposed exemption also does not permit a principal transaction in agency-guaranteed MBS. These MBS are guaranteed by Ginnie Mae (a government agency), Fannie Mae and Freddie Mac (each, a government sponsored enterprise), and therefore present identical or superior (in the case of explicitly government-guaranteed Ginnie Mae MBS) credit risk as Agency debentures which are permitted under the proposed exemption (and share the same 20% risk weight under bank regulatory capital rules). Agency MBS, however, are *far* more liquid than agency debentures. In 2014, the average daily trading volume of agency MBS was $177.9 billion. In contrast, the average daily trading volume for debentures in 2014 was $5.3 billion. For reference, the same average for corporate debt was $19.9 billion, and for US Treasury securities, $505.4 billion. Agency MBS *are the second most liquid fixed-income security in the US*.[16] They are held by millions of retirement accounts. Given that liquidity and credit risk are factors in the inclusion of asset classes in this exemption, agency MBS should be allowed under the exemption. The criteria set forth by the Department do not justify the exclusion of agency MBS.

The Result of These Restrictions

We are mystified at the Department's picking and choosing among securities, blessing some and nixing others. No basis is provided in the preamble or elsewhere for the Department's choices. There is no evidence that the Department considered the knock on effect of its "legal lists" on the capital markets. Nor does the Department consider the effect on the mortgage market if all IRA holders of these securities are compelled to liquidate their holdings in 8 months. Moreover, the Department is moving away from its principles based exemptions like QPAM, toward exemptions that will quickly become outdated as new products are introduced to the markets that may be better, safer, more efficient, and/or more flexible. In 1975, there were no ETFs. If Congress or the Department had had a "legal list" of permissible securities, how long would it

[16] See http://www.sifma.org/uploadedFiles/Research/Statistics/StatisticsFiles/CM-US-Bond-Market-Trading-Volume-SIFMA.xls?n=30624 for details.

have taken for the Department to amend its exemptions to add ETFs, other new products and new innovative products in the future? We think this is a bad approach, for the markets in general and for retirement investors in particular. Unless the Department has no faith in its fiduciary rule, and in its impartial conduct standards, it should leave the investment choices to retirement investors.

Other Conditions

With respect to the quite minimal list of securities remaining, the proposed exemption requires that the debt security possesses no greater than a moderate credit risk and is sufficiently liquid that the Debt Security could be sold at or near its fair market value within a reasonably short period of time. We are concerned that with this further restriction, the Department is ignoring sales from plans. Moreover, it is undercutting its own best interest standard. It may well be that clients choose to purchase high yield securities, or are prepared to give up liquidity temporarily in a retirement account where they may not need liquidity for 25 years or where bonds are intended to be held to maturity.

Additionally, it would be operationally impossible to obtain precise and timely credit risk ratings for all debt securities at the point of sale due to the dynamic nature of the market. As noted in a Deloitte report assessing the anticipated operational impact of the proposed rule, depending on the specific debt security, there will be limited consistency in determining ratings as a result of securities not being rated at all, or the rating being outdated. As a result of liquidity being a point of time determination, concluding if a debt security is "sufficiently liquid" will be difficult and subjective. Furthermore, financial market fluctuations will create situations where there are changes to prices, credit ratings or liquidity conditions in the time between the initial transaction disclosure recommendation and the customer's decision to execute the transaction. For the firm to stay in compliance with the exemption, the investment professional would be required to perform additional disclosures if prices, credit ratings or liquidity changes during this time period. Delays caused from performing repetitive disclosure process may have unintended harmful consequences to customers such as best execution requirements and pricing disparities.

Moreover, in defining these terms, the Department uses terminology borrowed from a totally different regulatory regime created for a different purpose and then substitutes different words to make the terms incomprehensible. Even if the wording can be corrected, this sets up a speculative, forward looking test that no one can be assured of meeting, and takes a standard that is potentially relevant to a securities purchase and applies it as well to sales, when the investor's needs may be quite different – liquidating a poor credit risk or an illiquid investment.

The standard used in the proposed exemption -- no greater than a moderate credit risk and is sufficiently liquid that the debt security could be sold at or near its fair market value within a reasonably short period of time -- is similar to that used by the SEC but for an entirely different purpose. Indeed, there is no similar restriction for retail or institutional accounts under the securities laws relating to risk or liquidity and we believe it is inappropriate for this exemption to have such a restriction.

The language in the proposed exemption is borrowed from the Investment Company Act and we do not think it is an apt reference here. The standard that the Department has borrowed from the securities laws relates to business and industrial development companies ("BIDCOs"), which may be deemed to be investment companies under the Investment Company Act of 1940 because they invest in securities. BIDCOs are companies that operate under state statutes that provide direct investment and loan financing, as well as managerial assistance, to state and local enterprises. Section 6(a)(5) of the Investment Company Act exempts BIDCOs from most provisions of that Act subject to certain conditions ("BIDCO exemption"). One of these conditions permits BIDCOs to purchase debt securities issued by an investment company or private fund (*e.g.*, hedge fund) if the debt security meets a standard of credit-worthiness established by the Commission. On November 19, 2012, the Commission adopted rule 6a-5 to establish this credit quality standard. Rule 6a-5 was effective on December 24, 2012. As is clear, the purpose of the rule has nothing to do with retirement investors, and is directed instead at an entirely different purpose.

More troublesome is that the Department has changed the SEC definition in a way that makes less sense and seems circular. Rule 6a-5 provides that the debt instrument is subject to no greater than moderate credit risk and sufficiently liquid that it can be sold at or near its *carrying value* within a reasonably short period of time. The Department has replaced "carrying value" with "fair market value." Since fair market value is the price that can be obtained in the market, and one will not know what price is obtainable in the market until one attempts to sell it, it is hard to imagine how one will meet this condition. The SEC formulation at least permits the BIDCO to look at daily carrying values rather than an unpredictable market standard.

The SEC guidance is far clearer. The rule explanation notes:

> In making credit quality determinations, a BIDCO's board of directors or members (or its or their delegate) can also consider credit quality reports prepared by outside sources, including ratings of a nationally recognized statistical rating organization ("NRSRO") that the BIDCO board or members conclude are credible and reliable for credit quality determinations.
>
> As a result of rule 6a-5, section 6(a)(5) also limits a BIDCO's investments in mutual funds to mutual funds that invest at least 65% of their assets in debt securities issued by investment companies or private funds that meet the credit quality standard in rule 6a-5.

Thus, even the standard applicable to BIDCOs does not require that all of its debt securities meet this credit and liquidity standard. We urge the Department to eliminate this standard and not further limit the debt securities that a plan participant, plan or IRA can purchase on a principal basis. As noted above, unless the Department has no faith in the impartial conduct standards and the new fiduciary rule, it should not micromanage what retirement investors can invest in and how those transactions can be effected.

But even more critical is that this condition applies to purchases and sales, ignoring the fact that financial institutions are relied on by their clients and by the SEC and FINRA to effect facilitation trades for clients who want to liquidate securities and are unable to do so with a third party. This condition would not only preclude all principal transactions except for the categories of securities that the Department's staff is comfortable with (keeping in mind that they are not familiar with the markets and have no general authority to regulate those markets), but then only if the securities are "no greater than a moderate credit risk and [are] sufficiently liquid that the Debt Security could be sold at or near its fair market value within a reasonably short period of time". We urge the Department to eliminate this condition entirely, and to expressly provide that a financial institution can facilitate a trade as principal in any security, at the client's direction, if the financial institution reasonably believes that it can offer a better price than is being offered from public sources such as alternative trading systems, Bonddesk and the like.

Pricing

The proposed exemption requires that the purchase or sale be executed at a price that the adviser and the financial institution reasonably believe is at least as favorable to the plan as the price available to the plan in a transaction that is not a principal transaction. We do not object to this.[17] But the Department goes on to require that the price be at least as favorable to the plan as the contemporaneous price for the Debt Security, or a similar security if a price is not available with respect to the same Debt Security, offered by two ready and willing counterparties that are not Affiliates.[18]

This provision ignores anonymous trading systems such as Bonddesk, although SIFMA facilitated meetings between the Department and Bonddesk in 2011. It assumes that two prices

[17] We note that the Department permits the comparison to be made against a trade away, with commission and markup or markdown from the third party dealer. "When comparing the price offered by the counterparties referred to in (2), the Adviser and Financial Institution may take into account a commission as part of the resulting price to the Plan, participant or beneficiary account, or IRA, as compared to the price of the Debt Security, including any mark-up or mark-down." This provision is appropriate.

[18] We note that FINRA, in the past, used a "3 quote" rule under 5310, but FINRA removed that requirement and replaced it with reasonable diligence, rigorous and regular review, and similar requirements. At that time, FINRA found the costs associated with the delay would not be beneficial to investors.

can be obtained, and that the dealer quoting these prices stands ready to transact at these prices, assuming also that the plan client is waiting by his phone or computer for a call back from his financial professional and nearly simultaneously, approves one of the trade prices which has not moved. More likely, hours will have gone by, dealers will no longer be willing to transact at those prices, and the process must be restarted. This will be a very inefficient process and will result in retirement investors receiving worse execution and suffering from less liquidity than non-retirement accounts. These assumptions are not based on how the markets operate, and reflect the Department's lack of understanding of market practice. The Department is intending to change how markets operate, but the markets will only be changed for retirement investors -- and not positively at that. We urge the Department to rethink this condition, replacing it with a condition that the financial professional reasonably believes it is offering a fair price under FINRA Rule 2121, and requiring the financial institution to provide evidence of other prices in the security that day upon request.

The fair pricing rules of FINRA, which should be incorporated explicitly into the proposed exemption incorporate a variety of factors and do not suggest that only a rigid "two quotes" rule is protective. The Department does not explain why these FINRA pricing rules are inadequate or unprotective. They are the rules that apply to these same customers as retail customers of financial institutions subject to FINRA supervision and the rules that apply to third party dealers who will, in the absence of adequate relief in this regulation, be selling these same instruments to all plans, from sophisticated institutional accounts to retail accounts.

Moreover, the two quote requirement actually hurts plans holding illiquid securities. This condition of the proposed exemption would not permit a sale of a security to the financial institution in a situation where the financial institution is acting as a liquidity provider, and where no one else stands ready to buy the security. We cannot understand why this condition is in the interest of plans and we urge the Department to permit sales to a financial institution where two quotes are not available and the financial institution reasonably determines that it is offering a fair price to the investor.

At the most basic level, the question being raised by the Department in the two quote requirement is the fairness of the price. However, the Department chooses to not acknowledge FINRA's extraordinarily detailed guidance on pricing. See FINRA Rule 2121. In addition, FINRA surveils prices and requires financial institutions to justify any prices that FINRA believes could be outside a reasonable market range. Dealers are further subject to a best execution standard that buttresses the fair pricing standard (see FINRA rule 5310). Tools exist today for price discovery and they are readily available and subject to continual improvements. It would be far better for participants to see how the security they are buying or selling is trading in the market, rather than seeing two indicative quotes that may not be available when the client approves the trade. TRACE, FINRA's online reporting system, provides much of that transparency to an ordinary investor. Other large firms have similarly comprehensive pricing history on their websites.

> TRACE was established in July 2002 to create a regulatory database and bring transparency to the corporate bond market. Transparency in non-144A transactions was fully phased in by January 2006, offering real-time, public dissemination of transaction and price data for all publicly traded corporate bonds—including intra-day transaction data and aggregate end-of-day statistics (most active bonds, total volume, advances and declines, and new highs and lows). Transparency in 144A transactions in corporate debt was added on June 30, 2014. Agency debentures were added in March of 2010 and are subject to real-time dissemination. On November 12, 2012, FINRA began disseminating transaction information for agency pass-through mortgage-backed securities traded "to-be-announced" (TBA). FINRA began disseminating information for so-called specified pool transactions in agency pass-through mortgage-backed securities and SBA-backed securities in July 2013. On June 1, 2015, FINRA brought transparency to the asset-backed securities market, providing investors with post-trade price information for asset-

backed securities, including those backed by auto loans, credit card receivables and student loans.[19]

In summary, we do not believe that the two quote requirement is workable or in the interest of retirement investors. We are concerned about the lost opportunities for the retail investor, the consequences of the timing of the disclosures, and the pricing issues, including whether this process is consistent with the duty of best execution.

Markup and Markdown Disclosure

We urge the Department to eliminate the requirement that a markup or markdown must be disclosed. A markup or markdown could be based on many different factors, including depth of inventory, access to the security in the market at a particular time and risk. Commissions, in contrast, are shown on confirms, available upon request, disclosed as part of the section 408(b)(2) disclosure, and generally quite transparent. We believe that the reference point for the Department to focus on is the price, which will be provided to the client before the transaction, and on the confirm after the transaction. It will be confusing to retail investors to see a price, which already reflects the markup or markdown, and then the markup or markdown separately. Retirement investors will not receive it when the transaction is effected with a third party even though there will be both a markup and a commission on that trade.

While the SEC and FINRA have detailed rules relating to markups and markdowns, there is no current requirement that markups and markdowns be disclosed. The FINRA rules reflect the nuances of a regulatory authority very familiar with the markets. They are detailed and comprehensive. We urge the Department to allow FINRA to take the lead here as they consider the appropriate disclosure regime. As one can see from FINRA Notice 14-52 relating to matched trades, it took 13 examples to explain how the proposed rule's markup disclosure rule for matched trades would work in the real world. Some of the examples rely on weighted averages,

[19] FINRA, FINRA Solicits Comment on New Academic TRACE Data Set, July 16, 2015, http://www.finra.org/newsroom/2015/finra-solicits-comment-new-academic-trace-data-set (last visited July 20, 2015)

others on "last in first out." The comments received by FINRA reflect real concern that these somewhat arbitrary calculation rules don't work. Simply announcing that markups and markdowns should be disclosed, as the Department has done, without defining those terms, and without providing any methodology for calculating markups and markdowns, will create confusion and chaos, with every dealer calculating markups and markdowns differently, subject to the prohibited transaction penalty requiring reversal of the trade, guarantee of any loss, and payment of an excise tax on the entire principal amount. The more likely result is that no one will take the chance that their calculation of the markup or markdown will be deemed to be "wrong". Dealers will not transact on a principal basis with plans if they are required to provide markup and markdown information that is entirely undefined, for fear of losing the exemptive relief they need.

Annual Disclosure and Additional Disclosure on Request

We believe that the annual disclosure is duplicative of the pre-transaction disclosure and post-transaction confirmation disclosure. The proposed rule requires that all transactions be reported to the client within 45 days after the end of a calendar year. In the event the department is determined to proceed with an annual disclosure requirement, we believe 45 days is too short a period of time to provide this information to all the financial institution's retirement clients. SIFMA members generally provide this kind of reporting, at least in the retail setting, within 90 days after the end of the calendar year. We respectfully request a 90 day period to provide this report. With respect to the content of the report, we do not understand some of the language used in the requirement and would appreciate clarification. The report requires:

> (1) A list identifying each Principal Transaction engaged in during the applicable period, the prevailing market price at which the Debt Security was purchased or sold, and the applicable mark-up or mark-down or other payment for each Debt Security; and

We are not certain what the Department means by "the prevailing market price at which the Debt Security was purchased or sold". As noted above, the prevailing market price is the price *from* *which* the client price is calculated.[20] Thus, by definition, the prevailing market price is not the price at which the debt security was purchased from or sold to a retirement investor. We believe that the sentence should be clarified to read: "the price at which the Debt Security was purchased or sold". And again, we believe it is not appropriate to require the disclosure of the markup or markdown for the reasons described elsewhere in this comment.

The proposed exemption also requires that upon request, apparently at any time prior to the end of the six year period following the purchase or sale, the financial institution must provide any information at all about the debt security and its purchase or sale. We strongly urge the Department to provide a "reasonably available" and an "in its possession" modifier.

> (d) Upon Request. Upon the Retirement Investor's reasonable request, prior to or following the completion of a Principal Transaction, the Adviser or Financial Institution must provide the Retirement Investor with *reasonably available* additional information *in its possession* regarding the Debt Security and its purchase or sale; provided that such request may not relate to a Principal Transaction that was executed more than six (6) years from the date of the request.

Otherwise, the financial institution could be required to fully research anything the client wants to know about the issuer, or capture all transactions in the security, or some other arduous and unique request. In addition, the proposed exemption should permit a reasonable charge for the information. In the absence of such a reasonable charge, the price of the advisory services will be increased to anticipate such requests.

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[20] FINRA Rule 2121, section .02:

> (b) Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this Supplementary Material .02, the prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with FINRA pricing rules. (See, e.g., Rule 5310).

We assume that these disclosure provisions relate only to transactions made in connection with the provision of investment advice and that where the dealer is not acting as a fiduciary, the conditions of other exemptions apply. We ask the Department to clarify this point in any final rulemaking.

We appreciate the Department's consideration of this comment, and are grateful for the Department's willingness to receive additional information regarding principal transactions. We are happy to meet with the Department at its convenience. For further discussion, please contact the undersigned at 202-962-7329.

Sincerely,

Lisa J. Bleier

Lisa J. Bleier
Managing Director, Federal Government Relations
and Associate General Counsel

FINRA Appendix

(b) Prevailing Market Price

(1) A dealer that is acting in a principal capacity in a transaction with a customer and is charging a mark-up or mark-down must mark-up or mark-down the transaction from the prevailing market price. Presumptively for purposes of this Supplementary Material .02, the prevailing market price for a debt security is established by referring to the dealer's contemporaneous cost as incurred, or contemporaneous proceeds as obtained, consistent with FINRA pricing rules. (See, *e.g.*, Rule 5310).

(2) When the dealer is selling the security to a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous purchases in the security or can show that in the particular circumstances the dealer's contemporaneous cost is not indicative of the prevailing market price. When the dealer is buying the security from a customer, countervailing evidence of the prevailing market price may be considered only where the dealer made no contemporaneous sales in the security or can show that in the particular circumstances the dealer's contemporaneous proceeds are not indicative of the prevailing market price.

(3) A dealer's cost is considered contemporaneous if the transaction occurs close enough in time to the subject transaction that it would reasonably be expected to reflect the current market price for the security. (Where a mark-down is being calculated, a dealer's proceeds would be considered contemporaneous if the transaction from which the proceeds result occurs close enough in time to the subject transaction that such proceeds would reasonably be expected to reflect the current market price for the security.)

(4) A dealer that effects a transaction in debt securities with a customer and identifies the prevailing market price using a measure other than the dealer's own contemporaneous cost (or, in a mark-down, the dealer's own proceeds) must be prepared to provide evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or, the dealer's proceeds) provides the best measure of the prevailing market price. A dealer may be able to show that its contemporaneous cost is (or proceeds are) not indicative of prevailing market price, and thus overcome the presumption, in instances where (i) interest rates changed after the dealer's contemporaneous transaction to a degree that such change would reasonably cause a change in debt securities pricing; (ii) the credit quality of the debt security changed significantly after the dealer's contemporaneous transaction; or (iii) news was issued or otherwise distributed and known to the marketplace that had an effect on the perceived value of the debt security after the dealer's contemporaneous transaction.

(5) In instances where the dealer has established that the dealer's cost is (or, in a mark-down, proceeds are) no longer contemporaneous, or where the dealer has presented evidence that is sufficient to overcome the presumption that the dealer's contemporaneous cost (or proceeds) provides the best measure of the prevailing market price, such as those instances described in (b)(4)(i), (ii) and (iii), a member must consider, in the order listed, the following types of pricing information to determine prevailing market price:

(A) Prices of any contemporaneous inter-dealer transactions in the security in question;

(B) In the absence of transactions described in (A), prices of contemporaneous dealer purchases (sales) in the security in question from (to) institutional accounts with which any dealer regularly effects transactions in the same security; or

(C) In the absence of transactions described in (A) and (B), for actively traded securities, contemporaneous bid (offer) quotations for the security in question made through an inter-dealer mechanism, through which transactions generally occur at the displayed quotations.

(A member may consider a succeeding category of pricing information only when the prior category does not generate relevant pricing information (*e.g.*, a member may consider pricing information under (B) only after the member has determined, after applying (A), that there are no contemporaneous inter-dealer transactions in the same security).) In reviewing the pricing information available within each category, the relative weight, for purposes of identifying prevailing market price, of such information (i.e., either a particular transaction price, or, in (C) above, a particular quotation) depends on the facts and circumstances of the comparison transaction or quotation (i.e., such as whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction and timeliness of the information).

(6) In the event that, in particular circumstances, the above factors are not available, other factors that may be taken into consideration for the purpose of establishing the price from which a customer mark-up (mark-down) may be calculated, include but are not limited to:

• Prices of contemporaneous inter-dealer transactions in a “similar” security, as defined below, or prices of contemporaneous dealer purchase (sale) transactions in a “similar” security with institutional accounts with which any dealer regularly effects transactions in the “similar” security with respect to customer mark-ups (mark-downs);

• Yields calculated from prices of contemporaneous inter-dealer transactions in "similar" securities;

• Yields calculated from prices of contemporaneous dealer purchase (sale) transactions with institutional accounts with which any dealer regularly effects transactions in "similar" securities with respect to customer mark-ups (mark-downs); and

• Yields calculated from validated contemporaneous inter-dealer bid (offer) quotations in "similar" securities for customer mark-ups (mark-downs).

The relative weight, for purposes of identifying prevailing market price, of the pricing information obtained from the factors set forth above depends on the facts and circumstances surrounding the comparison transaction (i.e., whether the dealer in the comparison transaction was on the same side of the market as the dealer is in the subject transaction, timeliness of the information, and, with respect to the final factor listed above, the relative spread of the quotations in the similar security to the quotations in the subject security).

(7) Finally, if information concerning the prevailing market price of the subject security cannot be obtained by applying any of the above factors, FINRA or its members may consider as a factor in assessing the prevailing market price of a debt security the prices or yields derived from economic models (*e.g.*, discounted cash flow models) that take into account measures such as credit quality, interest rates, industry sector, time to maturity, call provisions and any other embedded options, coupon rate, and face value; and consider all applicable pricing terms and conventions (*e.g.*, coupon frequency and accrual methods). Such models currently may be in use by bond dealers or may be specifically developed by regulators for surveillance purposes.

(8) Because the ultimate evidentiary issue is the prevailing market price, isolated transactions or isolated quotations generally will have little or no weight or relevance in establishing prevailing market price. For example, in considering yields of "similar" securities, except in extraordinary circumstances, members may not rely exclusively on isolated transactions or a limited number of transactions that are not fairly representative of the yields of transactions in "similar" securities taken as a whole.

(9) "Customer," for purposes of Rule 2121, Supplementary Material .01 to Rule 2121 and this Supplementary Material .02, shall not include a qualified institutional buyer ("QIB") as defined in Rule 144A under the Securities Act of 1933 that is purchasing or selling a non-investment grade debt security when the dealer has determined, after considering the factors set forth in Rule 2111(b), that the QIB has the capacity to evaluate independently the investment risk and in fact is exercising independent judgment in deciding to enter into the transaction. For purposes of Rule 2121, Supplementary Material .01 to Rule 2121 and this Supplementary Material .02, "non-investment grade debt security" means a debt security that: (i) if rated by only one nationally recognized statistical rating organization ("NRSRO"), is rated lower than one of the four highest generic rating categories; (ii) if

rated by more than one NRSRO, is rated lower than one of the four highest generic rating categories by any of the NRSROs; or (iii) if unrated, either was analyzed as a non-investment grade debt security by the dealer and the dealer retains credit evaluation documentation and demonstrates to FINRA (using credit evaluation or other demonstrable criteria) that the credit quality of the security is, in fact, equivalent to a non-investment grade debt security, or was initially offered and sold and continues to be offered and sold pursuant to an exemption from registration under the Securities Act of 1933.

(c) "Similar" Securities

(1) A "similar" security should be sufficiently similar to the subject security that it would serve as a reasonable alternative investment to the investor. At a minimum, the security or securities should be sufficiently similar that a market yield for the subject security can be fairly estimated from the yields of the "similar" security or securities. Where a security has several components, appropriate consideration may also be given to the prices or yields of the various components of the security.

(2) The degree to which a security is "similar," as that term is used in this Supplementary Material .02, to the subject security may be determined by factors that include but are not limited to the following:

(A) Credit quality considerations, such as whether the security is issued by the same or similar entity, bears the same or similar credit rating, or is supported by a similarly strong guarantee or collateral as the subject security (to the extent securities of other issuers are designated as “similar” securities, significant recent information of either issuer that is not yet incorporated in credit ratings should be considered (*e.g.*, changes to ratings outlooks));

(B) The extent to which the spread (i.e., the spread over U.S. Treasury securities of a similar duration) at which the “similar” security trades is comparable to the spread at which the subject security trades;

(C) General structural characteristics and provisions of the issue, such as coupon, maturity, duration, complexity or uniqueness of the structure, callability, the likelihood that the security will be called, tendered or exchanged, and other embedded options, as compared with the characteristics of the subject security; and

(D) Technical factors such as the size of the issue, the float and recent turnover of the issue, and legal restrictions on transferability as compared with the subject security.

(3) When a debt security's value and pricing is based substantially on, and is highly dependent on, the particular circumstances of the issuer, including creditworthiness and

the ability and willingness of the issuer to meet the specific obligations of the security, in most cases other securities will not be sufficiently similar, and therefore, other securities may not be used to establish the prevailing market price.

APPENDIX 5

sifma
Invested in America

July 20, 2015

By U.S. Mail and Email: e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11712
Suite 400
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: ZRIN: 1210-ZA25; PTE Application D-11687

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to provide comments regarding the Department of Labor's ("Department") proposed amendment to PTE 75-1, Part V, which extends relief to extensions of credit in connection with securities transactions under section 408 of the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and section 4975(b) of the Internal Revenue Code of 1986, as amended (the "Code"). We appreciate the opportunity to comment and hope that our comments are helpful to the Department as it assesses the impact of the proposal on plans and their participants as well as IRAs. SIFMA shares the Department's concern that normal securities transactions for plans and IRAs be effected in as efficient and economic a manner as possible and that the exemptions themselves, and how they are to be interpreted, do not result in costly litigation.
Attached hereto are SIFMA's submissions for the related rulemakings being undertaken by the Department. These attachments are an integral part of this submission.[2]

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

PTE 75-1 was the first class exemption issued by the Department after the enactment of ERISA. As the Department noted at the time of the January 13, 1975 proposal, SIFMA filed the application, along with the National Association of Securities Dealers ("NASD") and certain broker-dealers, to obtain clarity on the nature and extent to which ordinary and customary transactions between broker-dealers and employee benefit plans are subject to the prohibited transaction rules.[3] Among the concerns raised by the applicants were the complexity of the fiduciary provisions, the risks of civil liability, and the potential disruption to the capital markets, with the attendant adverse consequences to plans.[4] In connection with the application, the Department noted that the SEC had expressed "deep concern" about the uncertainty in the securities industry and the potential disruption to the capital markets.[5] The original proposal contained no relief for extensions of credit, and provided only a few weeks of relief, until February 15, 1975, if the broker-dealer was providing investment advice to the plan.

The Department proposed interim relief on February 4, 1975, again citing the SEC's "great concern about the severe disruption and dislocation in the capital markets and the probably concomitant negative impact of employee benefit plans".[6] The Department noted that the record established that the "securities industry is singularly important in facilitating the raising of capital and is singularly important in maintaining market liquidity, particularly for institutional investors. Further, the field of securities trading is unique, complex and closely regulated."[7] On August 8, 1975, the Department proposed a permanent exemption for 5 categories of transactions, including agency transactions, principal transactions in any security, the purchase of securities in an underwriting from a fiduciary and the receipt of compensation by a member of the underwriting syndicate, purchases and sales of securities by market makers in a security, and extensions of credit in connection with the purchase or sale of securities, so long as no

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2 See Appendices numbered 1-8.
3 Proposed Exemption, 40 Fed. Reg. 2483 (January 13, 1975).
4 Id.
5 Id.
6 40 Fed. Reg. 5201 (February 4, 1975).
7 Id.

compensation was received by a fiduciary in connection with the extension of credit. The exemption was finalized on October 31, 1975.[8]

In recognition of the fact that virtually all broker-dealers may be deemed to be acting as fiduciaries with respect to IRAs and other similar retail accounts if the Department's proposed changes to its regulations under 29 CFR 2510.3-21 are finalized, the Department proposes to amend its exemption for extensions of credit in connection with securities transactions.

The Department properly recognizes that this relief is important to the orderly settlement of transactions. However, we do not understand why the Department has limited the relief to settlement failures when it noted, forty years ago, that this relief is also necessary in connection with short sales, options contracts, and other transactions. These transactions will continue to take place for IRAs and plans and the relief provided under this exemption is critical to a short sale, an options trade or a margin transaction. We assume that the Department is not intending to outlaw these transactions for all plans and IRAs, and assuming we are correct in that assumption, we respectfully request that the Department reinstate the additional relief under current law.

In addition, we believe that the language that the Department has chosen in section (c)(1) of its proposal will generate confusion and litigation and will impede efficient settlement of transactions. That proviso limits relief to situations where the settlement failure is not the result of "action or inaction"[9] on the part of the broker-dealer or its affiliate. In our members' experience, every settlement failure involves different and conflicting interpretations regarding the cause of the settlement failure. Recollections differ, markets change, questions are raised. Most of the time, the parties agree to disagree and no time or money is spent trying to determine with certainty exactly whose fault the failure was. The language in subsection (c)(1) will require that kind of fact intensive inquiry every time, and a clear assumption of blame by the

[8] 40 Fed. Reg. 50845 *October 31, 1975).

[9] It is not clear what the Department has in mind here. Is it that the broker needs to monitor settlement with such assiduity that it can take advantage of the last clear chance to avoid a fail? We do not think this course is rational in the market place.

counterparty, its agent, or the plan's custodian, in order to be certain that the terms of the exemption are met. We can envision the chaotic aftermath of every fail, and we do not see why the Department believes that result is in the interest of IRAs and plans, especially because that kind of factual inquiry will surely increase the cost of the extension of credit only for IRAs and plans, since only these clients will require this kind of certainty. Or no one will use the exemption at all, and instead will increase commissions and markups to accommodate the risk of a fail and an interest free extension of credit while the fail is worked out.

Broker-dealers work out these issues regularly, and do not charge clients when it is their fault. The Federal Reserve Board's Reg T and the SEC's Rule 15c3-3 provide detailed guidance on when a client can be held responsible for a settlement failure. All firms have policies and procedures regarding the allocation of costs of a settlement failure. We do not believe that a condition which uses the vague but potentially over inclusive language used here will ultimately be in the interest of IRAs, plans and plan participants. To the extent that broker-dealers are unable to affirmatively determine that the failure was not due to "action or inaction" on their part, they will simply increase their fees to cover any potential fail issues.

We suggest the following revisions to the language of paragraph (c):

(c) Notwithstanding section (a)(2), a fiduciary within the meaning of ERISA section 3(21)(A)(ii) or Code section 4975(e)(3)(B) may receive reasonable compensation for extending credit to a plan or IRA in connection with a securities transaction if:

(1) To the extent that an extension of credit is in connection with a settlement failure, such failure was not caused by such fiduciary or an affiliate;

(2) The terms of the extension of credit are at least as favorable to the plan or IRA as the terms available in an arm's length transaction between unaffiliated parties;

(3) Prior to any initial extension of credit after the applicability date, the plan or IRA receives written disclosure of (i) the rate of interest (or other fees) that will apply and (ii) the method of determining the balance upon which interest will be charged, in the event that the fiduciary extends credit to avoid a failed purchase or sale of securities, as well as prior written disclosure of any changes to these terms. This Section (c)(3) will be considered satisfied if the plan or IRA receives the disclosure described in the Securities and Exchange Act Rule 10b-16;

It is appropriate that the Department's disclosure requirement is based on SEC required disclosure and that it has determined that compliance with the SEC standard will constitute compliance with the disclosure requirements of this exemption. As noted in other comments, we think holding financial institutions to the same standard will decrease the costs of compliance, will minimize errors, and will ultimately be in the best interest of IRAs, plans and their participants.

SIFMA and its members appreciate the opportunity to comment and look forward to meeting with the Department to discuss our concerns. For further discussion, please contact the undersigned at 202-962-7329.

Sincerely,

Lisa J. Bleier

Lisa J. Bleier
Managing Director, Federal Government Relations
and Associate General Counsel

APPENDIX 6

July 20, 2015

By U.S. Mail and Email: e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W. , Suite 400
Washington, D.C. 20210

Re: ZRIN: 1210-ZA25; PTE Application D-11850

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to provide comments regarding the Department of Labor's ("Department") proposal to amend and partially revoke Prohibited Transaction Exemption ("PTE") 84-24[2] under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). We appreciate the opportunity to comment and hope that our comments are helpful to the Department as it assesses whether changing the current exemption and eliminating the ability of individual retirement accounts ("IRAs") to rely on the exemption will serve the interests of retirement investors.

1 SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org

2 Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transaction Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters, 80 Fed. Reg. 22010 (April 20, 2015).

Attached hereto are SIFMA's submissions for the related rulemakings being undertaken by the Department. These attachments are an integral part of this submission.[3]

Proposed Amendments to and Partial Revocation of PTE 84-24

In its current form,[4] PTE 84-24 provides relief from the prohibitions of ERISA §§ 406(a)(1)(A) through (D) and 406(b) and the parallel provisions of the Internal Revenue Code of 1986, as amended ("Code") for certain transactions relating to purchases by ERISA plans and IRAs of insurance and annuity contracts and for the receipt by an insurance agent, broker or pension consultant of a sales commission in connection with such purchases, provided that the conditions of the exemption are satisfied. PTE 84-24 also provides similar relief for purchases by ERISA plans and IRAs of mutual fund shares and for the related receipt by principal underwriters of a sales commission, if the exemption's conditions are met.

The proposed amendments to PTE 84-24's conditions would require anyone providing fiduciary investment advice to an ERISA plan or an IRA in reliance on the exemption to satisfy Impartial Conduct Standards, which require the adviser to act in the investor's best interest, disclose material conflicts of interest, and not make misleading statements about recommended investments, fees, material conflicts of interest and any other matters relevant to the investor's decision. With respect to IRAs, the Department proposes to revoke PTE 84-24 for IRA purchases of variable annuities and other annuity contracts that "are securities under the federal securities laws", for IRA purchases of mutual fund shares, and for the receipt by insurance agents and brokers, pension consultants and principal underwriters of commissions in connection with such sales. Insurance agents, brokers, pension consultants and insurance companies engaging in

[3] See Appendices numbered 1-8.

[4] *See* 49 Fed. Reg. 13208 (Apr. 3, 1984); 49 Fed. Reg. 24819 (June 15, 1984) (correction): Investment in Load Mutual Funds Where Fund Principal Underwriter, Etc. or Affiliate is Service Provider or Fiduciary, as amended 71 Fed. Reg. 5887 (Feb. 3, 2006).

such transactions would instead rely on the Department's proposed exemption to allow certain investment advice fiduciaries to receive compensation in connection with transactions involving plans and IRAs (including the supplemental exemption for purchases of insurance and annuity contracts) ("BIC Exemption").[5] PTE 84-24 would continue to apply to IRA purchases of insurance and annuity contracts that "are *not* securities" and for the receipt by insurance agents and brokers and pension consultants of a sales commission in connection with such purchases, provided that the conditions of the exemption are satisfied.

In addition, the DOL proposes to add specific definitions for "insurance commissions" and "mutual fund commissions" that would be covered by PTE 84-24. Under these narrowed definitions, insurance agents, brokers, and pension consultants selling insurance contracts to ERISA plans under this exemption would have to limit their compensation to a sales commission as newly defined, and principal underwriters selling mutual fund shares to ERISA plans would have to limit their compensation to a sales load, and would be unable to receive revenue sharing, 12b-1 fees, subtransfer agency fees, or any other compensation related to their sale or holding. Thus, because these fees are currently paid to plan service providers, retirement accounts will likely be changed to wrap fee arrangements to allow for an offset of any third-party payments against the wrap fee.

SIFMA disagrees with the amendments to, and partial revocation of, PTE 84-24 and urges the Department to permit plans covered by ERISA to decide for themselves how their service providers should be compensated, so long as that compensation is fully disclosed.[6] All of these

[5] Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960 (April 20, 2015).

[6] We believe that the amendments are unnecessary and reflect a lack of consideration of other, more appropriate and cost-effective approaches. For over thirty years, PTE 84-24 has permitted fiduciary advisers to both IRAs and plans to sell insurance or annuities, purchase and sell affiliated mutual fund shares and receive compensation in connection therewith. This is not an exemption from 1975, where the Department did not consider the abilities and sophistication of IRA owners in fashioning relief and now requires a fresh look. It is an exemption that the Department revisited in 2004 without changing a single provision relating to IRAs. The Department has had every

same service providers entirely revised their disclosure under the Department's section 408(b)(2) regulations just three years ago. But these amendments signal that no amount of additional disclosure is enough and that all but certain limited fees are simply prohibited. The Department has not provided a record to support its case that disclosure for fiduciaries is not adequate for ERISA covered plans. Despite its amendment of this exemption four times since it was first granted in 1977, the Department has never suggested that the fully protective disclosure conditions of the exemption, which has always applied to investment advice fiduciaries, do not work. We urge the Department not to finalize the amendments to this exemption.

We are concerned that the Department has significantly underestimated the cost and burden that financial institutions will have to bear to make sure that they have not received any of the now prohibited compensation. The change to the industry – the overwhelming majority of financial professionals who were not subject to fiduciary rules suddenly being subject to them – upends the compensation systems of financial institutions vis a vis mutual funds and insurers. The communications and revision to systems to carve out all ERISA and IRA accounts from these revenue streams will take years and involve reprogramming, testing, verifying and reconciliation with each insurance company and each mutual fund complex. There is no simple switch to turn off, and no simple formula for revising flat dollar payments, such as revenue sharing or training allowances, to meet the Department's ban on this compensation. With an unreasonably short transition period and the massive amount of work necessary to turn off this compensation, we believe the Department has not adequately thought through the work and costs involved for financial institutions.

SIFMA also believes that the impartial conduct standards are unnecessary for ERISA plans and adds costs and burdens that lack any justification under ERISA or in the history of the

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opportunity to modify the exemption conditions in connection with IRAs and has chosen, as recently as 2004, not to do so. The amendments are not supported by any convincing policy reasons.

marketplace since PTE 84-24 was granted. ERISA plans already operate under a fiduciary standard. That standard was, until this exemption, based on disclosure and not on prescriptive fee engineering by the Department. As explained in the preamble to the proposal, the Department's primary goal in amending and partially revoking PTE 84-24 is to "increase the safeguards" relating to covered transactions. SIFMA is concerned that the Department proposes to increase safeguards and, thus, the costs and difficulty of complying with the exemption conditions, without offering any evidence that the existing safeguards, which have been in place for over 30 years, have failed to protect plans or IRAs. SIFMA is concerned that the increased costs and difficulty of moving all advised IRAs out of this exemption and into the BIC exemption will result only in diminished choices for participants.

Section I. Covered Transactions

Who can use the exemption. The Department has significantly restricted the persons who can use the exemption by excluding IRAs from most of the relief provided. It has neglected, however, to mitigate the confusion caused by Footnote 4 of Advisory Opinion 2000-15, which suggests that the exemption cannot be used where fiduciaries are providing investment advice for a fee. Under the text of current PTE 84-24, a principal underwriter, or its affiliate, can receive compensation under the exemption so long as it does not have discretionary authority over the assets of a plan. However, in Advisory Opinion 2000-15, the Department suggested that PTE 84-24 would not cover any fiduciary providing investment advice for a fee. The proposed amendment leaves this language unchanged and does not mention the advisory opinion in the preamble.

Since the net result of the Department's definition of fiduciary proposal will be to make many financial professionals fiduciaries and require them to provide written acknowledgement of their services, if not a written contract, we are concerned that the exemption will not be available to virtually any fiduciary. We urge the Department to make clear that advisory fiduciaries expressly appointed to provide investment advice for a fee are covered by the relief under the exemption.

The proposed amendment provides as follows:

> (a) The insurance agent or broker, pension consultant, insurance company, or investment company Principal Underwriter is not (1) a trustee of the plan or IRA (other than a Nondiscretionary Trustee *who does not render investment advice with respect to any assets of the plan*), (2) a plan administrator (within the meaning of ERISA section 3(16)(A) and Code section 414(g)), (3) a fiduciary who is expressly authorized in writing to manage, acquire or dispose of the assets of the plan or IRA on a discretionary basis, or (4) an employer any of whose employees are covered by the plan. Notwithstanding the above, an insurance agent or broker, pension consultant, insurance company, or investment company Principal Underwriter that is Affiliated with a trustee or an investment manager (within the meaning of Section VI(e)) with respect to a plan or IRA may engage in a transaction described in Section I(a)(1)-(4) of this exemption (if permitted under Section I(b)) on behalf of the plan or *IRA if the trustee or investment manager has no discretionary authority or control over the assets of the plan or IRA involved in the transaction other than as a Nondiscretionary Trustee.*

We have several comments on this language. First, we believe the formulation in the last sentence is confusing and would benefit from clarification that the trustee or investment manager may have discretion over certain assets of the plan, so long as such trustee or investment manager does not have discretion over the assets involved in the transaction. In this regard, we suggest the following:

> Notwithstanding the above, an insurance agent or broker, pension consultant, insurance company, or investment company Principal Underwriter that is Affiliated with a trustee or an investment manager (within the meaning of Section VI(e)) with respect to a plan or IRA may engage in a transaction described in Section I(a)(1)-(4) of this exemption (if permitted under Section I(b)) on behalf of the plan or *IRA if the trustee or investment manager has no discretionary authority or control over the IRA's or Plan's assets involved in the transaction other than as a Nondiscretionary Trustee.*

We are also concerned that a financial professional will not be able to receive a commission with respect to its own IRA, or the IRA of any family member (including parents, children, brothers, sisters and spouses of brothers and sisters) when purchasing a fixed annuity. Nor will such a commission be payable for small family owned businesses where the financial professional is related to the owner of the business who would have to approve the transaction. The language provides as follows:

> (2) Following the receipt of the information required to be disclosed in paragraph (b)(1), and prior to the execution of the transaction, the independent fiduciary acknowledges in writing receipt of the information and approves the transaction on behalf of the plan. The fiduciary may be an employer of employees covered by the plan, but may not be an insurance agent or broker, pension consultant or insurance company involved in the transaction. The fiduciary may not receive, directly or indirectly (e.g., through an Affiliate), any compensation or other consideration for his or her own personal account from any party dealing with the plan in connection with the transaction.

We would suggest the following change:

> (2) Following the receipt of the information required to be disclosed in paragraph (b)(1), and prior to the execution of the transaction, the independent fiduciary acknowledges in writing receipt of the information and approves the transaction on behalf of the plan. The independent fiduciary may be an employer of employees covered by the plan, but may not be an insurance agent or broker, pension consultant or insurance company involved in the transaction except with respect to the person's own IRA or the IRA of a family member. The independent fiduciary shall be deemed to be independent of such person even if he or she is a relative of such person. The independent fiduciary may not receive, directly or indirectly (e.g., through an Affiliate), any compensation or other consideration for his or her own personal account from any party dealing with the plan in connection with the transaction

Commissions. The proposal covers, among other things, "Insurance Commissions" and "Mutual Fund Commissions." An "Insurance Commission" is defined in Section VI as "a sales commission paid by the insurance company or an Affiliate to the insurance agent or broker or pension consultant for the service of effecting the purchase or sale of an insurance or annuity contract, including renewal fees and trailers, but not revenue sharing payments, administrative fees or marketing payments, or payments from parties other than the insurance company or its Affiliates." The term "Mutual Fund Commission" is defined to mean "a commission or sales load paid either by the plan or the investment company for the service of effecting or executing the purchase or sale of investment company shares, but does not include a 12b-1 fee, revenue sharing payment, administrative fee or marketing fee." SIFMA believes that these definitions should cover all forms of disclosed and agreed upon compensation, regardless of the source of payment. Agents, brokers, consultants and principal underwriters, including both employees and independent contractors and persons overseeing their activities, are compensated in a variety of ways, including commissions, revenue sharing, service fees, salaries and other consideration. There is no valid basis for favoring one form of disclosed and agreed compensation over another. Accordingly, we urge the Department to make clear that all disclosed and agreed compensation be covered and to delete the proposed specific exclusions.[7]

There is no reason why financial professionals should be denied relief for any form of compensation for their services to plans, particularly in light of the enhanced fee disclosure regulations in place. In addition to the substantial increases in disclosures implemented by the Department, the SEC has vastly simplified the disclosure of 12b-1 and other investment company fees through implementation of the widely used summary prospectus disclosure document. We therefore see little advantage in the limitations in these definitions, while we do see disadvantages to them. In the absence of relief for these other expenses under PTE 84-24, financial professionals will charge asset-based fees that are likely to be higher, and simply offset the 12b-1 fees, service fees, sub-transfer agency and other fees dollar for dollar, which may well exceed current fee levels. Further, as discussed in detail earlier in this comment, the amount of work necessary to effect this change will be enormous and, if the Department proceeds with

[7] We are particularly concerned about subtransfer agency fees. As the Department knows, many financial institutions use omnibus accounts at mutual fund companies, allowing the mutual funds to avoid recordkeeping for the hundreds of thousands accounts at the financial institution, and using the financial institution to do that recordkeeping and subaccounting for them. It would be an enormous burden on mutual funds and highly inefficient for the markets in general if mutual funds could not rely on and pay financial institutions for these services. Financial institutions will not perform these functions for free, so clients will be charged additional amounts for subtransfer agency services if the financial institution cannot receive subtransfer agency fees from the mutual fund. We urge the Department to rethink exclusion of subtransfer agency fees.

them, the transition rules should permit any compensation currently received to continue for at least 18 months after the effective date.

The definition of "Insurance Commission" provides for sales commissions to be paid to an insurance agent, broker or pension consultant from either the insurance company *or an Affiliate*, as that term is defined in Section VI(a). Because references to insurance companies and other persons are deemed to include Affiliates under Section 6(e), the Department should delete the words "or an Affiliate" after the words "insurance company" in the definition of "Insurance Commission."

Exclusion of Mutual Fund and Variable Annuity Purchases by IRAs. SIFMA believes that the Department should retain PTE 84-24 for all annuity and mutual fund purchases by IRAs.[8] The Department states that the partial revocation proposed, and the consequential use of the BIC Exemption, "better protect the interests of IRAs with respect to investment advice regarding securities products." The Department presents no evidence that the current exemption fails to protect such interests. While the Department states that IRAs have grown and that financial services generally have become more complex in recent years, the Department provides no explanation as to how this growth and complexity have specifically affected transactions in annuities and mutual funds. Notably, Rule 12b-1 under the Investment Company Act of 1940, adopted in 1980, had been widely used in mutual fund pricing dating well before PTE 84-24 was granted. Regulation of mutual fund sales loads also became more stringent in the decade after PTE 84-24, and the limitations remain in place today.[9]

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[8] In Advisory Opinion 2000-15A, the Department clarified that PTE 84-24 applies to IRA transactions.

[9] In 1992, the Securities and Exchange Commission ("SEC") approved amendments to NASD Conduct Rule 2830, which in effect limited the maximum 12b-1 fees that many funds could deduct from fund assets pursuant to a rule 12b-1 plan, The NASD sales charge rule is administered by FINRA, which derives authority to regulate the level of mutual fund sales charges from section 22(b)(1) of the Investment Company Act of 1940. *See* Order Approving Proposed Rule Change Relating to the Limitation of Asset-Based Sales Charges as Imposed by Investment Companies, 57 Fed. Reg. 30985 (July 13, 1992), NASD Notice to Members 92-41 .

Forcing all mutual fund and variable annuity purchases by IRAs out of this exemption, and into the far more limited and restrictive BIC Exemption, is not supported by any convincing policy reasons, and the Department fails to explain why it is appropriate to do so. We respectfully submit that the Department has no reason to amend this exemption to exclude IRAs from its coverage. IRAs already receive all of the disclosure required with respect to plans under the exemption.

In addition, the Department's proposal fails to appreciate the difference between sophisticated investors and investors with smaller investable assets. It makes little sense to deprive sophisticated investors of the benefits of the exemption or force them into wrap programs with higher fees or the restrictive BIC Exemption, which the Department designed for unsophisticated investors. We believe that these amendments should be abandoned and re-proposed, changing only the disclosure conditions for IRAs.

At the very least, sophisticated IRA owners should be able to use the exemption under the same conditions applicable to plans. The Department has not analyzed the costs and benefits of continuing to permit IRA owners, much less sophisticated IRA owners, to use the exemption. We think it must do so.[10]

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[10] The Department could adopt the framework set forth in the Securities Act of 1933 for accredited investors, which sets forth specific qualifying criteria and verification standards. 17 CFR 230.501(a)(5) and (6). We believe this is a commonly used and commonly understood test and reflects a well-recognized standard of investors who are able to look after their affairs in a financially sophisticated manner. The Jumpstart Our Business Startups (JOBS) Act introduced the current test, and the test is consistently applied based on rule amendments and interpretive guidance , In its current form, the test provides as follows:

> (5) Any natural person whose individual net worth, or joint net worth with that person's spouse, exceeds $1,000,000.
>
> (i) Except as provided in paragraph (a)(5)(ii) of this section, for purposes of calculating net worth under this paragraph (a)(5):
>
> > (A) The person's primary residence shall not be included as an asset;
> >
> > (B) Indebtedness that is secured by the person's primary residence, up to the estimated fair market value of the primary residence at the time of the sale of securities, shall not be included as a liability (except that if the amount of such indebtedness outstanding at the time of sale of securities exceeds the amount outstanding 60 days before such time,

The Department's proposed revocation of coverage for IRAs purchasing a variable annuity "or other annuity contract that is a security under federal securities laws" is particularly puzzling. The Department cites as the underpinning for distinguishing between these and other annuities its concern that the BIC Exemption, including some of its disclosure requirements, may not be readily applicable to insurance and annuity contracts that "are not securities", or to distribution channels with characteristics that would not fit within the BIC Exemption. Conversely, the Department indicates in the preamble that it believes that annuities that "are securities" and mutual funds are distributed through the same channels as many other investments covered by the BIC Exemption, thereby leading it to propose to place these transactions into the BIC Exemption framework.

We urge the Department to abandon this distinction based on an annuity contract's status as a "security". The federal securities laws expressly cover all investments that are deemed to be securities under the Securities Act of 1933, which in turn subjects securities to the laws regarding registration, trading, sanctions for fraud, and many other substantive requirements. Some

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other than as a result of the acquisition of the primary residence, the amount of such excess shall be included as a liability); and

(C) Indebtedness that is secured by the person's primary residence in excess of the estimated fair market value of the primary residence at the time of the sale of securities shall be included as a liability;

(ii) Paragraph (a)(5)(i) of this section will not apply to any calculation of a person's net worth made in connection with a purchase of securities in accordance with a right to purchase such securities, provided that:

(A) Such right was held by the person on July 20, 2010;

(B) The person qualified as an accredited investor on the basis of net worth at the time the person acquired such right; and

(C) The person held securities of the same issuer, other than such right, on July 20, 2010.

(6) Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;

instruments that are deemed to be securities are exempt from registration with the SEC, but are nonetheless subject to other substantive regulations. Other securities are exempt from certain of the offering provisions of the federal laws. To place this distinction at the heart of Department of Labor exemptive relief creates uncertainty for investors in annuities and poses a definitional landscape that will shift over time, prompting changes in firms' abilities to rely either on PTE 84-24 or the BIC Exemption. This is underscored by the fact that we assume the Department meant to permit IRAs to be covered under PTE 84-24 for insurance contracts that are securities, so long as they are exempt securities.[11] Requiring plan and IRA fiduciaries, as well as financial intermediaries, to understand not only these very dense and prescriptive exemptions as well as the status of insurance products under the securities laws is unfair, costly and likely fraught with confusion. We urge the Department to permit all insurance products to continue to be sold under PTE 84-24. For example, many variable annuities have a fixed annuity component. How is that component to be treated under this exemption? In any event, if, however, the Department retains a limitation on IRA purchases of annuities in a final exemption, we recommend that the Department change the criteria in Section I(b) from an annuity that "is a security" to an annuity that is a *registered* security.

Section II. Impartial Conduct Standards

The proposal amends PTE 84-24 to require the fiduciary to comply with impartial conduct standards. We object to this requirement.

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[11] See the recent controversy at the SEC regarding indexed annuities. The SEC adopted a new regulation, Rule 151A under the Securities Act of 1933, which would have required SEC registration of equity indexed annuity contracts as securities and the sale of these products by registered broker dealers in accordance with SEC and FINRA sales practice standards. Rule 151A, which had a delayed effective date and never became effective, was challenged in court and vacated on procedural grounds. Today, the SEC does not specify whether or not these contracts are subject to federal securities laws: "Variable annuities are securities regulated by the SEC. An indexed annuity may or may not be a security; however, most indexed annuities are not registered with the SEC. Fixed annuities are not securities and are not regulated by the SEC." U.S. Securities and Exchange Commission website, Investor Information, *Fast Answers*, *Annuities*. http://www.sec.gov/answers/annuity.htm. Since that time, Congress has periodically considered legislation that would expressly exclude equity indexed annuities from the federal securities laws, and instead would have such annuities overseen by state insurance regulators.

Congress saw no reason to have a prudence standard for IRAs and believed that a violation of the prudence standard for ERISA plans should be remedied through litigation in federal court. Nonetheless, the proposal purports to condition relief under Section 4975 of the Code on the contractual assumption of a prudence standard that would be enforceable by IRA owners in state court. We do not believe that Congress intended a breach of the duty of prudence to violate the prohibited transaction provisions of ERISA and the Code. Our specific comments follow.

SIFMA strongly objects to these standards for plans covered under Title I of ERISA. The Department acknowledges in the preamble that the best interest standard "is based on longstanding concepts derived from ERISA and the law of trusts"; in particular, the duties of prudence and loyalty imposed by ERISA section 404(a). Requiring advisers to ERISA plans or plan participants to agree to, and comply with, a best interest standard separate and apart from their existing ERISA fiduciary duty is redundant and unnecessary to achieve the Department's stated goals. For ERISA plans, requiring advisers and financial institutions to adhere to a best interest standard as a condition for relief under the exemption ramps up the consequences of any fiduciary breach by imposing an excise tax on a prudence violation. We believe that is both inappropriate and contrary to Congress's intent. Title I has its own remedy scheme that Congress carefully crafted to be based on losses, not on foot faults. These plans are already covered by a comprehensive disclosure scheme and a regulation issued just three years ago. We urge the Department to delete this requirement from the exemption, and if the Department declines to do so, to make it applicable only to plans not covered under Title I of ERISA, but as modified below.

Respectfully, the Department does not have the statutory authority to require compliance with a prudence rule as a condition of a prohibited transaction exemption. Congress has issued more than 20 statutory exemptions; not a single one has, as a condition, a subjective and "reasonable person" standard or a subjective "misleading disclosure" standard which is punishable by transaction reversal and an excise tax, regardless of whether there is a loss on the trade and regardless of whether the disclosure is entirely correct but simply unclear. Nor has any exemption previously issued by the Department contained such a vague and subjective condition. These conditions are not administrable and therefore do not meet the standards for issuance of an exemption under section 408 of ERISA. If the Department insists on retaining compliance with a non-misleading disclosure condition in the exemption, we suggest instead that the Department explicitly adopt FINRA guidance relating to Rule 2210 regarding the term "misleading. Because violation of a prohibited transaction exemption has such dire consequences, we do not believe that an inadvertent, immaterial statement taken in the wrong way by a client should result in a reversal of the transaction, a guarantee of losses and an excise tax on the entire principal amount. We ask that the provision be clarified to require that the financial institution and any adviser acting for that institution reasonably believe that their statements are not misleading.

For the sake of completeness, we discuss below our other concerns with the best interest and other impartial conduct provisions. However, at the heart of the matter, these provisions should be eliminated for far more fundamental legal infirmities.

The language in the best interest standard that purports to require fiduciaries to prove that they acted "without regard to the financial *or other interests of* the … fiduciary, any affiliate or *any other party*" is unworkable. First, we believe the requirement that advice be "without regard" for the financial interests of the fiduciary will fail any time a plaintiff can prove that a covered person under the exemption did not receive the least possible compensation. We urge the Department to use a formulation consistent with that found in FINRA Rule 2111, namely, that the statements made in connection with the covered transactions are in the best interest of the client and put the client's interest before those of the person making those statements.

In addition, the proposed exemption in the language quoted above refers to "other interests" of "any other party" with no apparent limitation. We do not know what these references to other interests and other parties are intended to address and the preamble does not explain them.

Further, as noted above, to the extent applicable to ERISA plans, the best interest standard is inconsistent with ERISA and the Code. We request that this language be deleted from the exemption.

Section III. Recordkeeping Requirements

As with other exemptions being proposed, relief is conditioned on enhanced recordkeeping requirements. Our comments on those requirements follow immediately below.

Manner of Recordkeeping. First, the proposal specifically requires that the records be maintained "in a manner that is accessible for audit and examination". We believe that the term "reasonably" should be inserted immediately prior to the term "accessible", so that the subjective views of the person wishing to examine or audit the records do not become the basis for the imposition of excise taxes on the adviser.

Scope of Access. Second, the exemption should clarify that fiduciaries, employers, employee organizations, participants and their employees and representatives shall have access only to information concerning their own plans. Similarly, the exemption should clarify that any failure to maintain the required records with respect to a given transaction or set of transactions does not affect exemptive relief for other transactions.

Section IV: Definitions

Many of SIFMA's questions and comments regarding the proposed definitions for PTE 84-24 are raised above, as they arise in the exemption. What follows is a list of additional questions and comments concerning the definitions that are not specific to any particular functional part of the exemption.

Individual Retirement Account -- We believe that health savings accounts (HSAs), educational and other tax-favored savings vehicles not intended for retirement income should not be included in the definition of IRA. Such other accounts are, by their terms, not intended for retirement income, but, rather, for health care, educational and other expenses.

Material Conflict of Interest -- The exemption does not include any standard of materiality. Without a clear standard, "material" could be interpreted to cover even the most remote financial interest, regardless of whether the *effect* of the financial interest on one's judgment would be material. Is this definition intended to be consistent with case law addressing the scope of an adviser's fiduciary duties under the Advisers Act? If not, how is this definition intended to be different?

Relative. In the definition of Affiliate in Section VI(a)(2), which is unchanged from the existing exemption, we note that a "relative" as defined in Section VI(l) includes siblings and spouses of siblings, in contrast to other proposals included in the overall fiduciary advice proposal where the term is limited to those relatives specified in ERISA and the Code. For the sake of consistency, we recommend that the term as used in PTE 84-24 be modified to conform to that used in the BIC Exemption and other relief.

SIFMA and its members appreciate the opportunity to comment and look forward to meeting with the Department to discuss our concerns. For further discussion, please contact the undersigned at 202-962-7329.

Sincerely,

Lisa J. Bleier

Lisa J. Bleier
Managing Director, Federal Government
Relations and Associate General Counsel

APPENDIX 7

sifma

Invested in America

July 20, 2015

By U.S. Mail and Email: e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, N.W. , Suite 400
Washington, D.C. 20210

Re: ZRIN: 1210-ZA25; PTE Application D-11327

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to provide comments regarding the Department of Labor's ("Department") proposal to amend and partially revoke Prohibited Transaction Class Exemption ("PTCE") 86-128[2] and to amend and partially revoke PTCE 75-1 under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). We appreciate the opportunity to comment and hope that our comments are helpful to the Department as it assesses whether the proposal, as written, will continue to permit plans to achieve best execution for securities transactions or whether they will be relegated to a second class citizens in the market.

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org.

[2] Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTCE) 86-128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Proposed Amendment to and Proposed Partial Revocation of PTCE 75-1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefits Plans and Certain Broker-Dealers, Reporting Dealers and Banks, 80 Fed. Reg. 22021 (April 20, 2015).

Attached hereto are SIFMA's submissions for the related rulemakings being undertaken by the Department. These attachments are an integral part of this submission.[3]

SIFMA disagrees with most changes to PTCE 86-128, particularly the exclusion of advised IRAs. We believe that the changes are unnecessary and that they reflect a lack of consideration of other more cost effective approaches. PTCE 86-128 has long permitted discretionary and advisory fiduciaries of both IRAs and plans to use themselves or their affiliates to execute securities transactions. This is not an exemption where the Department, in fashioning relief, did not consider the abilities and sophistication of IRA owners. It is not an exemption that dates from 1975 and thus, in the Department's view, needs a fresh look. This is an exemption that the Department proposed on its own in 1986 to specifically cover plans and IRAs, regardless of size. And it is an exemption that the Department revisited in 2002 without changing a single provision relating to IRAs, including the reporting and disclosure provisions. The Department similarly excluded IRAs from enhanced disclosures under its recent revisions to the regulations under ERISA section 408(b)(2).

Forcing all advised IRAs out of this exemption and into the far more limited and restrictive BIC exemption is not supported by convincing policy reasons. The Department fails to explain why, if there must be a change, a more moderate approach – such as simply applying the reporting and disclosure requirements of this exemption to all plan investors, both plans and IRAs – would not be a more reasonable course.

We believe that the reason the Department will not permit advisory IRAs to use this exemption is because it intends to require financial advisors to have level compensation across all asset

[3] See Appendices numbered 1-8.

classes. This goal contravenes the entire commission-based structure of the agency trading of securities. We think the cost implications of the BIC exemption, compared to the far more reasonable cost increases that financial institutions would incur by extending the reporting and disclosure requirements of this exemption to IRAs, reflect an underlying disregard for the requirements of Executive Orders 12866 and 13563, as well as the Regulatory Flexibility Act.

There is no evidence of abuse of advised IRAs here. Advised IRAs have not been overcharged, and there is no evidence of churning or other unreasonable compensation. Advisers have not caused plans to invest disproportionately in equity securities or engaged in other abusive practices. We respectfully submit that the Department has no reason to amend this exemption to exclude advised IRAs from its coverage.

As explained in the preamble to the proposal, the Department's goal in amending and partially revoking PTCE 86-128 and 75-1 is to "increase the safeguards" relating to the covered transactions. SIFMA is concerned that the Department proposes to increase safeguards and, thus, the costs and difficulty of complying with the exemption conditions without offering any evidence that the existing safeguards, which have been in place for almost 30 years, have failed to protect plans or IRAs. SIFMA is also concerned that the increased costs and difficulty of moving all advised IRAs out of this exemption and into the BIC exemption, will result only in diminished opportunities for best execution and diminished choices for IRA owners.

Section I. Covered Transactions

Commissions. The proposal limits compensation under the exemption to "Commissions", which are defined as "a brokerage commission or sales load paid for the service of effecting or executing the transaction, but not a 12b-1 fee, revenue sharing payment, marketing fee, administrative fee, sub-TA fee or sub-accounting fee." Further, except with respect to "riskless principal" mutual fund purchases and agency cross-trades, "Commissions" are limited to payments directly from the plan or IRA. It is unclear why the Department would permit payment of fully disclosed and agreed commissions for agency cross transactions and from mutual funds for "riskless principal" transactions, but not agency transactions in mutual funds or other securities. SIFMA believes that PTCE 86-128 should cover all forms of fully disclosed and agreed upon compensation for effecting or executing a securities transaction, including the performance of clearance, settlement, custodial or other functions ancillary thereto, regardless of the source of payment. Accordingly, we urge the Department to amend the definition of "commission" to include payments of 12b-1 fees, service fees and sub-transfer agency fees paid by a mutual fund. There is no reason why financial professionals should be denied this form of compensation for their services to plans. In the absence of relief under PTCE 86-128, financial professionals will charge asset-based fees that are likely to be higher, and simply offset the 12b-1 fees, service fees, sub-transfer agency and other fees dollar for dollar.

Related Entities. SIFMA is appreciative of the Department's proposal to expand relief to entities in which the fiduciary has an interest that may affect its best judgment as a fiduciary, but which is not an affiliate of the fiduciary. SIFMA supports this provision.

Proposed Mutual Fund Transactions Exemption. The proposal moves the exemption in PTCE 75-1, Part II for third party mutual fund purchases to PTCE 86-128 and subjects those purchases to the impartial conduct standards and reporting and disclosure requirements of PTCE 86-128. The Department cites no evidence that the exemption in PTCE 75-1, which has existed for almost 40 years, has failed to protect plans or IRAs. The Department has never thought, before now, that it would be appropriate to move the exemption into PTCE 86-128, including when PTCE 86-128 was first promulgated and subsequently amended. Thus, SIFMA believes that the exemption should be left in 75-1 and not subjected to additional requirements that will unnecessarily increase the compliance burdens and costs and, thus, lead advisers to decline to execute or effect securities transactions or rely on alternatives that are more costly for plans and IRAs, such as wrap fee programs.

The preamble characterizes the transaction contemplated by the proposed mutual fund exemption as “a ‘riskless principal’ transaction”, in which “the fiduciary that is providing investment advice purchases shares on its own account for the purpose of covering a purchase order previously received from a plan or IRA, and then sells the shares to the plan or IRA to satisfy the order.” The result of this characterization is that the proposed relief would require a principal transaction confirmation, even though many market participants confirm such sales as agent. In addition, SIFMA believes that reducing the scope of relief to cover only “riskless” purchases is not appropriate. Certain registered investment companies, such as unit investment trusts, are both purchased and sold on a principal basis. Because the BIC exemption does not cover principal transactions, the Department’s proposal inexplicably leaves the purchase and sale of such registered investment companies without an exemption. We assume the Department did not intend such a result, which would arbitrarily favor certain forms of open-end registered investment companies over others. For the foregoing reasons, SIFMA respectfully urges the Department to retain the existing language of PTCE 75-1, Part II(2), but with the deletion of the “open-end” qualifier to permit the purchase and sale of unit investment trusts.

Scope of the Exemption. One of the most striking features of the Department’s proposal is the revocation of coverage for advised (but not managed) IRAs, thus forcing reliance on the BIC Exemption. The blanket exclusion of advised IRAs from relief under the exemption is unwarranted. Rather than considering whether to simply impose disclosure conditions for advised IRAs similar to those that have always applied to advised plans, the Department radically departs from this exemption to force all commissions into a far more burdensome regime, which will likely increase commission rates, rather than lower them or keep them at current levels. The Department offers no empirical or other evidence indicating that advised

IRAs have been harmed under the existing exemption or that the costs of allowing them to continue to use it outweighs the benefits. SIFMA urges the Department to reconsider the coverage limitations under the BIC exemption and to follow a middle path that permits agency commissions for advised IRAs under PTCE 86-128, conditioned on the same disclosure requirements as advised plans.

The blanket exclusion of advised IRAs also fails to appreciate the difference between sophisticated investors and investors with smaller investable assets. It makes little sense to deprive sophisticated investors of the benefits of the exemption or force them into wrap programs with higher fees or the restrictive BIC Exemption, which the Department designed for unsophisticated investors. We believe that these amendments should be abandoned and re-proposed, changing only the disclosure conditions for IRAs. At the very least, sophisticated IRAs should be able to use the exemption with the disclosure required for plans.[4]

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[4] The Department could use the test in the Securities Act of 1933 for accredited investors. 17 CFR 230.501(a)(5) and (6). We believe this is a commonly used and commonly understood test and reflects a well-recognized standard of investors who are able to look after their affairs in a financially sophisticated manner. The test provides as follows:

> (5) Any natural person whose individual net worth, or joint net worth with that person's spouse, exceeds $1,000,000.
>
> (i) Except as provided in paragraph (a)(5)(ii) of this section, for purposes of calculating net worth under this paragraph (a)(5):
>
> > (A) The person's primary residence shall not be included as an asset;
> > (B) Indebtedness that is secured by the person's primary residence, up to the estimated fair market value of the primary residence at the time of the sale of securities, shall not be included as a liability (except that if the amount of such indebtedness outstanding at the time of sale of securities exceeds the amount outstanding 60 days before such time, other than as a result of the acquisition of the primary residence, the amount of such excess shall be included as a liability); and
> > (C) Indebtedness that is secured by the person's primary residence in excess of the estimated fair market value of the primary residence at the time of the sale of securities shall be included as a liability;
>
> (ii) Paragraph (a)(5)(i) of this section will not apply to any calculation of a person's net worth made in connection with a purchase of securities in accordance with a right to purchase such securities, provided that:

(Continued …)

Section II. Impartial Conduct Standards.

The proposal amends PTCE 86-128 to require the fiduciary to comply with impartial conduct standards. We object to this requirement.

Congress saw no reason to have a prudence standard for IRAs and believed that a violation of the prudence standard for ERISA plans should be remedied through litigation in federal court. Nonetheless, the proposal purports to condition relief under Section 4975 of the Code on the contractual assumption of a prudence standard that would be enforceable by IRA owners in state court. We do not believe that Congress intended a breach of the duty of prudence to violate the prohibited transaction provisions of ERISA and the Code. Our specific comments follow.

SIFMA strongly objects to these standards for plans covered under Title I of ERISA. The Department acknowledges in the preamble that the best interest standard "is based on longstanding concepts derived from ERISA and the law of trusts"; in particular, the duties of prudence and loyalty imposed by ERISA section 404(a). Requiring advisers to ERISA plans or plan participants to agree to, and comply with, a best interest standard separate and apart from their existing ERISA fiduciary duty is redundant and unnecessary to achieve the Department's stated goals. For ERISA plans, requiring advisers and financial institutions to adhere to a best interest standard as a condition for relief under the exemption ramps up the consequences of any

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(A) Such right was held by the person on July 20, 2010;
(B) The person qualified as an accredited investor on the basis of net worth at the time the person acquired such right; and
(C) The person held securities of the same issuer, other than such right, on July 20, 2010.

(6) Any natural person who had an individual income in excess of $200,000 in each of the two most recent years or joint income with that person's spouse in excess of $300,000 in each of those years and has a reasonable expectation of reaching the same income level in the current year;

fiduciary breach by imposing an excise tax on a prudence violation. We believe that is both inappropriate and contrary to Congress's intent. Title I has its own remedy scheme that Congress carefully crafted to be based on losses, not on foot faults. These plans are already covered by a comprehensive disclosure scheme and a regulation issued just three years ago. We urge the Department to delete this requirement from the exemption, and if the Department declines to do so, to make it applicable only to plans not covered under Title I of ERISA, but as modified below.

Respectfully, the Department does not have the statutory authority to require compliance with a prudence rule as a condition of a prohibited transaction exemption. Congress has issued more than 20 statutory exemptions; not a single one has, as a condition, a subjective and "reasonable person" standard or a subjective "misleading disclosure" standard which is punishable by transaction reversal and an excise tax, regardless of whether there is a loss on the trade and regardless of whether the disclosure is entirely correct but simply unclear. Nor has any exemption previously issued by the Department contained such a vague and subjective condition. These conditions are not administrable and therefore do not meet the standards for issuance of an exemption under section 408 of ERISA. If the Department insists on retaining compliance with a non-misleading disclosure condition in the exemption, we suggest instead that the Department explicitly adopt FINRA guidance relating to Rule 2210 regarding the term "misleading. Because violation of a prohibited transaction exemption has such dire consequences, we do not believe that an inadvertent, immaterial statement taken in the wrong way by a client should result in a reversal of the transaction, a guarantee of losses and an excise tax on the entire principal amount. We ask that the provision be clarified to require that the financial institution and any adviser acting for that institution reasonably believe that their statements are not misleading.

For the sake of completeness, we discuss below other concerns with the best interest and other impartial conduct provisions. However, at the heart of the matter, these provisions should be eliminated for far more fundamental legal infirmities.

The language in the best interest standard that purports to require fiduciaries to prove that they acted "without regard to the financial *or other interests of* the … Related Entity or *any other party*" is unworkable. First, we believe the requirement that advice be "without regard" for the financial interests of the adviser sets up a standard that an adviser will fail any time a plaintiff can prove that the adviser did not recommend the investment that paid him the least. FINRA uses a much more common sense test that does not contain this flaw— i.e., that the adviser provides recommendations that are in the best interest of his client and put his client's interest before his own. We urge the Department to use this formulation, which is found in FINRA Rule 2111.

In addition, the proposed exemption in the language quoted above refers to "other interests" of "any other party" with no apparent limitation. We do not know what these references to other interests and other parties are intended to address and the preamble does not explain them. Further, as noted above, to the extent applicable to ERISA plans, the best interest standard is redundant and unnecessary. We request that this language be deleted from the exemption.

Also troubling is the impartial conduct standards' prohibition on unreasonable compensation "in relation to the total services the person and any Related Entity provide to the plan." This Department does not explain this new formulation of reasonable compensation. Nor does the Department attempt to justify the differences between this formulation and Congress's view of reasonable compensation, which does not require all compensation received by a fiduciary to be justified by a particular set of services to a particular account. We urge the Department to use the language it has used since the enactment of ERISA and as recently as 2012, when it entirely revised its regulations under ERISA § 408(b)(2). We urge the Department not to create two entirely different standards for commission compensation. The Department concedes that the section 406(a) relief for receipt of commissions comes from section 408(b)(2). The relief for section 406(b) should use the same definition of reasonable compensation, and that definition should not require every dollar received to be traceable to the service provided with respect to each individual trade. That is not how the securities commission system works, and the cross-subsidies inherent therein for large and small transactions, domestic and international transactions, and readily-traded and harder-to-trade securities should not cause a fiduciary to lose the benefit of this exemption.

Section III. Conditions Applicable to Transactions Described in Section I(a).

Recapture of Profits Exception. The existing exemption provides relief to employers and plan administrators for transactions executed for their own plans if all profits are recaptured for the benefit of the plans. Under the existing text, however, it was unclear whether discretionary trustees could also use this exception. SIFMA welcomes the Department's clarification (in Section V(b)) that discretionary trustees may utilize the exemption if they comply with the "recapture of profits" exception.

30-Day Reauthorization Period & Alternative Termination Notices. The proposal amends the annual reauthorization process to provide that the "[f]ailure to return the form or some other written notification of the plan's intent to terminate the authorization within thirty (30) days from the date the termination form is sent to the authorizing fiduciary will result in the continued authorization of the authorized person to engage in the covered transactions on behalf of the plan." It is not clear whether the fiduciary is authorized to continue utilizing the exemption in the interim – i.e., while it waits to see whether the form is returned. We suggest a clarification that the authority continues in the interim, which may be accomplished by inserting the following immediately after the phrase "on behalf of the plan": "provided that the prior authorization shall be deemed to continue until the earlier of the end of such thirty-day period or the date the authorized persons receives written notification of such termination".

Separately, SIFMA believes that permitting "some other written notification" (i.e., informal notice) to terminate a prior authorization imports uncertainty into the process. While some informal notifications may be clear, others may not be. Requiring plans to return the proper termination form provides clarity as to the authorizing fiduciary's intent and is no more burdensome than the longstanding practice under ERISA of requiring participants to apply for benefits or designate beneficiaries on proper forms.

Portfolio Turnover Analysis from Investment Advisory Fiduciaries. The proposal seeks to expand the existing requirement to provide an annual portfolio turnover ratio to fiduciaries that merely provide investment advice. *See* Section III(f)(4)(C). Currently, only fiduciaries with discretionary authority need provide the analysis. SIFMA believes that requiring investment advice fiduciaries to provide annual portfolio turnover analyses (whether to ERISA plans or IRAs) is not workable. Such fiduciaries, by definition, do not direct trades themselves and often do not custody the resulting positions. Therefore, in many cases, they will not have sufficient information to provide an annual portfolio turnover analysis and should be excluded from this requirement. In addition, where the client chooses to trade frequently, we see no reason why the analysis, which is meant to evidence whether or not a discretionary fiduciary is churning the account, is appropriate. In such cases, the fiduciary cannot churn the account because every trade must be directed by the independent plan or IRA fiduciary. The portfolio turnover analysis is also expensive, complicated and easily misconstrued. The Department does not provide any justification regarding the expansion of this requirement to advice fiduciaries. It does not analyze the cost of applying this requirement to every single advisory account, nor does it consider more reasonable alternatives, such as a requirement to do such an analysis on request.

It does not even describe this change in the preamble. We strongly urge the Department to continue to limit the portfolio turnover analysis to discretionary fiduciaries.

Section IV. Conditions Applicable to Transactions Described in Section I(b) (Mutual Funds).

As explained in detail above, SIFMA believes that the exemption for registered investment companies in PTCE 75-1, II(2) should be left in place, continue to cover sales and not subjected to additional requirements under PTCE 86-128, and that it should cover all registered investment companies and not just open end investment companies, so that unit investment trusts can be purchased and sold by plans.[5] These requirements will unnecessarily increase compliance burdens and costs and, thus, lead advisers to decline to execute or effect such trades or rely on alternative options.

Section V. Exceptions From Conditions.

Adviser Must Provide All Information Reasonably Necessary to Determine Reauthorization. The proposal changes the standard of information that the adviser must provide to the authorizing fiduciary from information "reasonably available" that the adviser "reasonably believes to be necessary" to all information that "is reasonably necessary." It is unclear why the Department is discarding a standard that has worked well for decades and substituting a new standard that requires advisers to provide information they may not have. The Department acknowledged this concern in originally developing this standard, noting that, without the "reasonably available" qualifier, the "broker could be forced to provide information

[5] We note that such investments cannot be sold under the Department's proposed principal transaction exemption since that exemption only covers debt securities and they cannot be sold under the BIC exemption because that exemption excludes principal transactions.

about its competitors or business practices that it might not possess and could not easily obtain." Preamble to PTCE 79-1, 44 FR 5963, 5965 (Jan. 30, 1979). Further, it is unclear why the Department is requiring the adviser to potentially provide more information that it "reasonably believes" is necessary. Requiring the adviser to prove that it has provided all information that others might find relevant – which could include just about anything, including information regarding competitors and unrelated litigation against the adviser – or face excise taxes will force many advisers to cease relying on the exemption, even at the cost of best execution, and lead other advisers to provide voluminous disclosures in which the most relevant information is lost.

Section VI. Recordkeeping Requirements

As with other exemptions being proposed, relief is conditioned on enhanced recordkeeping requirements. Our comments on those requirements follow immediately below.

Manner of Recordkeeping. First, the proposal specifically requires that the records be maintained "in a manner that is accessible for audit and examination". We believe that the term "reasonably" should be inserted immediately prior to the term "accessible", so that the subjective views of the person wishing to examine or audit the records do not become the basis for the imposition of excise taxes on the adviser.

Scope of Access. Second, the exemption should clarify that fiduciaries, employers, employee organizations, participants and their employees and representatives shall have access only to information concerning their own plans. Similarly, the exemption should clarify that any failure to maintain the required records with respect to a given transaction or set of transactions does not affect exemptive relief for other transactions.

30-Day Rule. Third, SIFMA believes the 30-day period for providing written notice of the adviser's refusal to provide privileged or confidential information is too short, particularly for larger firms with separate legal, compliance and business functions and comprehensive, multi-layered information security protocols. Additional time will be necessary to permit coordination among the responsible legal, compliance and business personnel, the gathering and review of the requested material, correction of misdirected mail and other inadvertent procedural errors and preparation and delivery of the response. SIFMA respectfully requests that the Department change the 30-day deadline to 90 days. While many responses will not require 90 days, a significant buffer of time is appropriate given the draconian ramifications – excise taxes – of failing to meet the requirements of the exemption.

Section VII: Definitions

Many of SIFMA's questions and comments regarding the proposed definitions for PTCE 86-128 are addressed as they arise in the proposed investment advice definition itself. What follows is a list of additional questions and comments concerning the definitions that are not specific to any particular functional part of the exemption.

Independent – As written, the definition of "independent" would disqualify any company that receives compensation from the adviser without qualification. Thus, disqualification would extend to companies that lease office space or provide goods or services to the adviser, including, e.g., accounting, legal, consulting, security, parking and window washing services. To the extent any such company sponsors a plan, the company would not be "independent" under the exemption, regardless of how small the amount of income received from the adviser. Historically, the Department has addressed this issue appropriately in virtually every exemption it has granted, and we assume its failure to do so here was inadvertent. Accordingly, we suggest that subsection (2) of the definition of "independent" in Section VII(f) should be replaced with the following: "receives less than 5% of its gross annual income from such person". In addition, subsection (3) should be revised to make clear that an IRA owner will not be deemed to fail the independence requirement simply because he or she is an employee of the adviser.

Individual Retirement Account -- We believe that health savings accounts (HSAs), educational and other tax-favored savings vehicles not intended for retirement income should not be included in the definition of IRA. Such other accounts are, by their terms, not intended for retirement income, but, rather, for health care, educational and other expenses.

Material Conflict of Interest -- As discussed above, the definition does not include any standard of materiality. Without a clear standard, the definition could be interpreted to cover even the most remote financial interest, regardless of whether the *effect* of the financial interest on one's judgment would be material. Is this definition intended to be consistent with case law addressing the scope of an adviser's fiduciary duties under the Advisers Act? If not, how is this definition intended to be different?

SIFMA and its members appreciate the opportunity to comment and look forward to meeting with the Department to discuss our concerns. For further discussion, please contact the undersigned at 202-962-7329.

Sincerely,

Lisa J. Bleier

Lisa J. Bleier
Managing Director, Federal Government Relations
and Associate General Counsel

APPENDIX 8

July 20, 2015

By U.S. Mail and Email: e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11820
Suite 400
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: ZRIN 1210-ZA25

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to provide comments regarding the Department of Labor's ("Department") proposed amendments to PTCE 75-1, Parts III and IV, 77-4, 80-83, and 83-1 (the "Class Exemptions") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and section 4975 of the Internal Revenue Code ("Code") (referred to as the "Proposal"). SIFMA appreciates the opportunity to comment and hope that our comments are helpful to the Department as it assesses the impact of these changes to the current exemptions on IRAs, plans and their participants[2]. SIFMA shares the Department's interest in making sure that plans, their participants and IRAs are treated fairly in the market place and have the ability to trade effectively and efficiently in all markets.

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org

[2] The term "plan" includes references to its participants and beneficiaries.

Attached hereto are SIFMA's submissions for the related rulemakings being undertaken by the Department. These attachments are an integral part of this submission.[3]

With respect to each of these exemptions, the Department proposes to add the following conditions:

1. The fiduciary must act in the best interest of the plan or IRA;

2. All compensation received by the fiduciary must be reasonable "in relation to the total services the fiduciary provides to the plan or IRA".

3. The fiduciary's statements about recommended investments, fees, material conflicts of interest, and any other matters relevant to a plan's or IRA owner's investment decisions, are not misleading. A material conflict of interest exists when a fiduciary has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA owner.

The Proposal provides that a fiduciary's failure to disclose a material conflict of interest relevant to the services the fiduciary is providing or other actions it is taking in relation to a plan's or IRA owner's investment decisions is deemed to be a misleading statement. However, the definition of Material Conflict of Interest includes no materiality test and thus, apparently would include every conceivable conflict, no matter how minor and even if no harm were to be caused by such failure. Certainly, where the consequence of a failure to meet a condition is reversal of the transaction, a requirement to make the plan or IRA whole for lost earnings (normally calculated at the highest rate that could have been earned), plus the payment of an excise tax, it is hard to conclude that every single conflict must be identified in order for the exemption to apply. The Proposal also provides that a fiduciary acts in the "Best Interest" of the plan or IRA when the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then

[3] See Appendices numbered 1-8.

prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the plan or IRA, without regard to the financial or other interests of the fiduciary *or any other party* (emphasis added). These amendments apply to discretionary and advisory fiduciaries of both plans and IRAs.

We urge the Department to abandon this part of the Proposal entirely. If the Department chooses not to do so, SIFMA strongly urges the Department to eliminate this provision for Title I plans. It is duplicative of, and inconsistent with, existing requirements for plans covered by Title I. The Department acknowledges in the preamble that the best interest standard "is based on longstanding concepts derived from ERISA and the law of trusts"; in particular, the duties of prudence and loyalty imposed by ERISA § 404(a)[4]. Requiring advisers to ERISA plans or plan participants to agree to, and comply with, a best interest standard separate and apart from their existing ERISA fiduciary duty under ERISA section 404(a) is redundant and unnecessary to achieve the Department's stated goals.

For ERISA Title I plans, requiring advisers and financial institutions to adhere to a best interest standard as a condition for relief under these class exemptions significantly increases the adverse consequences of any fiduciary breach by imposing an excise tax, as well as other required corrections, on a prudence violation. We believe this result is inappropriate, contrary to the statutory framework, and Congress's intent.

ERISA plan participants and their fiduciaries have the ability to sue in federal court for any violation of section 404. Plans covered by Title I are already protected by comprehensive fiduciary requirements, and a comprehensive disclosure scheme, buttressed by a regulation issued just three years ago. Title I also has its own remedy regime that Congress carefully

[4] Section 404 of ERISA imposes the standard of care which must be exercised by a fiduciary, including, in relevant part, that "…a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries…(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of a like character and like aims…" This requirement is commonly referred to as the "expert prudent man rule". A violation results in a breach of fiduciary duty, actionable under ERISA section 502.

crafted which is based on losses, not on foot faults. Under the Proposal, even the smallest, most immaterial, undisclosed conflict would allow a participant unhappy with his or her trade to seek reversal of the transaction, regardless of whether the failure to disclose a conflict was significant, or even related to the trade. We believe that is both inappropriate and contrary to Congress's intent. The Department's own regulation interpreting section 408(b)(2) is diametrically different from the Proposal, in that the section 408(b)(2) regulation provides that failures to disclose can be remedied by a correction, without loss of the relief afforded by the exemption. The standard enunciated in the Proposal itself is not administrable because it is entirely subjective, and therefore violates the requirements of section 408(a) of ERISA. Adding an excise tax penalty is duplicative and punitive and had Congress wanted to subject prudence violations to an excise tax, it would have done so.

Even for Title II plans, the Department lacks statutory authority to require compliance with a prudence rule as a condition of a prohibited transaction exemption. As noted above, the conditions regarding the "reasonable person" or "misleading disclosure" standards are not administrable and therefore do not meet the standards for issuance of an exemption under ERISA § 408(a). Additionally, Congress has issued more than 20 statutory exemptions, virtually all of which cover IRAs. Not one of those exemptions has imposed a "reasonable person" standard or a subjective "misleading disclosure" standard as a condition punishable by transaction reversal, payment of lost earnings, and an excise tax, regardless of whether there is a loss on the trade and regardless of whether the disclosure is entirely correct but simply unclear. Nor has any exemption previously issued by the Department contained such vague and subjective conditions as are contained in the Proposal. Had Congress wanted to subject Title II plans to either or both of these standards, it would have done so and as it hasn't, we question the Department's statutory authority to do so.

We note that Congress specifically included a prudence standard in ERISA and specifically excluded a prudence standard in the Code. We suggest that the reason for that distinction is the very difficulty the Department overlooks here: that the standard is not susceptible of a bright line test for which an excise tax is appropriate. Nonetheless, the Proposal purports to condition relief under section 4975 of the Code by creating a subjective, "community-based" condition for use of the exemption, the failure of which, in any respect, would make the relief under the exemption unavailable. We do not believe that Congress intended a breach of the duty of prudence to violate the prohibited transaction provisions of ERISA and the Code.

We note that no exemption previously issued by the Department has contained such vague and subjective conditions such as these. If the Department insists on retaining compliance with non-misleading disclosure as a condition, we suggest instead that the Department explicitly adopt FINRA guidance relating to Rule 2210 regarding the term "misleading.[5] Because violation of a prohibited transaction exemption has such dire consequences, we do not believe that an inadvertent, immaterial statement taken in the wrong way by a client (or in hindsight alleged to have been misunderstood by a disgruntled client) or an immaterial omission should result in a reversal of the transaction, a guarantee of losses and an excise tax on the entire principal amount. The Proposal as drafted requires perfect disclosure, and any foot fault eliminates the relief. It shifts the burden of proof to the fiduciary to prove that a transaction was in the best interest of the client, to prove that the disclosure was perfect, and the compensation reasonable. At the very least, the condition should be that the fiduciary reasonably believed that the fiduciary's statements were not misleading.

SIFMA hopes that the Department will eliminate these amendments for all the reasons given above. Should it choose not to do so, the following comments point out additional flaws in the drafting. The Proposal requires fiduciaries to prove that advice was given "without regard to the financial *or other interests of* the … [financial institution] or *any other party*." We do not know what these references to other interests and other parties mean and the preamble does not explain them. Given the risks of penalties for prohibited transactions and the threat of class action

[5] See e.g, FINRA Frequently Asked Questions regarding Rule 2210. http://www.finra.org/industry/finra-rule-2210-questions-and-answers

litigation for getting this wrong, we request that this language be deleted from the exemption.

The standard requires that the advice be "without regard" to the financial interests of the adviser.[6] We are concerned that under this standard as written, a fiduciary will fail any time a plaintiff can prove that the adviser did not recommend the investment that paid him or her the least. To date, neither the Department nor the courts have held that reasonable compensation means the lowest cost. Rather, as the Department notes on its website in "*Meeting Your Fiduciary Responsibilities,*" cost is an element that should be taken into account but it is not the sole determining factor.

FINRA uses a much more common sense test that does not contain a standard that cannot practically be met: it requires that the adviser make suitable recommendations based on the client's financial circumstances and needs and that the adviser put his client's interest before his own. We urge the Department to use the FINRA formulation. This formulation is found in supplementary guidance to FINRA Rule 2111 and we respectfully request that the Department use it here.[7]

Finally, we urge the Department to use a reasonable compensation standard consistent with section 408(b)(2) and the rules, regulations, advisory opinions and case law applicable to that formulation of reasonable compensation, rather than develop a totally new and unexplained standard that we believe is impossible to comply with. The industry knows what reasonable compensation means and that is the standard used in the statute. We do not believe that the phrase "reasonable in relation to the total services the fiduciary provides to the plan or IRA" will further compliance or provide any additional protection not currently available to plans and IRAs. This new formulation of reasonable compensation is unexplained. Nor does the Department attempt to justify the differences between this formulation and Congress's view of

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[6] We note that FINRA's markup/markdown rules expressly include consideration of the cost to the financial institution of obtaining and carrying the security. Rule 2121.01(b)(2) ("in the case of an inactive security the effort and cost of buying or selling the security"). Does the Department's formulation make the FINRA requirement impossible?

[7] FINRA RN 12-25, A1 (December 2012).

reasonable compensation, which does not require all compensation received by a financial institution to be justified by a particular set of services to a particular account. The Department's formulation ignores the reality that every relationship has some inherent conflict. Financial service providers are not charitable organizations and they are entitled to be compensated for the services and products they provide, taking into account the costs incurred in developing and maintaining them, the sales effort to get investors to use them, costs of regulatory compliance, etc. We believe this language is troublesome and we urge the Department to use the language it has used since the enactment of ERISA and as recently as 2012, when it entirely revised its regulations under ERISA § 408(b)(2).[8]

SIFMA and its members appreciate the opportunity to comment and look forward to meeting with the Department to discuss our concerns. For further discussion, please contact the undersigned at 202-962-7329.

Sincerely,

Lisa J. Bleier

Lisa J. Bleier
Managing Director, Federal Government Relations
and Associate General Counsel

[8] *See* 29 C.F.R. § 2550.408b-2(d) ("Section 2550.408c-2 of these regulations contains provisions relating to what constitutes reasonable compensation for the provision of services."); 29 C.F.R. § 2550.408c-2(b)(1) ("In general, whether compensation is 'reasonable' under sections 408(b)(2) and (c)(2) depends on the particular facts and circumstances of each case.").