THE
NEWPORT
GROUP

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July 21, 2015

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attention: Conflicts of Interest Rule
Room N-5655

Office of Exemption Determinations
Employee Benefits Security Administration
Attention: D-11712 and D-11713

United States Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Sent by Electronic Mail to:

Email: e-ORI@dol.gov.

Re: **RIN 1210-AB32 Proposed Fiduciary Advice Regulation and Proposed "Best Interest" Exemption (the "Proposal").**

Dear Sir or Madam:

The following comments are respectfully submitted on behalf of The Newport Group, Inc. ("Newport"). Newport and its affiliates provide record keeping, administration, and investment advisory services to plans subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). Newport also provides life insurance brokerage services which include general and separate account products (the latter constituting securities under the Securities Act of 1933). Newport does not have and does not sell proprietary investment products.

Newport's clients sponsor qualified pension, profit sharing, 401(k), ESOPs, nonqualified deferred compensation plans and voluntary employee beneficiary association arrangements (VEBA) trusts. Newport also provides life insurance brokerage to executive benefit plans. Newport does not provide services to individual retirement accounts.

Newport writes to provide its perspective on the need for new advice regulations and related exemptions with respect to each of the qualified, nonqualified and welfare benefit marketplaces and particularly in response to the Department's request for additional information.

1. Recent Industry Trends Indicate Less of a Need for Regulations Addressing Conflicts of Interest Based on Product Commissions.

Potential record keeping clients are introduced to Newport through independent financial intermediaries ("FAs") consisting of (i) registered representatives of broker-dealers and (ii) registered investment advisers ("RIAs") subject to the Investment Advisors Act of 1940 (the "Act"). During the last ten years, Newport has observed a dramatic shift away from broker referrals to the point where almost all of Newport's referrals currently are derived from RIAs. Newport observes competition from RIAs in plan markets as small as $1 million in assets. This shift began approximately ten years ago and has accelerated noticeably in the past five years. These changes are due to a number of events, including the availability of institutionally priced investments to small plans, increased competition between the advisor and broker business models, the wholesale shift among the larger brokerages toward fee-based pricing and technological developments which make it easier to scale advisory services across a large number of small plans. Newport expects this trend toward fee based advisory services to continue in the absence of further regulation by the Department.

The marketing of insurance products to pension and welfare plans has not changed materially in the past 30 years and nothing in recent history suggests a need for regulations that would change those practices.

Life insurance products are no longer sold to most defined contribution qualified plans because of statutory and regulatory restrictions. Annuity contracts are limited to terminal funding for terminating defined benefit plans. Such contracts are the exclusive means for providing benefits from terminated defined benefit plans. Existing regulations Department guidance adequately describe the fiduciary obligations attendant to conducting due diligence in the selection of the carrier and the policy. Group annuity contracts continue to be sold to some plans, but the use of such contracts in a low interest rate environment has declined steadily over the past 30 years. Newport has few, if any qualified plans under administration that are funded with group annuity contracts.

With respect to welfare plans, insurance is the only option for employers who chose not to self-insure. There is no indication in the Proposal of a history of abuse in the area of welfare plans, that the commission structure of insurance products leads to inappropriate recommendations, or that changing the rules will materially benefit plan participants. With the exception of VEBA's, the decision to purchase insurance is typically done by a corporation with premiums paid from corporate assets. Any savings in connection with the Proposal will benefit the employer, not the employees. The employer's interest is aligned with expense reduction, due diligence and conflict of interest mitigation.

Life insurance is frequently used as a financial hedge by sponsors of nonqualified deferred compensation plans. Such plans are exempt from ERISA's fiduciary rules. The policies are held by the corporation either directly or through a grantor trust and are reported as corporate assets on the sponsor's financial statements. Life insurance also is used by sponsors to provide certain welfare benefits to a select group of management or highly compensated employees including split-dollar, death benefit and supplemental life insurance. These plans, while not exempt from the fiduciary rules, are exempt from the obligation to hold assets in trust (See DOL Technical Release 92-01). In almost all instances, the employer bears the cost of the policies. The employee's interest, if any, is typically tied to the cash surrender value and the face amount of the

policy. Investment alternatives within insurance company separate accounts are no-load and institutionally priced (no 12b-1 fees). Brokers receive no additional compensation, direct or indirect, based on investment allocations that may be made by employers or participants within the policy.

Because the information relied on by the Department to support the Proposal does not reflect recent, dramatic changes in the participant-directed qualified plan marketplace (even since the 2010 proposed regulations), does not take into account the trajectory of those trends, and sweeps too broadly into areas including employer paid welfare plans and executive benefit programs where there is little evidence of abuse, Newport believes the need for additional advice regulations extending coverage to brokers are not demonstrated.

2. <u>The Line Between The Seller's Carve-Out and the Requirement to Comply with the Proposed Advice and BICE Exemption Does Not Appropriately Identify Sophisticated Investors or Identify a Market Requiring Department Oversight</u>

The Department has requested comment on whether the requirements for the so-called "seller's carve-out" appropriately identify sophisticated investors who understand that a broker is not acting in a fiduciary capacity. Among other requirements, the seller's carve-out applies to plans covering more than 100 participants. The 100 employee alternative is taken from the reporting exemptions as a reasonable approximation of a small plan with an unsophisticated employer.

There are many instances where a large employer has small plans for a division, subsidiary or eligible group that covers fewer than 100 participants. Under the Proposal, the same sponsor could be considered "sophisticated" with respect to the larger plan but unsophisticated with respect to the smaller ones. If headcount is a reasonable proxy, it should be based on total employees, not participants in a particular plan.

However, it is not clear that headcount is a reasonable proxy. ERISA does not waive the fiduciary standards for small plan fiduciaries. Rather, the reporting exemptions acknowledge that small plans are financially unsustainable if the cost of annual reporting and annual audits is disproportionate to plan benefits.

The Proposal also fails to acknowledge small plan markets where the purchaser is deemed to be sophisticated, such as welfare plans benefiting a "select group of management or highly compensated employees". Congress recognized that ERISA's protections are not required for top hat plans.

The Proposal assumes brokers predominate in markets where plan assets are under $100 million. As described above, Newport's experience is not consistent with this view. RIAs and brokers compete for plans with as little as $1 million in assets, primarily because the adviser believes the plan's assets will grow over time.

The financial services industry already has a test for disclosures to unsophisticated investors under the Securities Act of 1933, the Securities Exchange Act of 1934 and the exemptions for accredited investors. The Department's development a bright line test may simplify the application of the rules, but it does not properly or consistently identify unsophisticated investors

nor does it closely approximate a market that is underserved with impartial advice and deserving of substantial regulatory burden and ongoing oversight by the Department.

Even if unsophisticated, a small plan sponsor is just as capable of understanding the broker's selling role if disclosures are made in advance as provided in the seller's carve-out.

Newport requests that the seller's carve-out (if retained) apply without regard to plan size as long as the seller reasonably determines after disclosure of the seller's role that the buyer understands the seller is not acting in a fiduciary capacity, with a safe harbor for any sponsor who meets the accredited investor definition under federal securities laws at the point of sale.

3. The Proposal Should Clarify the Dual Requirements of Advice and the Contract or Arrangement That Elevates Advice to Fiduciary Status.

The Proposal provides a two-step process to becoming a fiduciary advisor, including rendering one of the categories of "advice" and then either (i) acknowledging fiduciary status or (ii) providing advice under an arrangement, oral or written, that the advice is 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 Proposal explains:

> This paragraph requires an agreement, arrangement, or understanding that advice is directed to a specific recipient for consideration in making investment decisions. 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.

In other places, the Proposal suggests that merely recommending a specific investment is enough to satisfy both the advice category and the "agreement" requirement. For example, model portfolios listing specific investments and directed to no one in particular would be considered fiduciary advice even though there is no contact let alone an oral or written agreement between the advisor and an individual participant. One can imagine other situations similar to the platform exemption where any one of three to five alternative "large cap growth" funds would be presented to a participants as "appropriate for a portfolio". To take it one step further, does an advisor who recommends a limited menu of investments to a plan sponsor of a participant-directed plan become an advisor to the participants solely because there is only one alternative for each investment class?

Does the recommendation of a menu of target date funds constitute advice to each participant whose age falls within a fund's designated target date at age 65?

If an oral or written agreement is required, what would be the effect of an oral or written disclaimer by a broker to the effect that he or she does not have an agreement to provide investment advice or impartial recommendations? If the seller's exemption or other carve-out is not available, is the seller a fiduciary?

Recommending a specific investment should not be enough to become a fiduciary. The regulations need to better explain how the second part of the test regarding the oral or written

understanding can be used to create or reject fiduciary status so that the parties have a clear as opposed to implied arrangement for fiduciary services.

4. Model Portfolios Should Not Be Considered Advice

The Proposal identifies model portfolios with specific fund recommendations as "advice", notwithstanding any disclaimers regarding the availability of other fund choices. The stated concern is the ability of brokers to steer participants toward certain investments for the benefit of the broker. However, the rule would also appear to apply to registered investment advisers who develop model portfolios and who have no incentive to steer participants into any particular fund. Under current law RIAs are not advisers to the participants if the requirements of IB 92-1 are followed.

Designating specific funds in a model is a matter of practicality. If specific funds are not used, the participants will need to reconstitute the model by selecting each fund and the allocation percentage for each. With a "platform" approach, this process is daunting for most participants. Most advisers therefore limit the menu to a few or even one option for each asset class and investment style. With a reduced menu, the use of a single selection button to automate the investment election is a natural next step.

A well-diversified, representative menu of investments across all asset classes and styles typically consists of 10-12 fund options. If the Proposal is adopted, the number will triple to 24 or 36 to provide sufficient alternatives for each class and style in order to avoid a "recommendation". Newport is of the view that adding such a degree of complexity, due diligence on behalf of a sponsor and pressure on the client to review the menu as part of its fiduciary oversight role and then communicating each of the options to the participants is not a worthwhile expenditure of adviser or sponsor resources. (Imagine 36 funds, fund fact sheets, prospectuses, 408(b)(2) and 404a-5 disclosures on a webpage that is supposed to be accessible in a simple format by the unsophisticated investor.) Advisers (both brokers and RIAs) will do it, however, if the alternative is to make them responsible as advisers to the participants. It is not clear that participants are better off with multiple choices, nor is there any indication returns would improve.

5. Additional Disclosures and Agreements Are Not Likely To Materially Change Behavior Or Investments

The Proposal requires a number of disclosures in various contexts, including (i) advice agreement (ii) seller's carve-out (iii) platform carve-out (iv) education carve-out, (v) BICE exemption. Fee disclosures are integral to the disclosures, along with conflicts of interest. The BICE exemption requires ongoing disclosures of various fees, transactions and returns.

In connection with the 408(b)(2) and 404a-5 regulations, Newport spent multiples of six figures on internal cost allocations related to fee disclosure compliance. This was an enormous sum of money for an open-architecture fee-transparent firm to spend in order to meet the technical requirements for disclosure that were largely met prior to the regulations.

The regulations were adopted with the purpose of promoting dissemination of investment information, and particularly cost, to sponsors and participants to assist them in making informed investment decisions. Following the 404a-5 disclosure deadline Newport received not a single inquiry from a participant about fees, investment information or expenses. We asked our key

clients if they received any inquiries. Not one. Not a single question on the quarterly statements. There was no perceptible surge in investment allocations after the disclosures were sent. It is highly unlikely that Newport's experience is unique among providers even among plans advised by brokers.

The Proposal purports to add disclosures substantially overlap those required under 408(b)(2) and 404a-5. Adding the requirement for two multi-party contracts with the sponsor and participant to qualify for the BICE exemption will not materially change investment performance.

The regulations should more clearly establish why advance and post-disclosures beyond those required under Section 408(b)(2) and 404a-5 and the quarterly statements received by plan participants are needed for ERISA plans. This should be a part of the cost-benefit analysis in support of the Proposal.

6. <u>The Cost-Benefit Analysis Should Consider Benefits at the Individual Investor Level, Not in the Aggregate Over 10 and 20 Years.</u>

The costs to the financial services industry to comply with the Proposal is immediate and estimable based on prior experience. It is larger than the cost estimated by the Department. The payoff is long-term, relatively small and speculative.

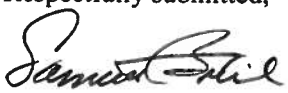
The 88 billion benefit to the IRA market over 20 years equates to $88 per year per account holder, uncompounded (assuming 50 million IRA account holders—the actual per-account figure may be substantially less). The estimated gains will not materially enhance retirement security. The cost to the industry to provide the $88 in enhanced return greatly exceeds the individual benefit.

The savings in the ERISA marketplace are less likely for the reasons set forth in this letter.

Conclusion

For the reasons set forth above, Newport asks that the Proposal reconsider (i) the need for the regulations and (ii) whether the same benefit can be obtained at far less cost using simplified regulations that disclose the capacity in which a seller of financial services is acting. While individual investors may not be sophisticated, it is possible to become acquainted with basic investment principles and alternative services with an internet connection. The failsafe for the unsophisticated investor is to let the marketplace sort out the options by putting the plan services out to bid.

Respectfully submitted,



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