

THE FINANCIAL SERVICES ROUNDTABLE

Financing America's Economy



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Via email to e-ORI@dol.gov

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

Attn: Definition of Fiduciary Proposed Rule

Dear Ladies and Gentlemen:

The Financial Services Roundtable¹ (“Roundtable” or “we”) welcomes the opportunity to comment on the proposal (the “proposal”) by the Department of Labor (the “DOL” or “Department”) to expand the definition of “fiduciary” under Section 3(21) of the Employee Retirement Income Security Act (“ERISA” or the “Act”).² The Roundtable also commends the Department for determining to hold at least one day of public hearings to obtain public comment.

The Roundtable respectfully requests, however, that the Department not address this issue independently, and that it instead withdraw its own rulemaking in order to work with the Securities and Exchange Commission (the “SEC”) to develop a uniform standard of care for broker-dealers and investment advisers when providing personalized investment advice to retail customers. We believe that such a collaborative approach is essential to preserving the range of investors’ choices that is available today from different types of financial institutions that have different business models, activities, and pricing structures.

The Roundtable also believes that implementation of the DOL proposal would cause unnecessary confusion. Since many existing prohibited transaction exemptions have been premised upon the current definition of investment advice fiduciary, we urge the Department to review the existing class exemptions, so that applying the definition of fiduciary to entities that are currently only service providers to plans may not prohibit the provision of services currently

¹ The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO.

Roundtable member companies provide fuel for America's economic engine, accounting directly for \$92.7 trillion in managed assets, \$1.2 trillion in revenue, and 2.3 million jobs.

² See *Definition of the Term “Fiduciary,”* 75 Fed. Reg. 65263 (Oct. 22, 2010).

relied upon by those plans. The Roundtable also notes that, effective July 16, 2011, fiduciaries and certain other service providers to employee pension benefit plans will be required to provide disclosure of direct and indirect compensation.³ It is essential that the DOL address the interaction of compliance obligations under new ERISA Regulation 2550.408b-2, which provides that “services providers” “must disclose to the responsible plan fiduciary direct and indirect compensation which the service provider expects to receive under a service contract with the fiduciary for a covered plan,” with any revision of the definition of “fiduciary.” If the definition of “fiduciary” is expanded such that the application of 408(b)(2) is expanded with little time for subject service providers to gear up for compliance, it will be necessary for the Department to adjust the compliance date to give service providers reasonable time to prepare.

I. The Need for a Uniform Approach

On July 21, 2010, Congress, pursuant to Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”), charged the SEC with, among other things, studying the obligations of broker-dealers and investment advisers (the “Report”).⁴ Among other things, the SEC was mandated to report on the effectiveness of existing federal and state legal or regulatory standards in the protection of retail customers relating to the standards of care for broker-dealers, investment advisers, and their respective associated persons when providing personalized investment advice and recommendations about securities to retail customers. The Report was submitted to Congress on January 22, 2011.⁵

Among other things, the SEC staff recommends that the SEC should promulgate rules to implement a uniform fiduciary standard of conduct for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers and such other customers as the SEC determines.⁶ The staff, consistent with Section 913, recommends that the SEC define the standard of care as a duty “to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice.” As part of its rulemaking, the staff recommends that the SEC address not only the components of a uniform fiduciary standard (*i.e.*, the duties of loyalty and care), but that it also provide guidance on specific scenarios to assist broker-dealers in transitioning to the new standard. Many of the issues that we would expect the SEC to address, *e.g.*, proprietary trading, compensation, sales of proprietary products, would be implicated for firms that are included in the DOL’s proposed definition of “fiduciary.” Accordingly, it is critical that the DOL and the SEC work together to develop a practical approach that addresses investor protection needs, but preserves investor choice and accommodates a range of business models.

³ See *Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure*, 75 Fed. Reg. 41600 (July 16, 2010).

⁴ Pub. Law No. 111-203, § 913(f), 124 Stat. 1376, 1828 (July 21, 2010).

⁵ Staff of the SEC, *Study on Investment Advisers and Broker-Dealers* (Jan. 2011), available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

⁶ See *id.* at 109-10.

The Roundtable has long been supportive of the harmonization of the regulations for broker-dealers and investment advisers when providing personalized investment advice about securities to retail customers. We also support strong consumer protections for retail investors. Consistent with Congress's interest in developing a uniform standard of care, we believe that these worthy goals can be achieved without subjecting broker-dealers and investment advisers to duplicative and overlapping regulatory regimes that create confusion among investors and may not recognize and allow for differences in the business models, services, and products provided by a range of financial services professionals. The Roundtable is concerned that the proposal would impose a uniform duty of care on a subset of the securities industry that would further increase investor confusion about the standard of care owed to them by their financial professionals and impose an additional and expensive layer of regulation on financial firms.

We also note the differing approaches of the DOL and the SEC with respect to fiduciaries' conflicts of interest. Although the Department generally prohibits, absent an exemption, conduct that is characterized by conflicts of interest, in some instances the SEC allows broker-dealers to manage and disclose conflicts, including by obtaining customers' consents.⁷ The two agencies are going down parallel tracks to address the same issues in sharply divergent ways. The Department is expanding the definition of fiduciary while preserving rules that would prohibit standard compensation practices in the broker-dealer industry. As proposed, disclosures of such practices would not cure a conflict of interest, although disclosure is a key element of the SEC's regulation of investment advisers and broker-dealers.

Accordingly, the Roundtable urges the Department to withdraw its rulemaking and to work with the SEC to develop a harmonized definition of "fiduciary" and concomitant regulatory regime applicable to market participants on all sides of this issue, but particularly with respect to overlapping activities related to individual retirement accounts ("IRAs") and small business retirement plans.⁸ Although we appreciate the Department's extension of the comment period for nearly two weeks following publication of the Report to provide commenters with a limited opportunity to evaluate the DOL's proposal jointly with the SEC's recommendations, we believe that the potentially momentous changes to the regulation of entities deemed to be fiduciaries under ERISA and the federal securities laws merits an integrated approach.

Notwithstanding the Roundtable's request that the DOL withdraw its rulemaking, our members support the Department's initiative to update the regulation of fiduciaries and to provide definitional guidance for the financial services and retirement planning industry to

⁷ See, e.g., Rules 206(3)-2 and 206(3)-3T under the Investment Advisers Act of 1940.

⁸ The Roundtable further notes that a broker-dealer that is deemed to be a fiduciary becomes subject to a minimum net worth standard under of the Internal Revenue Code that operates independently of the minimum net capital requirement for broker-dealers specified by Rule 15c3-1(a) under the Securities Exchange Act of 1934. Compare 26 C.F.R. § 1.408-2(e)(5)(ii)(B) (imposing a net worth requirement of the greater of \$100,000, or four percent of the value of all of the assets held in fiduciary accounts); with 17 C.F.R. § 240.15c3-1(a)(1)(ii) (requiring broker-dealers that calculate net capital under the alternative method to maintain net capital of not less than the greater of \$250,000 or two percent of aggregate debit items computed in accordance Rule 15c3-3A, 17 C.F.R. § 240.15c3-3A). Accordingly, we urge that the DOL and the SEC not work not only together to address these issues, but also confer with the Internal Revenue Service to address and avoid overlapping and inconsistent regulations.

ensure that plan participants and beneficiaries have clear and concise information. We therefore wish to offer the following specific comments on the Department's proposal.

II. Scope of the Definition of "Fiduciary"

The DOL's proposal would substantially increase the categories of service providers who are deemed "fiduciaries" for purposes of ERISA. While the Roundtable appreciates the need to ensure that the Act reflects developments with respect to investment advice provided to retirement plans and beneficiaries, we believe that the wide reach of the proposed language would have unintended consequences that could create uncertainty among service providers and potentially reduce the level and types of services available to benefit plan beneficiaries and individual retirement account ("IRA") investors.

We believe that it is imperative that the DOL and the SEC work together to develop an integrated and practical outcome resulting from the application of the standard or standards of conduct applicable to financial intermediaries. A critical part of this endeavor will be developing a business-neutral model that does not favor advisory relationships or brokerage relationships, and addresses practical issues that flow from normal course activities, including principal trading, proprietary products, and compensation, and provides a practical means for managing conflicts and identifying and addressing prohibited transactions.

One fundamental issue that will need to be resolved is that the DOL prohibits persons or entities that are deemed "fiduciaries" from engaging in certain activities, but the SEC generally allows entities deemed to be fiduciaries, such as broker-dealers that are dually-registered as investment advisers or affiliated broker-dealers and advisers to manage conflicts of interest by disclosing them to clients. In this way, broker-dealers are not limited in making recommendations that are in the best interests of their clients, but that otherwise would be precluded as a result of a conflict of interest, which can exist in principal trading or sales of proprietary products.

One specific comment that we have regarding the definition of fiduciary is that, under proposed paragraph (c)(1)(ii)(A) an oral or written representation or acknowledgement by a person that it is acting as a fiduciary or making recommendations would result in the imposition of fiduciary status. We agree that if a person providing advice represents or acknowledges that it is acting as a fiduciary or making recommendations described in paragraph (c)(1) of the proposed regulation, such person is and should have the responsibilities of acting as a fiduciary. The Roundtable is concerned, however, that if oral representations are sufficient to result in fiduciary status, faulty recollections by persons interacting with financial institutions could result in after-the-fact fiduciary status. Accordingly, we strongly urge the Department to provide that a person can only be deemed to have represented or acknowledged that it is acting as a fiduciary under paragraph (c)(1)(ii)(A) if it does so in writing.

A. Elimination of the "Regular Basis" and "Mutual Understanding" Requirements

As proposed, there would no longer be a requirement that a plan fiduciary provide advice on a regular basis. As a result, a person could be deemed a fiduciary as a result of a one-off

conversation, an informal discussion with human resource professionals, or other inadvertent triggers. If a plan manager happens to have informal, one-off discussions at a conference with a variety of contacts with which the plan executes transactions and receives brokerage commissions, it is unclear whether each of those contacts, and the contacts' employers, would then become fiduciaries. The risk of inadvertent fiduciary status will reduce the flow of information in the marketplace as broker-dealers and other financial institutions will sharply curtail the ability of personnel to have even informal communications with clients and potential clients.

In addition, the proposal does not require that the parties have a mutual agreement, arrangement, or understanding with a plan or plan fiduciary that the advice will serve as a primary basis for plan investment decisions. We believe that the current mutual agreement or understanding requirement provides certainty to both parties of a fiduciary relationship. Absent such an agreement, misunderstandings could result between the parties about whether a person is acting as a fiduciary and has complied with the attendant responsibilities, including disclosure of conflicts of interest.

The Roundtable further believes that fiduciary status should not apply when advice "may be considered." The current rule provides that a person will be a fiduciary when the person and the plan agree that the advice "will serve as a primary basis" for investment decisions with respect to plan assets. This is reasonable and in keeping with the intent of ERISA. The fiduciary standards of ERISA should only apply when the parties reasonably expect that the advice given and received will serve as a basis for a decision. A plan may solicit advice from a number of persons without engaging them as an advisor. A requirement for a written agreement between the parties would make the existence of the fiduciary relationship clear to both parties and help prevent inadvertent violations.

B. Seller's Exception

As proposed, a person will not be considered to be providing investment advice if (1) such person can demonstrate that the recipients of the advice know or reasonably should know that such person is providing the advice in its capacity as a purchaser or seller of a security or other property, or an agent of or appraiser for a purchaser or seller, (2) the person's interests are adverse to the interests of the advice recipient's, (3) such person is not undertaking to provide impartial investment advice and (4) such person has not acknowledged that it is providing advice as an ERISA fiduciary.⁹

Roundtable members are concerned that if a securities broker, insurance agent, or real estate broker makes a recommendation to a plan regarding the purchase or sale of a security or property and ends up not acting for the other side of the transaction, it will not be able to rely on this exception. In addition, if this exception is adopted as proposed, we respectfully ask the Department to clarify the meaning of "adverse interest." For example, if a broker-dealer who otherwise has a customer, albeit not a fiduciary, relationship with a plan or plan beneficiary acts as agent for the other side of a securities transaction, is that sufficient to render the broker-dealer's interests "adverse"? Also, we respectfully assert that a requirement to inform a party

⁹ See *Definition of the Term "Fiduciary,"* 75 Fed. Reg. at 65267-68.

that otherwise has a customer relationship that a broker is “adverse” could potentially result in investor confusion and effectively limit investor choice in selecting brokers.

Additionally, since the proposed regulation may expand the definition of investment advice to also include referrals to or recommendations of investment advisers, the Roundtable believes that the seller’s exception should be expanded to include recommendations regarding the purchase of services and not limited to recommendations of purchases or sales of property.

The Roundtable supports the Department’s recognition that many service providers offer platforms of investments that do not involve rendering investment advice, but instead provide a menu of investments from which plan fiduciaries can select a more limited menu that will be made available to plan participants. In the context of IRAs and 401(k) plans, however, we believe that it would be helpful for the DOL to provide additional guidance regarding what constitutes “individualized” needs, and particularly ask that the SEC clarify the application of the investment platform exception to IRAs. We note, for example, that the description of the DOL’s economic impact study, as discussed in the release, does not address IRAs.

C. Potential for Significant Harm to Investors

The Roundtable’s members are keenly concerned that the elimination of the mutual written agreement requirement and the practical elimination of the seller’s exception would greatly diminish, if not eliminate, the range of account services, including information tailored to a particular investor’s needs provided to retail investors by broker-dealers. This would result in two classes of investors. The first would be investors who can afford to pay higher fees based off the size of their accounts or assets under management. Those investors would receive investment advice. The second class of investors would be those who have brokerage accounts, and generally only pay fees when they effect transactions and receive investment advice that is incidental to those trades. The Roundtable believes that if the “regular basis” and “mutual understanding” requirements are eliminated, this second class of investors is likely to no longer receive investment advice, unless the investor is willing to establish an advisory account, which likely will result in higher fees for the investor.¹⁰ We further believe that, as the SEC staff recognized in its Report, it is important that any refinements to the standard of care as applicable to broker-dealers and investment advisers not limit investor choice, but instead preserve investor access to various fee structures, products, services, and account options.¹¹

Further guidance is needed as to where the line between “investment advice” and “investor education” is drawn. We are concerned that the availability of information to non-advisory clients likely would also diminish because of concerns that educational information, or opportunities to participate in occasional webcasts or conference calls might be deemed investment advice and result in an inadvertent fiduciary relationship. The Roundtable respectfully requests the DOL to confirm that the current broad exception for education is the same for IRAs and 401(k) plans.¹²

¹⁰ See Oliver Wyman, *Standard of Care Harmonization Impact Assessment for SEC* (Oct. 2010).

¹¹ See Report at 113.

¹² 29 C.F.R. 2509.96-1 (2010).

D. Appraisals, Valuations, and Fairness Opinions

The DOL proposes to include under Sec. 2510.3-21(c)(1)(i) under the Act “the provision of appraisals and fairness opinions concerning the value of securities or other property,” even if such appraisals and valuations are not prepared for or used in connection with the management or investment of plan assets. Roundtable members are particularly concerned that the exception in Section 2510.3-21(c)(2)(iii) of the proposed regulations has the potential of making every report provided by a trustee or custodian to a plan fiduciary a fiduciary service. We respectfully recommend that the Department revise the proposed text of the regulation by omitting the requirement that the report be provided for purposes of compliance with the reporting and disclosure requirements of the Act. In other words, we believe that this subparagraph should end with “shall not include the preparation of a general report or statement that merely reflects the value of an investment of a plan or a participant or beneficiary.”

We are also concerned about the impact that inclusion of the appraisals of securities and property could have on employee stock options plans (“ESOPs”) as well as hard to value assets such as swaps and derivatives. The Roundtable does not believe that the preparers of appraisals, valuations, or fairness opinions should themselves be deemed fiduciaries for purposes of the Act. Rather, we believe that the fiduciary responsibility should rest with the provider of investment advice to use appropriate diligence in selecting the preparer of the opinion or report.

Instead of including appraisers within the definition of “fiduciary,” the Roundtable believes that it would be more appropriate to require this category of market participants to meet certain minimum qualification standards. We also note that providers of fairness opinions are generally already subject to comprehensive regulation by the SEC as broker-dealers, and in the case of providers of fairness opinions in connection with municipal securities, municipal advisors. In addition to the requirement that the SEC consider whether broker-dealers have a fiduciary duty to their retail clients when providing personal investment advice about securities, Section 975 of the Dodd-Frank Act specifically notes that municipal advisors have a fiduciary duty to their clients. Once again, we believe that the DOL and the SEC should coordinate the determination of the appropriate standard of care for issuers of fairness opinions.

E. Management of Securities or Other Property

The proposal applies to advice or recommendations as to the management of securities or other property, however, no guidance is provided as to the meaning of “management of securities or other property.” For example, it is unclear whether this would include recordkeeping and other administrative services, or even a recommendation as to a property management company to use for a rental property. The Roundtable respectfully requests that the DOL clarify that the phrase “management of securities or other property” does not include recommendations of administrative services, property managers, or other non-investment management-related services.

V. Definition of Compensation

The DOL proposes that a person would be deemed to provide investment advice to an employee benefit plan if, among other things, the person provides advice or makes recommendations, and in return receives a fee or other compensation. The proposed new rule would define the direct or indirect receipt of a fee or other compensation for investment advice to include “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.” Among other things, this would include brokerage commissions, mutual fund sales, and insurance sales commissions as well as fees and commissions based on multiple transactions involving different parties.

The proposal’s inclusion of brokerage commissions, including those with respect to mutual fund shares and insurance products, paid in the course of providing investment advice steps ahead of Congress’s directive to the SEC in Section, 913 of the Dodd-Frank Act that the SEC consider whether to eliminate the “broker” exception from the definition of “investment adviser” in Section 202(a)(11)(C) of the Investment Advisers Act of 1940.¹³ That current statutory provision allows broker-dealers to provide investment advice in connection with the execution of securities transactions for customers as long as the broker receives only brokerage commissions for effecting a transaction and does not receive a separate fee for providing the advice. The Department’s proposal, however, would essentially eliminate the ability of broker-dealers to avail themselves of this exception if the investment advice is provided to plan fiduciaries, beneficiaries, or participants.

Given that Congress specifically charged the SEC in Section 913 of the Dodd-Frank Act to study the regulation of broker-dealers and investment advisers and to engage in rulemaking necessary to address any gaps in their regulation, we believe that the SEC, and not the DOL, should be charged with promulgating any regulations that could potentially fundamentally change the manner in which broker-dealers are compensated. The Roundtable believes that the conflicting perspectives on broker compensation further support why the Department and the SEC should work closely together to address the definition of “fiduciary” as it is proposed to apply to broker-dealers and investment advisers.

The Roundtable is particularly concerned that the application to affiliates is overly broad and far-reaching, without identifying the actual or potential harm to investors. It would be logistically difficult to track compliance for complex, multinational financial institutions that engage in a variety of investment advice, transactional, insurance, real estate, and other potentially covered activities in numerous entities. Further, it does not reflect the use of internal controls, such as information barriers, that have been recognized by the SEC as effectively walling off affiliated entities so that conflicts and other compliance risks are effectively managed. Accordingly, we respectfully ask that the DOL narrow the application to affiliates.

¹³ The definition of “investment adviser” does not include “any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore.”

VII. Conclusion

The Roundtable thanks the Department for the opportunity to provide the views of its members on the proposed rules, and supports the Department's initiatives to better protect plan beneficiaries and investors in IRAs and other retirement accounts. Given, however, that both the DOL and the SEC are at the threshold of introducing momentous changes to the regulation of entities deemed to be fiduciaries under ERISA as well as the federal securities laws, the Roundtable strongly urges the DOL to withdraw its proposed rulemaking in order that the Department and the SEC can work together to harmonize the regulation of fiduciaries that are subject to the Act and the federal securities laws. We believe that regulatory changes in this area should benefit from the findings of the study mandated by the Dodd-Frank Act and warrant a collective approach in light of the complexity of the issues, the potential far reaching scope and implications of the DOL and SEC initiatives, and the risk of inconsistent and overlapping regulation. Similarly, we ask that the Department also take into account its own concurrent rulemakings in order to provide deemed fiduciaries appropriate time to comply with all new requirements, including those imposed by 408(b)(2).

If it would be helpful to discuss the Roundtable's specific comments or general views on this issue, please contact me at Rich@fsround.org. Please also feel free to contact the Roundtable's Senior Regulatory Counsel, Brad Ipema, at Brad.Ipema@fsround.org.

Sincerely yours,



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cc: Phyllis C. Borzi, Assistant Secretary
Employee Benefits Security Administration