SIFMA
Securities Industry and
Financial Markets Association

October 6, 2008

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

Re: Proposed Investment Advice Exemption and Proposed Class Exemption on Investment Advice

Ladies and Gentlemen:

On behalf of the Securities Industry and Financial Markets Association ("SIFMA")[1], I am writing in response to the Department of Labor's ("Department") proposed regulation under the Employee Retirement Income Security Act of 1974 ("ERISA") that will provide additional guidance on the statutory exemption for investment advice, and the proposed class exemption for investment advice that does not meet the statutory exemption.

SIFMA and its members appreciate the opportunity to comment on the proposed regulations and the proposed class exemption. We strongly support the proposed regulation and class exemption and commend the Department of Labor for their work. The regulation and exemption have been subject to a thorough process of evaluation and analysis and we believe that with a few modifications, will serve retirement plan participants and IRA investors for many years to come.

Overall, we believe that the regulations tie closely to the statutory exemption and are generally workable. We believe the class exemption will be a major step forward toward actually delivering useful, prompt and responsive investment advice to participants in self-directed plans and IRA owners. Without the class exemption, the hurdles to providing investment advice are just too high: the corporate restructuring necessary to provide that advice on a fee level basis, and the restraints of delivering only advice that is generated by a model, regardless of the individual circumstances and preferences of the participants and IRA owners.

[1] SIFMA brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

SIFMA also appreciates that the Department has affirmed that the proposed regulations and class exemption are not intended to alter past guidance. For example, the threshold question with any advice interaction, broadly defined, remains whether the definition of a "Fiduciary" is triggered within the meaning of 29 CFR Section 2510.3-21. If, for example, the conduct of a representative at one of our member firms in occasionally assisting a client with his or her IRA does not rise to the level of "investment advice" under that definition, then the sanctions resulting from application of section 4975 of the Code, by reason of section 4975(c)(1)(A) through (F) of the Code would not apply. It would therefore not be necessary to comply with the proposed regulations or class exemption (or any other PTE). The understandable focus and attention on the proposed regulations and class exemption and how they apply to IRAs should not obscure this point, and it would be helpful for the Department's final guidance to reiterate it.

Scope of Relief

The scope of the exemptions should be clarified to explicitly include relief for extensions of credit, and uses of plan assets that are intrinsic to trading and that have been previously covered in trading exemptions such as PTE 75-1 and 86-128. In addition, the relief should extend to transaction such as overdrafts, float, settlement extensions of credit, short sales, debt instruments, etc. We believe that the proposed regulation and the proposed exemption would be clearer and raise fewer questions if they explicitly provide for relief for extensions of credit. Finally, we hope the Department will confirm that where a plan used a broker dealer for brokerage without advice, that service has no effect on the availability of the statutory or class exemption where other, separate transactions are engaged in with that broker dealer after a fiduciary advisor provides investment advice to a participant.

The Department should also include ministerial rebalancing of a portfolio in the scope of the exemption. Under this type of activity, the fiduciary advisor would be covered under the exemption when an IRA owner or participant has given standing instructions to rebalance the portfolio on a pre-determined basis. This should not be deemed to be a discretionary action on the part of the advisor but will occur solely at the direction of the participant within the meaning of the statutory and class exemption. We also urge the Department to include the kind of re-optimization or re-allocation that has been permitted in the TRAK, Target and PACE exemptions, which permit changes to a portfolio when the model changes and clients receive advance notice.

We believe that the class exemption computer model rule applicable to IRAs for which computer models are not compatible should be extended to brokerage windows under 401(k) plans. These investment options are really no different than open-ended investment IRAs and the need for advice to plan participants in the context of these brokerage windows may be even more acute than in the context of asset allocation to a discrete set of funds. We believe that the Department has the authority to extend this rule to brokerage windows in 401(k) plans and we hope that it will agree that the rules proposed in the class exemption fit well in the 401(k) brokerage window context.

Many IRA owners and plan participants in brokerage windows use investment advisers to help them select discretionary managers, who may or may not be affiliated with the advisor. That process usually takes place in wrap programs but need not be limited to that format. While we understand that the exemptive relief in the class exemption will not apply to discretionary management, we urge the

Department to make clear that it does apply to recommendations made by the financial advisor that will enable a participant to select different discretionary managers for different asset classes.

Finally, the proposed class exemption does not currently permit advice to be provided to participants in the self-directed plans of financial institutions that provide advice unless the advice is provided by an entity independent of that institution. We think this omission is inconsistent with the Department's and Congress' long held view that it would be inappropriate to make the plans of a particular institution use products of competitor institutions. See for example, ERISA section 408(b)(4) (permitting plans maintained by a bank to invest in its own deposits), section 408(b)(5) (permitting plans maintained by an insurer to use the insurer's own products), section 408(b)(6) (permitting plans of a bank to receive ancillary services from the bank), section 408(b)(8) (permitting plans of a bank or insurance company to invest in that institution's pooled funds), PTE 77-3 (permitting plans of mutual fund advisors to invest in the affiliated mutual funds, and PTE 79-13 (permitting plans of closed end investment companies to invest in the affiliated closed end fund), and PTE 79-41 (permitting plans of insurers to invest in their own products). We think there should be no different result here. Plans of financial institutions should not have to select their competitor's advice product and the competitors may not be willing to provide advice if they thought there was any possibility of reverse engineering a trade secret. The result of this impasse would be that participants in a financial institution plan would be unable to have advice and they are no less in need of advice than any other group of employees.

Computer Models

SIFMA agrees with the Department's treatment of employer stock under the computer model option. Many investment advisors believe that a non-diversified portfolio which presents the same risks as a participant's employment risk is not necessarily in the best interest of participants. By excluding the employer stock but taking the portfolio investment in employer stock as the adviser finds it, the adviser will be able to recommend an asset allocation that recognizes, but does not change the employer stock decisions made by the participant. The exclusion permitted by the proposed regulations will typically be dealt by including an assumption that the participant does have an allocation to a single equity investment and appropriate diversification should be recommended by the model.

In addition to the exceptions for employer stock and self-directed brokerage windows, we encourage the Department to provide an exception for in-plan annuity investment options, to permit such options to be disregarded in applying the computer model. These investment options are an increasingly important option for participants to structure payments in anticipation of their financial needs in retirement. However, it is our understanding that many computer models are not able to take such options into account. We request that the employer stock and self-directed brokerage window exceptions be extended to include such options, to avoid penalizing plans that include these types of investment vehicles to assist plan participants in planning and saving for retirement.

We also urge that the final regulation and exemption retain flexibility that is provided in the guidance regarding off-model advice. SIFMA believes that this provision will make advice far more useful, less rigid and more accessible to plan participants and IRA owners. Under the Sun America option, many participants have been dissatisfied with the advice they receive because of the constraints on the advice provider. The off-model advice guidance the Department has proposed will significantly

enhance the quality of the advice that participants receive through electronic means. It would be very helpful if the Department could confirm that the fiduciary advisor who provides off-model advice can rely on the information provided by a participant. For example, a 401(k) recordkeeper may offer participants access to a model developed by another, such as Morningstar, Financial Engines, or a proprietary model that complies with the Pension Protection Act. If an employer also provides access through a second advice provider – such as a retail brokerage firm - can the advisor rely on the results of the computer model when making off-model recommendations? Without some confirmation that the advisor can rely on the documentation from the participant, it is unlikely that the off-model alternative can be used except when a participant seeks advice from the provider of the model.

Audit Requirements

The proposed regulation and class exemption require the fiduciary advisor to obtain an independent audit on an annual basis. SIFMA has a number of comments regarding the audit requirements. First, it appears that the auditor may not be required to be a certified public accountant but it is not completely clear. If the Department believes that being an accountant is not required, it would be helpful to include a statement in the preamble that audits could be performed by professionals other than traditional accounting firms. It would be helpful if the Department provided some examples of appropriate experience that might qualify a firm for this role.

Another issue relates to auditor independence. The proposed auditor independence requirement is defined by reference to affiliation. We would like to confirm that there is no prohibition on using the same firm to certify the model as well as perform the annual audit referenced in the regulations as long as the certifying firm does not receive more than 10 percent of its revenue from the fiduciary advisor. In addition, we would appreciate the Department's confirmation that the fact that the auditor may audit the company that is providing the advice or certifying the model, an affiliate of either, or a fund maintained by the entity providing the advice or an affiliate does not disqualify the auditor in any way. Any other answer is impractical in light of the small number of firms that will offer their services to perform these audits.

The Department should also permit the audit requirement for the class exemption to be satisfied when an independent auditor reviews the audit performed by the internal audit department of the fiduciary advisor. The independent auditor would have the role of reviewing the audit for completeness. This type of audit is more in line with general corporate auditing standards for publicly held companies under the securities laws and would make the audits far more affordable without jeopardizing their thoroughness.

The audit requirements could also benefit from some additional clarity. For example, we believe that it should meet the audit requirements of the regulation and the class exemption if the auditor reviews the fiduciary advisor's policies and procedures, and reviews a reasonable sample of accounts for the documentation required to be maintained. In connection with sampling, we urge the Department to clarify that neither the exemption nor the class exemption require each IRA to be audited, so long as the sampling of documentation includes at least some IRAs. In addition, it is assumed that the regulation will not require that actual transactions be audited at all, and we would appreciate clarification on that point. We urge the Department to consider the cost and time required of any other approach; for a firm with 15,000 registered representatives, thousands of IRAs that elect to retain an adviser for a fiduciary advice program

and hundreds of plan clients, the audits would consume the entire year and millions of dollars. In addition, under the proposed class exemption, the documentation for IRAs under the model requirements requires that the adviser describe why any advice that resulted in higher fees to the advisor was prudent. We think it would be impossible for the audit to test for prudence on a "Monday morning quarterback" basis.

We also believe that the timing of the audit report should be the same for IRAs and plans – 60 days. A shorter time is very impractical for a large institution and there appears to be no particular reason for the shorter period for IRAs. Especially where the audit must be mailed or otherwise delivered to all accounts, where hundreds of thousands of accounts are concerned, 60 days is quite a short period of time. We also hope that the Department will make clear that the auditor need not send its audit report directly to clients, but rather, the fiduciary advisor will bear the responsibility for delivering the report.

The proposed regulation and the proposed exemption require notification of the Department in the case of any evidence of noncompliance. There is concern that this standard will result in thousands of reports to the Department detailing immaterial errors of recordkeeping and record retention. It would be very helpful if the Department added a standard of materiality to this requirement. In addition, we strongly urge a cure period. The audit provisions should make clear that if there is a problem that is capable of cure and cure is effected within 15 days, no notice need be sent to the DOL.

Application of Bonding Rules

It is noted that the proposed regulation and the proposed class exemption require the entity that certifies the model to be a fiduciary. Under section 412 of ERISA, every fiduciary to a plan must be bonded, regardless of whether that fiduciary handles plan assets, unless an exemption applies. We do not readily see an exemption in the regulations for a model certifier. Accordingly, it would be beneficial for the Department to amend section 412 to exempt the entity certifying the model from the bonding requirements.

Scope of Fee Leveling

We believe that the Department has correctly recognized under the proposed class exemption that the level fee requirement should relate to the individual giving the advice, and not to his or her employer or the employer's affiliates. However, the expansiveness of the language requiring fee leveling, both under the proposed exemption and the proposed regulation are unworkable. Under the fee-leveling provisions, both proposals prohibit a fiduciary advisor to receive compensation, commissions, fees, bonuses, awards or promotions that vary based on advice given. The Department should recognize, however, that advisors are paid and promoted based on sales; all sales, and not just those resulting from fiduciary investment advice. If financial advisor entities are required to exclude all sales to advised plan participants or IRAs from any bonus, award or promotion decision of a fiduciary advisor, advisors may refuse to give advice because of the dampening effect it will have on the opportunity to advance. SIFMA recommends that the language be revised so that the advisor's compensation will be level, and no award, bonus or promotion will be specifically correlated to particular investment advice given under the Department's rules.

Disclosure Information

SIFMA appreciates that the Department has provided a model disclosure document in the guidance. However, we suggest a potential amendment to the disclosure requirements to ensure that it doesn't require disclosure of all information about all investments that are available in the market. Perhaps some examples would be helpful that make clear that the disclosure is related to the general types of products that will be recommended (i.e., "We will be recommending stocks, bonds, mutual funds and insurance products; however, there are many other investment products available in the market that we do not typically recommend under this program, and those might result in higher or lower fees for us than the universe of products that we will recommend.") In addition, both the regulation and the exemption use the term "all" fees and compensation, and "all" services. As we have commented before in other contexts, we are concerned that the term "all" will either drown the participant in disclosure in a non-helpful manner, or will be used to deny the exemption to an advisor for an inadvertent or immaterial failure to disclose a particular fee or fact. We urge the Department to provide a materiality standard.

In addition, as the Department has recognized in the Form 5500 disclosure, spreads on principal transactions are not disclosed. We believe it is very important for the Department to reiterate this point in the final exemption and final regulation so that advisors will not be required to estimate or guess at spreads that are not disclosed to any other investor and that at best would be haphazard and misleading.

It would also be extremely helpful to indicate in the final guidance that the required disclosures may be provided in another disclosure document that is already provided to plan participants or IRA holders. For example, broker-dealer firms that are also registered as investment advisers may offer certain advice programs to ERISA plan accounts or IRAs. Under SEC Rule 204-3, these firms already provide a disclosure brochure or form to clients and prospective clients. Some of the disclosures required under the proposed regulations and class exemption overlap with these SEC Form ADV Part II disclosures. Provided that both SEC and DOL requirements are met in a single disclosure brochure (including the "clear and conspicuous" requirement), allowing a single disclosure document would reduce the overall burden and result in more efficient and clear disclosure to plan participants and IRA holders. This would be consistent with Section III(g) of the class exemption that the fiduciary adviser provides appropriate disclosure in accordance with all applicable securities laws.

Definition of Affiliate

Both the proposed regulation and the proposed class exemption define affiliate as owning, controlling or holding with the power to vote. We believe this is a mistake; as the Department recognized in the preamble to its changes to QPAM, the holding reference sweeps in every investment manager whose accounts hold a particular security. That definition would make virtually every financial institution an affiliate of each other. We urge the Department to use the definition of affiliate in 29 CFR 2510.3-21.

Part V of the Class Exemption

Part V of the Class Exemption provides that if there is a pattern and practice of noncompliance with the exemption, the exemptive relief is unavailable for the entire period. We strongly object to this provision. Each of those instances of noncompliance was non-exempt, as is the normal penalty for failure

to comply with the conditions of an exemption. It is punitive and unfair to go backwards and deny the exemption to hundreds or thousands of compliant transactions, because of subsequent patterns or practices. We urge the Department to delete this provision.

In conclusion, we believe that the Department has done a thoughtful and careful job ensuring that the advice provisions are flexible, but protective of participants and in addition, has focused on methods to encourage the provision of advice to participants and IRA owners, as Congress clearly intended. We look forward to continuing to work with the Department on these important issues and hope you will call upon us and our members if you have particular questions on which we might be helpful.

Best regards,

Liz Varley

cc: Robert Doyle