



August 5, 2020

The Honorable Jeanne Klinefelter Wilson  
Acting Assistant Secretary  
U.S. Department of Labor  
Employee Benefits Security Administration  
200 Constitution Ave NW  
Washington, DC 20210

**RE: Improving Investment Advice for Workers & Retirees (ZRIN 1210-ZA29)**

Dear Assistant Secretary Klinefelter Wilson:

The Institute for Portfolio Alternatives (“IPA”) submits the following comments in support of the Department of Labor’s (the “Department”) proposed class exemption *Improving Investment Advice for Workers and Retirees* (the “Proposed Exemption”).<sup>1</sup> We believe that a workable exemption modeled after the Securities and Exchange Commission’s (“SEC”) *Regulation Best Interest* serves the interest of retirement savers.<sup>2</sup> Such an exemption ensures that retirement savers receive high-quality advice and encourages investment professionals and financial institutions to offer advice. We support the restoration of the Department’s long-standing “Five-Part Test” for fiduciary status under Employee Retirement Income Security Act (“ERISA”) section 3(21)(A)(ii).<sup>3</sup> However, we are concerned that the Proposed Exemption departs too far from *Regulation Best Interest* and that the preamble to the Proposed Rule attempts to amend the Five-Part Test in a manner that is inconsistent with the Administrative Procedures Act (“APA”) and the Fifth Circuit’s decision in *Chamber of Commerce v. Acosta*.<sup>4</sup>

The IPA represents sponsors of investment products, retail distributors such as broker-dealers and registered investment advisers, and other entities involved in the syndication and sale of SEC-registered investment vehicles that provide alternative portfolio diversifying investments (“PDI”) for Main Street investors. These products provide benefits to investors including low correlation to the traded markets and were historically available only to institutional investors. For example, over the last 20 years, private real estate as measured by the NCREIF ODCE has had a low correlation of .20 to the S&P 500 according to Morningstar, Inc. For over 30 years, the IPA has raised awareness of PDI products among

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<sup>1</sup> See 85 Fed. Reg. 40834 (July 7, 2020).

<sup>2</sup> See 84 Fed. Reg. 33318 (July 12, 2019).

<sup>3</sup> See 29 C.F.R. 2510.3-21(c); 85 Fed. Reg. 40589 (July 7, 2020).

<sup>4</sup> See 5 U.S.C. § 553; *Chamber of Commerce v. Acosta*, 885 F.3d 360 (5th Cir. 2018).

stakeholders and market participants, including investment professionals, policymakers and the investing public. We support efforts to help retirement investors achieve their financial goals by diversifying their portfolios through increased access to alternative investment strategies including real estate, public and private credit, and other real assets.

Below, we discuss the Department’s “reinstatement” of the Five-Part Test. We then focus on five areas where we suggest the Proposed Exemption should be improved. In addition to the areas discussed below, we encourage the Department to streamline other conditions in the Proposed Exemption. The Department’s aim should be that Retirement Investors receive prudent advice and that the interests of Retirement Investors are not subordinated to the interests of the Investment Professional, Financial Institution, or any other party. If this aim is met, additional conditions (and in particular where other regulators already require similar but not identical conditions) like disclosures, record retention, audits, and certifications do not enhance Retirement Investor outcomes but instead increase compliance costs on the Financial Institution, Investment Professional and Retirement Investor without a corresponding investor benefit.

## **I. The Five-Part Test**

The Department should clarify that the Five-Part Test is to be interpreted using the court decisions and Department guidance that predates the vacated 2016 “fiduciary rule.” In the preamble to the Proposed Rule, the Department offers a number of novel interpretations of the Five-Part Test. The Department should either formally withdraw this guidance or clarify that, before any of the new interpretations may become binding, the Department recognizes that it would be required to go through a rule making process that complies with APA section 553.

In addition to APA concerns, we are also concerned that some of the changes suggested in the preamble would make ERISA fiduciaries out of individuals who are not in a relationship of “trust and confidence” with respect to a plan or IRA holder. The Fifth Circuit made clear that a relationship of “trust and confidence is the *sine qua non* of fiduciary status.”<sup>5</sup>

### **A. The Reinstated Five-Part Test**

On June 29, 2020, the Department announced that it had “submitted a technical amendment to conform the text of the Code of Federal Regulation” to “reinstat[e] the 1975 regulation and its five-part test for defining an investment advice fiduciary.”<sup>6</sup> The Department did this because the Fifth Circuit’s decision mandated the reinstatement.<sup>7</sup>

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<sup>5</sup> *Chamber of Commerce*, 885 F.3d at 371.

<sup>6</sup> 85 Fed. Reg. at 50489-90.

<sup>7</sup> *Id.*

Under the Five-Part Test, a financial institution or investment professional is a fiduciary if, for a fee, they –

1. Render 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;
2. On a regular basis to the plan;
3. 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
4. Such services will serve as a primary basis for investment decisions with respect to such plan assets, and
5. 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.<sup>8</sup>

These five prongs are well-defined by case law,<sup>9</sup> and the Fifth Circuit’s decision in *Chamber of Commerce v. Acosta* summarized it succinctly: “The 1975 regulation captured the essence of a fiduciary relationship known to the common law as a special relationship of trust and confidence between the fiduciary and his client...the DOL’s original regulation specified that a fiduciary relationship would exist only if, inter alia, the adviser’s services were furnished ‘regularly’ and were the ‘primary basis’ for the client’s investment decisions.”<sup>10</sup>

In its technical amendment, the Department explained that it was “simply conducting the ministerial task of implementing the mandate issued by the Fifth Circuit.”<sup>11</sup> Based on this language, the Department formally reinstated the Five-Part Test as it had been interpreted for the preceding 45 years.

## **B. Reinterpretation of the Five-Part Test in the Proposed Exemption**

While the technical amendment states that the Department is merely reinstating the Five-Part Test, the Proposed Rule’s preamble indicates that the Department is instead substantially revising the Five-Part Test. The preamble suggests that the Five-Part Test now has only two or three distinct parts. Such changes would require the Department to go through either formal or informal rule making.<sup>12</sup>

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<sup>8</sup> 29 C.F.R. 2510.3-21(c)(2).

<sup>9</sup> See, e.g., *Fink v. Union Cent. Life Ins. Co.*, 94 F.3d 489 (8<sup>th</sup> Cir. 1996); *Schloegel v. Boswell*, 994 F.2d 266 (5<sup>th</sup> Cir. 1993); *Farm King Supply, Inc. v. Edward D. Jones & Co.*, 884 F.2d 288 (7<sup>th</sup> Cir. 1989); *Rosenbaum v. Hartford Fire Ins. Co.*, 104 F.3d 258 (9<sup>th</sup> Cir. 1996).

<sup>10</sup> *Chamber of Commerce*, 885 F.3d at 365.

<sup>11</sup> *Id.* at 50490.

<sup>12</sup> 5 U.S.C. § 553.

While the preamble is concerning in a number of ways (for example, the plain regulatory text of the first prong exclusively discusses securities and assets with zero mention of account types), we focus below on two sections of the preamble that could be interpreted to remove the “mutual understanding”, “primary basis”, and “regular basis” prongs.

First, the preamble states that “written statements disclaiming a mutual understanding or forbidding reliance on the advice as a primary basis for investment decisions are not determinative.”<sup>13</sup> We respectfully disagree. If one party states that there is not a mutual understanding, there can be no mutual understanding. “Mutual” means “shared in common” or “joint.”<sup>14</sup> That “mutual understanding” requires both the advice giver and the advice recipient to agree that the recommendation may be a primary basis is well understood.<sup>15</sup> In fact, the Department has recognized the unavoidable consequences of the inclusion of the word “mutual” as recently as 2015 –

“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.”<sup>16</sup>

Second, in the preamble, the Department has also seemingly written out the “regular basis” prong. In fact, the Department suggests that one could satisfy the “regular basis” prong retroactively.<sup>17</sup> This interpretation is inconsistent with the Fifth Circuit’s holding that a relationship of “trust and confidence” only exists after advice has been provided “regularly.”<sup>18</sup> If someone receives a series of recommendations on the same day from an individual that they have never entered into a prior relationship with, such as a recommendation to sell assets in a retirement plan, open an IRA, and hire the individual as an investment manager for that IRA, these would not be the type of series of recommendations that could satisfy the “regular basis” prong because there would not be a relationship of “trust and confidence” until after the individual had been hired as an investment manager. As recently as 2015, the Department recognized that a “regular basis” is not merely a quantity of simultaneous recommendations but requires that an advice relationship exists over a period of time –

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<sup>13</sup> See 85 Fed. Reg. at 40840.

<sup>14</sup> “Mutual.” *Merriam-Webster.com Dictionary*, Merriam-Webster, <https://www.merriam-webster.com/dictionary/mutual> (last visited Aug. 3, 2020).

<sup>15</sup> *Farm King Supply, Inc. v. Edward D. Jones & Co.*, 884 F.2d 288 (7<sup>th</sup> Cir. 1989); *Olson v. E.F. Hutton & Co.*, 957 F.2d 622 (8<sup>th</sup> Cir. 1992); *Rosenbaum v. Hartford Fire Ins. Co.*, 104 F.3d 258 (9<sup>th</sup> Cir. 1996).

<sup>16</sup> 80 FR 21927, 21934 (April 20, 2015).

<sup>17</sup> See 85 Fed. Reg. at 40839-40.

<sup>18</sup> See *Chamber of Commerce*, 885 F.3d at 380.

“the ‘regular basis’ requirement also deprives individual participants and IRA owners of statutory protection when they seek specialized advice on a one-time basis, even if the advice concerns the investment of all or substantially all of the assets held in their account (e.g., as in the case of an annuity purchase or a roll-over from a plan to an IRA or from one IRA to another).”<sup>19</sup>

These are two examples where the preamble to the Proposed Rule appears to change the Five-Part Test without complying with the APA. The Department should reconsider this approach. If it believes it is appropriate to expand the criteria for determination of fiduciary status that is currently embodied in the Five-Part Test, it should propose new regulations in the regular course. Should the Department later seek to amend the Five-Part Test to change the types of communications that constitute fiduciary investment advice, that change would not be “ministerial” and the Department should seek to comply with the APA and the Fifth Circuit’s decision in *Chamber of Commerce v. Acosta*.

## II. The Terms of the Exemption

We believe the Proposed Exemption could become a key tool for allowing Investment Professionals and Financial Institutions to provide Retirement Investors with access to high-quality investment advice. For the exemption to serve that purpose, it should be streamlined. Below, we have highlighted five areas where we believe that the Department should modify the Proposed Exemption in a final exemption.

### A. Account Monitoring

In the preamble, the Department suggests that an Investment Professional or Financial Institution could not satisfy the Proposed Exemption by recommending complex investments without also providing continuous monitoring.<sup>20</sup> This statement appears to suggest the Proposed Exemption’s “best interest” standard goes beyond ERISA’s prudence requirement, because the Department’s regulation at 29 CFR § 2550.404a-1 regarding a fiduciary’s duty of prudence in connection with investment decisions does not require account monitoring. This requirement would also have the effect of not only chilling certain types of investments, but it would deter certain types of investment relationships.

Under the Securities and Exchange Commission’s *Interpretation Regarding the Solely Incidental Prong of the Broker-Dealer Exclusion from the Definition of Investment Adviser*, the SEC cautions that its rules do “not permit a broker-dealer to agree to monitor a customer account in a manner that in effect results in the provision of advisory services that are not in connection with or reasonably related to the broker-dealer’s primary business of effecting securities transactions, *such as providing continuous monitoring*” (emphasis added).<sup>21</sup> The SEC has stated that because ongoing monitoring of investment recommendations is often a hallmark of an investment advisory relationship, if a broker-dealer performed

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<sup>19</sup> 80 Fed. Reg. 21927, 21934 (April 20, 2015).

<sup>20</sup> 85 Fed. Reg. at 40843.

<sup>21</sup> 84 Fed. Reg. 33681, 33687 (July 12, 2019)



ongoing monitoring services for a customer, it could not satisfy the “solely incidental” exception in the Investment Advisers Act of 1940 (“Advisers Act”) and thus must register under the Act as an investment adviser. The ongoing monitoring language in the Proposed Exemption is thus in direct conflict with the provisions of the Advisers Act, the *Regulation Best Interest* and SEC guidance.

The interaction of these provisions could prevent also broker-dealers from recommending more complex investments such as PDIs even if a broker believes the investment to be prudent for the Retirement Investor, because compliance with the exemption would require registration as an investment adviser. Moreover, the “monitoring” requirement harms Retirement Investors by limiting investor choice. For many Retirement Investors, a one-time commission to learn about a prudent, complex investment is preferable and more cost-effective than the cost of entering into a long-term and continuing fee advisory relationship.

Ongoing monitoring fees directly impact the availability and cost of financial advice for Retirement Investors, particularly those with small dollar accounts or “buy-and-hold” strategies. As an example of the impact of the loss of episodic brokerage services for Retirement Investors, suppose Mr. and Mrs. Smith, 55 and 57 years old, respectively, have an IRA with \$50,000, which they intend to keep invested for at least 7 years until their retirement. They want to invest in a diversified portfolio of mutual funds with a combination of stocks and bonds, and have two options: (1) a brokerage account paying a one-time average commission of 5%, or (2) a fee based account where they will pay 1.5% per year as the standard rate for smaller accounts. Mr. and Mrs. Smith will pay a one-time commission of approximately \$2,500 to invest through a brokerage account at the time the investment is made versus an annual fee of approximately \$750 per year for a total of \$5,250 (more than double the one-time brokerage fee) in an advisory account over the next seven years. If the account increases in value over the seven years, then the annual fees paid will increase as well. The Department should not compel Retirement Investors to engage registered investment advisers and to incur ongoing monitoring costs in order to invest in complex products.

The Department should revise this language to make clear that broker-dealers, insurance agents, and others can recommend complex products to Retirement Investors without a corresponding ongoing monitoring obligation of the Investment Professional or Financial Institution. Retirement Investors should have flexibility to select the scope, payment method, and type of investment-related services most appropriate to their retirement saving needs.

## **B. Acknowledgement of Fiduciary Status**

The Proposed Exemption would require a Financial Institution to provide a written disclosure acknowledging “that the Financial Institution and its Investment Professionals are fiduciaries under ERISA and the Internal Revenue Code (the “Code”), as applicable, with respect to any fiduciary investment advice provided by the Financial Institution or Investment Professional to the Retirement

Investor.”<sup>22</sup> We request that this requirement be removed. If the Department deems it appropriate to require a written acknowledgement in the final exemption, the Department should instead require an Investment Professional or Financial Institution to state that they cannot subordinate the interests of the Retirement Investor to their own interests or those of any third-party.

We are concerned that requiring a fiduciary acknowledgement will deter Investment Professionals and Financial Institutions from relying on the exemption in situations where an Investment Professional believes that he or she is not a fiduciary but where out of an abundance of caution, he or she would otherwise use the exemption. Encouraging Investment Professionals and Financial Institutions to use the exemption, even where they may not be fiduciaries, benefits Retirement Investors.

The acknowledgement could also be considered “materially misleading” under *Regulation Best Interest*. In its discussion of dual registrants, the SEC made clear that registered investment advisers are fiduciaries while broker-dealers are held to a standard of care that “draw[s] from key principles underlying the fiduciary obligation that applies to investment advisers under the Advisers Act, while being tailored to the broker-dealer model.”<sup>23</sup> That is, registered investment advisers are fiduciaries while broker-dealers are not. We are concerned that a fiduciary acknowledgement could undermine the SEC’s decision to not impose a uniform fiduciary conduct standard on broker-dealers and registered investment advisers.<sup>24</sup>

Finally, “fiduciary” has now been interpreted differently under ERISA, the Advisers Act, and various state laws.<sup>25</sup> In different jurisdictions, calling oneself a “fiduciary” triggers different obligations.<sup>26</sup> Additionally, retirement savers may be confused about which “fiduciary” standard applies. To avoid triggering inconsistent state laws and avoid investor confusion, we encourage the Department to require that an Investment Professional provide a clear statement of the standard of care rather than a statement of status. We would also note that compliance with multiple or conflicting regulatory regimes increases the cost and complexity of compliance for regulated entities and individuals. This cost is ultimately borne by investors and does not justify this additional protection.

### **C. Annual Certification**

The Department should eliminate the annual CEO certification requirement, or, if it is unwilling to entirely eliminate the requirement, the certification should be harmonized with FINRA’s annual review for broker-dealers. Section II(d) of the Proposed Exemption requires Financial Institutions to undertake an annual retrospective compliance review. The review must be reduced to a written report

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<sup>22</sup> 85 Fed. Reg. at 40863, § II(b)(1).

<sup>23</sup> 84 Fed. Reg. at 33346.

<sup>24</sup> *Id.* at 33322.

<sup>25</sup> *See, e.g.*, 84 Fed. Reg. 33669 (July 12, 2019); 950 Mass. Code Regs. 12.204; 85 Fed. Reg. 39111 (June 30, 2020).

<sup>26</sup> *See, e.g.*, 950 Mass. Code Regs. 12.204.

presented to the Financial Institution's Chief Compliance Officer and Chief Executive Officer.<sup>27</sup> The Chief Executive Officer must then certify review of the report and certify certain findings regarding the financial institution's compliance policies and procedures.<sup>28</sup>

The annual review and certification will likely increase the costs Retirement Investors face as the costs of the annual review and certification are likely to be ultimately borne by those investors. Because other regulators already have similar requirements, the Department should instead permit entities subject to other annual review or certification requirements to comply with those processes as a substitute for the Department's. For example, FINRA Rule 3130(c)(3) requires broker-dealers to conduct an annual compliance review and certification. Requiring broker-dealers to undergo two similar annual reviews and certifications increases costs without a corresponding benefit to Retirement Investors.

Harmonization would also address other concerns regarding the annual certification requirement. We believe that the requirement to audit specific transactions is unworkable, and we are concerned that the requirement of annual audits, which should be a source of self-improvement, could have unintended consequences as a litigation tool if the annual audit and other disclosure requirements are retained.

#### **D. Loss of the Exemption**

Section III of the Proposed Exemption describes circumstances by which an Investment Professional or Financial Institution may lose eligibility to rely on the Proposed Exemption. Investment Professionals and Financial Institutions would become ineligible for a period of ten years following conviction of a crime described in ERISA section 411 or upon the Department Office of Exemption Determinations' ("OED") declaration that the Financial Institution or Investment Professional has: (A) engaged in a systematic pattern or practice of violating the conditions of this exemption in connection with otherwise non-exempt prohibited transactions; (B) intentionally violated the conditions of this exemption in connection with otherwise non-exempt prohibited transactions; or (C) provided materially misleading information to the Department.<sup>29</sup> Should one Financial Institutions lose eligibility, all other Financial Institutions in the same Control Group lose eligibility.<sup>30</sup>

We have two concerns. First, applying the penalty across an entire control group is a disproportionate and unwarranted penalty. Even if entities share some overlapping ownership, it is rare that all members of a control group exercise authority over sibling entities or parent entities. The penalty for failure to comply with an exemption is the occurrence of a non-exempt prohibited transaction. That, by itself, triggers tax penalties and liability under ERISA. While we are aware that PTE 84-14 has a similar mechanism where entities convicted of serious crimes can lose the ability to serve as "qualified

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<sup>27</sup> 85 Fed. Reg. at 40864, § III(d)(2).

<sup>28</sup> *Id.* at 40864, § III(d)(3).

<sup>29</sup> *Id.* at 40863, § III(a)(2).

<sup>30</sup> *Id.* at 40863, § III(b)(2).



professional asset managers”, we have concerns that this mechanism has no basis in the statute and is problematic constitutionally. ERISA’s statutory penalties are sufficient.

Second, we believe the OED cannot prohibit a specific individual or entity from relying on a class exemption. Not only does the exemption fail to provide meaningful due process, but the OED is not a judicial body. It is made up of non-officers of the United States (i.e., career staff who have not been appointed by the President). The structure contemplated by the proposed exemption fails the tests set out by the Supreme Court in *Lucia v. SEC*, 585 U.S. \_\_\_, 138 S.Ct. 2044 (2018).

We encourage the Department to eliminate the provisions where certain entities could lose access to the Proposed Exemption. As described above, ERISA and the Code already provide penalties for non-exempt prohibited transactions. The Department should not craft additional penalties that Congress has not itself included.

#### **E. Good Faith Correction of Errors**

Finally, we ask the Department to include a good faith method for correcting violations of the Proposed Exemption modeled off of the Department’s compensation disclosure regulation at 29 C.F.R. § 2550.408b-2. That regulation provides that a good faith failure, following the exercises of reasonable diligence, to disclose the required information will not result in a loss of the section 408(b)(2) exemption provided that the service provider discloses the information within 30 days of discovery of the error or omission.<sup>31</sup> Here, Financial Institutions and Investment Professionals should be given a similar mechanism for correction of errors that they may determine through their compliance systems or as a result of their annual review of transactions.

In its current form, we believe the Proposed Exemption is unworkable. Financial Institutions are expected to perform audits of a sample of transactions, but the Department would leave Financial Institutions in the impossible position where they may discover technical violations without having a way to cure them. We believe this can be addressed through a good faith correction of errors mechanism.

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<sup>31</sup> 29 C.F.R. § 2550.408b-2(c)(1)(vii).

We encourage the Department to complete this important and timely rule making, but we also urge it to modify the proposal to comply with the Fifth Circuit's decision in *Chamber of Commerce v. Acosta* and the requirements of the APA. With appropriate streamlining, the Proposed Exemption could become a vital mechanism for providing Retirement Investors with more access to high-quality advice.

If the IPA may be of any assistance, please do not hesitate to contact me or Anya Coverman, IPA's Senior Vice President, Government Affairs and General Counsel, at (202) 548-7190.

Sincerely,



Anthony Chereso  
President & CEO, Institute for Portfolio Alternatives