BLACKROCK

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Via e-mail to e-ORI@dol.gov

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

Re: <u>Proposed Regulation Amending Definition of Investment Advice</u>

BlackRock [1] is pleased to offer its comments on the Department of Labor's (the "Department") proposed rule setting forth the circumstances under which a person is considered to be a "fiduciary" for purposes of ERISA, by reason of providing investment advice to an employee benefit plan subject to ERISA ("Plan") or a Plan's participants and beneficiaries (the "Proposed Rule")[2].

The fundamental objective of the Proposed Rule is to impose fiduciary status and responsibility on entities that provide individualized investment advice to Plans, but currently are able to avoid characterization as a fiduciary because their activities do not satisfy one of the elements of the existing rule defining when the provision of investment advice will cause a Plan service provider to become a fiduciary (the "Current Rule")[3]. We share the Department's goal of protecting Plans and their participants and beneficiaries and appreciate its desire to update the Current Rule to reflect changes in the financial services industry and to provide greater certainty regarding when persons providing "advice" are subject to ERISA's fiduciary standards. However, we believe that the Proposed Rule reaches conduct far beyond the Department's stated objective and lacks clarity in a number of key respects. Specifically, the Proposed Rule ensnares activities that have never been viewed as investment advice, confuses status with conduct, and eliminates important hallmarks of a fiduciary investment advisory relationship (*e.g.*, that the advice be individualized to the needs of a Plan or its participants and beneficiaries and based on a mutual agreement or understanding). As written, the Proposed Rule threatens to increase costs to Plans, to adversely affect the quality of services to Plans and their participants and beneficiaries and to preclude Plans from participating in certain types of investments and strategies.

Moreover, as the Department is aware, there are several other regulatory projects underway which involve financial services firms and their role in providing services or advice to Plans. In particular, Section 913 of the Dodd-Frank Wall Street Reform and

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1 BlackRock is one of the world's leading asset management firms, and one of the largest managers of assets of employee benefit plans subject to the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). We manage over $3.45 trillion on behalf of institutional and individual clients worldwide through a variety of equity, fixed income, cash management, alternative investment, real estate and advisory products. Our client base includes corporate, public, multi-employer pension plans, insurance companies, third-party mutual funds, endowments, foundations, charities, corporations, official institutions, banks, and individuals around the world.

2 75 Fed. Reg. 204 (Oct. 22, 2010).

3 29 C.F.R. 2510.3-21, et. seq.

Consumer Protection Act of 2010 (the "Dodd-Frank Act") requires the Securities and Exchange Commission ("SEC") and the Commodity Futures Trading Commission ("CFTC") to promulgate business conduct rules for swap dealers and major swap participants when dealing with counterparties, with a specific focus on "special entities" such as Plans. The statutory language also includes a requirement that special entities have an independent representative, and if the entity is ERISA-regulated that the representative be an ERISA fiduciary. The CFTC has already proposed its business conduct rules, and the SEC is expected to do so shortly. It is possible that, without active coordination between the Department and the SEC and CFTC, financial services providers could find themselves having to comply with different sets of rules for the same transaction, or even that this compliance is not achievable due to conflicting requirements. Such a result is not in the best interests of Plans and their participants and beneficiaries, as these financial instruments are used both to enhance returns and manage liability risks for defined benefit plans. Failure to coordinate the differing regulatory projects could result in Plans being unable to engage in swaps and other derivatives. We urge the Department to coordinate its rulemaking with that of the other two agencies.

BlackRock asks the Department to consider the following specific concerns and suggested modifications to the Proposed Rule.

I. *The Proposed Rule Will Have an Adverse Effect on Services to Plans at an Increased Cost*

In acting as a discretionary investment manager and ERISA fiduciary, asset managers, such as BlackRock, contract with entities to provide services that are necessary to manage the Plan's assets, including brokerage, prime brokerage, custody and fund accounting, administration, record keeping, research, auditing and valuation. We are concerned that, given the breadth of the Proposed Rule, many service providers that asset managers engage to help manage Plan assets may be considered fiduciaries. Some service providers may leave the market to avoid being considered fiduciaries. Others may increase their fees to compensate for the increased legal risk resulting from fiduciary status or seek to limit the services they provide (including information on markets, securities and other assets and valuation) to avoid fiduciary status. As a result, asset managers will have a more limited choice of service providers and/or trading counterparties, and may not be able to transact with entities that provide high quality services and/or the best prices to the Plan.

Moreover, it is important for an asset manager acting as an ERISA fiduciary to know whether the entity that it is engaging to provide a particular service, or with whom it is transacting, may be considered a fiduciary. Asset managers need this information to facilitate compliance with their fiduciary and co-fiduciary obligations and to avoid breaching ERISA's prohibited transaction rules. Under the Proposed Rule, it will often be difficult, or even impossible, for the asset manager to determine whether a particular entity is acting as a fiduciary with respect to a Plan client, unlike the relatively clear determinations that exist today under the Current Rule. The ambiguity in the Proposed Rule will require asset managers to significantly expand their compliance programs, so that they do not inadvertently deal with a fiduciary in circumstances where engaging or transacting with a fiduciary may be prohibited by ERISA or a condition of one of the many statutory, individual or class exemptions from ERISA's prohibited transaction rules on which they rely on a regular basis in managing Plan assets. The revised compliance programs may force asset managers not to retain the services of, or engage in transactions (especially principal transactions) with, certain key financial institutions, even where those financial institutions would otherwise be the best choice for the Plan. In addition, the significant cost of overhauling compliance policies and procedures and systems will likely be passed on to Plans and their participants and beneficiaries. Thus, the difficulty in identifying fiduciaries and the increased compliance burden that follows from that difficulty will likely increase costs for, and reduce the investment return to, Plans without any corresponding benefit.[4]

The breadth and lack of clarity of the Proposed Rule may also have an adverse impact on the relationships that we and other asset managers build with our ERISA Plan clients. When BlackRock provides individualized investment advice or acts as a discretionary investment manager to a Plan, we understand and embrace our role as an ERISA fiduciary. Further, if an asset manager provides consulting services pursuant to a mutual agreement with a Plan, and as part of that engagement the asset manager provides material individualized advice to assist the Plan in managing assets, fiduciary status may be appropriate. However, asset managers are constantly in communication and developing their relationships with their Plan clients. Plan clients are further generally interested in a broader dialogue with their asset managers than discussion with respect to a specific, existing mandate, including exploring the possibility of engaging them to manage additional Plan assets or to invest Plan assets across multiple asset classes. As currently drafted, the Proposed Rule could cause many of these ongoing communications and interactions between asset managers and Plans to be considered fiduciary advice. For example, under the Proposed Rule, discussions regarding new or different investment opportunities or strategies or regular updates on market conditions and the economic outlook could be considered investment advice. Even a casual conversation over coffee regarding new products could be construed as fiduciary investment advice. The breadth of the Proposed Rule coupled with the lack of clarity could have a chilling effect on communication between a Plan client and its asset manager. To avoid inadvertent fiduciary status, asset managers may restrict discussions with Plan clients other than formal and specific communications about a managed portfolio.

II. *The Proposed Rule Should Be Revised to Require that the Advice or Recommendations Must Be Individualized Before Fiduciary Status Can Be Triggered and that Education, Information and Tools for Plan Sponsors Should be Excluded from the Definition of Investment Advice*

Education for Plan sponsors as well as Plan participants and beneficiaries has been an important cornerstone of the Department's mission. The Department has undertaken initiatives to educate the Plan community including making available publications and tools designed to enhance the knowledge of fiduciaries and participants. Indeed, the Department recognized the need of Plan participants and beneficiaries to receive investment education in adopting Interpretive Bulletin 96-1, which contains non-exclusive examples of investment education not considered to be investment advice. The Department's new regulations on disclosure to defined contribution plan participants are intended to better educate and inform Plan participants about their investment choices.[5] The Proposed Rule expressly states that providing the services set forth in Interpretive Bulletin 96-1 will not be considered the provision of investment advice.

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[4] As the Department knows, for defined contribution plans, the fees and expenses incurred in connection with managing assets have a material impact on investment returns and are one of the most significant factors impacting the amount of money a participant will have for retirement. *See* 29 C.F.R. § 2550.404a-5, 75 Fed. Reg. 202 (Oct. 20, 2010).

[5] *Id*.

Plan sponsors or other service providers have sought and increasingly desire analogous investment education and tools whether to help think about designing a 401(k) investment menu or funding liabilities in a defined benefit plan. However, in a break with more than 30 years of precedent and consistency with the federal securities laws, the Department has proposed deleting the concept that investment advice must be tailored to the individual needs of the client. Thus, instead of facilitating the flow of information to Plan sponsors, the Proposed Rule threatens to hinder these activities by imposing fiduciary status on entities that make available or provide generalized education and tools to Plan sponsors and other service providers.

Asset managers provide Plan sponsors as well as other financial institutions with a variety of tools and services to assist in the process of designing Plans and investment strategies for Plans. For example, asset managers provide education through speaking engagements, webinars discussing trends, computer-based tools that assist in comparing and evaluating options and publications. Asset managers further provide thought leadership with respect to asset allocation and liability hedging, as well as data reporting, risk analysis and other information that is designed to assist the Plan and/or the Plan's other service providers in thinking critically about issues. These activities and materials are not individualized to the needs of the Plan, or may not include any specific advice or recommendations. Often materials are not even directed to Plans. We are concerned that these types of educational activities and assistance could be considered "investment advice" because there is no requirement in Section (c)(i) of the Proposed Rule that the information or tools provide advice that is individualized to the needs of the Plan. We are also concerned that, as currently drafted, there is a risk that generalized information and advice not directed to a Plan, but which finds its way to a Plan sponsor or a participant or beneficiary could be considered fiduciary advice. However, education, information, data analysis and many other services do not create a fiduciary relationship. We believe that, to ensure that quality information and education regarding all aspects of Plan design and investment continues to be available, Section (c)(1)(i) should be revised to include the requirement that advice must be individualized to the needs of and directed to the Plan or its participants and beneficiaries before it can give rise to fiduciary status.

Further, although Sections (c)(ii)(B) and (C) of the Proposed Rule include a limited exemption for marketing securities to Plan sponsors and the provision of general financial information and data to assist a Plan fiduciary in selecting and monitoring the investment alternatives chosen, these exclusions are too narrow and do not specifically carve out education, training and the provision of data with respect to Plan design alternatives, services available to Plans, information regarding market practices, risk and liability management and the impact that the choices made by the Plan sponsor can have on Plan participants and beneficiaries. Thus, in addition to adding to Section (c)(i) the requirement that any advice or recommendations provided must be individualized to the needs of and directed to the Plan, we suggest that additional exclusions be added to Sections (c)(ii) of the Proposed Rule for: (A) speaking engagements, webinars, publications and other forums where Plans sponsors receive training and information regarding plan design alternatives, market practices, liability management or other services; (B) the provision of computer-based tools to assist a Plan sponsor in selecting investment alternatives for a defined contribution Plan and assessing investment strategies and liability risks for a defined benefit plan; and (C) the provision of risk analysis, research and other data reporting to a Plan, where that analysis or other reporting is not accompanied by specific advice or recommendations regarding the purchase or sale of securities or other property or the management of the securities held in a Plan's portfolio (*e.g.*, whether to tender securities in an offering or how to vote a proxy).

III. *When Plan Assets Are Managed by Sophisticated Fiduciaries, Service Providers and Counterparties in Trading Relationships Should Not Be Considered Fiduciaries With Respect to Those Assets*

The Proposed Rule appears to be based on an assumption that certain service providers have too much influence on the decisions made by Plans or their asset managers. In situations where a sophisticated financial institution, such as BlackRock, has undertaken responsibility as an ERISA fiduciary, it is not in the best interests of Plans or their participants and beneficiaries to impose fiduciary status and responsibility on other service providers engaged by the investment manager (other than a subadviser who is engaged to assist in making investment decisions) to fulfil its mandate. Large and sophisticated asset managers, such as BlackRock, make their own investment decisions and do not look for investment advice from broker-dealers, counterparties in trading relationships and similar service providers. We suggest that the Department adopt a rule which provides that where assets are being managed on a discretionary basis by an entity that qualifies as a "qualified professional asset manager" or "QPAM", the service providers that the QPAM engages to assist in the provision of its fiduciary services (other than a subadviser who is engaged to assist in making investment decisions) should not be considered fiduciaries to the extent they are providing services in connection with the QPAM's management of the Plan's assets.

In addition, asset managers may enter into swaps, derivatives, forward and futures contracts, securities lending and other trading activities on behalf of Plan clients in reliance on a statutory, class or individual exemption from ERISA's prohibited transaction rules, including PTE 2006-16, PTE 81-8 and PTE 75-1, Part II and Part V and the service provider exemption in Section 408(b)(17) of ERISA. As drafted, the Proposed Rule could restrict the ability of an asset manager to use these exemptions because one of the conditions in those exemptions is that the counterparty cannot be an entity that renders investment advice to the Plan. As set forth above, given the broad sweep of the Proposed Rule, in many cases, a discretionary asset manager could not determine whether exemptive relief is available because it could not ascertain whether the counterparty (or its affiliate) provided some "advice" (as defined under the Proposed Rule) that caused it to be a fiduciary with respect to the Plan assets the asset manager is otherwise managing. Considering a counterparty in a trading relationship to be a fiduciary is also inconsistent with the Dodd-Frank Act, where Congress expressly rejected provisions that would have imposed a fiduciary duty on swap counterparties.[6]

To address this issue, we suggest that the Department adopt a rule which provides that if a transaction is entered into on behalf of a Plan by an entity that qualifies as a QPAM, the counterparty to any transaction entered into on behalf of the Plan should not be considered a fiduciary under the Proposed Rule for purposes of determining whether a statutory, class or individual exemption from ERISA's prohibited transaction rules is available to cover the transaction.

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[6] During the House-Senate conference, Congress struck a provision from the Senate version of H.R. 4173 that would have imposed a fiduciary duty on a dealer entering into a swap as a counterparty to a defined category of entities, including Plans.

IV. *Advice Incidental to Asset Management or to Discuss Possible Engagements Should Require Both Mutual Agreement and Additional Compensation*

The Proposed Rule creates uncertainties about when fiduciary status attaches, and should include the requirement of a mutual agreement or understanding. As described above, Plan sponsors frequently have discussions with their asset managers regarding managing investment strategies and potential changes in asset allocation. The asset manager generally does not receive compensation for this exchange of information and ideas in addition to the compensation it is already receiving for managing a portion of a Plan's portfolio. Asset managers should be able to continue to participate in this ongoing dialogue and to respond to requests from Plan sponsor clients for information about the Plan's investment portfolio or related issues.

In addition, asset managers may discuss potential engagements with Plan clients including by responding to requests for proposals ("RFPs") solicited by Plan sponsors or other service providers to evaluate potential managers. Ordinary requests for information or RFPs require asset managers to provide information regarding securities and other property, valuation, management or allocation of assets. The responses to RFPs, while tailored to the particular questions asked or investment mandate under consideration, are not intended to be a recommendation for an investment decision. By contrast, these discussions and exchanges of information serve a vital need for the Plan sponsor or other fiduciary to evaluate potential asset managers and enhance their knowledge in the process. If the asset manager is not ultimately hired, there should be no backward looking claim that the assistance created a fiduciary investment advisory relationship. If the asset manager is hired, it will take on fiduciary status and all of the attendant responsibilities.

To avoid these activities from being considered investment advice, we recommend that the Department include a requirement that the advice be pursuant to a mutual agreement or understanding and that there must be specific additional compensation for the advice given before fiduciary status can attach.

V. *The Status of an Entity or an Affiliate as a Registered Investment Adviser Should Not Trigger Fiduciary Status*

Section (c)(1)(ii)(C) of the Proposed Rule creates a status based test, so that if a person or entity is providing information and is itself, or an affiliate is, a registered investment adviser, the person or entity meets that status-based test. Nearly all asset managers located in the United States or with clients located in the United States are either registered investment advisers or have affiliates that are registered investment advisers. Under the Proposed Rule, any entity that communicates with a Plan or its participants and beneficiaries and makes suggestions regarding Plan investments, even where those suggestions are not individualized, could be considered a fiduciary, simply because the entity has affiliates that are registered investment advisers. In our view, section (c)(1)(ii)(C) of the Proposed Rule should either be deleted or revised to reflect that status as a registered investment adviser is only relevant where the registered investment adviser is directly providing individualized advice or recommendations to the Plan for compensation.

VI. *Valuation*

Under the Proposed Rule, valuing an asset of a Plan or fund where there is no generally recognized market value for the asset could make the person providing the valuation an ERISA fiduciary, if the entity providing the valuation is a registered investment adviser or otherwise has a status described in Section (c)(1)(ii) of the Proposed Rule. Thus, many service providers (*e.g.*, administrators, custodians, and prime brokers) and trading counterparties may become ERISA fiduciaries if they provide valuations or information regarding the value of a security or other asset. This could cause many such service providers to exit the market or increase their fees. In addition, as set out above, this rule could restrict Plans from engaging in many common transactions because the fiduciary status of the entity providing the valuation would cause the transaction to be prohibited under ERISA.

Moreover, as currently contemplated in the Proposed Rule, if the investment manager (or an affiliate of an investment manager) of an investment vehicle that is not subject to ERISA (such as a registered mutual fund, hedge fund or private equity fund), provides valuation services for the investment vehicle, there is a risk that the investment manager or its affiliate would be considered a fiduciary with respect to the provision of valuation services to the non-plan asset vehicle and that all the investment activities of the vehicle would be subject to ERISA. This would stand on its head Congress' and the Department's long standing distinctions between investment products that are subject to ERISA's fiduciary and prohibited transaction rules and those that are not. We do not believe the Department intended this result. Even if the Department determines that, in certain circumstances, entities that provide valuations should be considered fiduciaries, they should not be considered fiduciaries when they perform valuation services with respect to assets held by a vehicle that is not otherwise subject to ERISA, simply because Plans invest in the vehicle.

Conclusion

We share the Department's resolve to assure a secure retirement for all Americans. However, as set forth above, we are concerned that the breadth and lack of clarity of the Proposed Rule will result in significantly greater harm than good for Plans and their participants and beneficiaries. Accordingly we recommend that the Department adopt the changes outlined above.

BlackRock welcomes the opportunity to further discuss its views on this important topic with Employee Benefits Security Administration staff and others in the Department.

Sincerely,

Barbara G. Novick
Vice Chairman