**MANAGED FUNDS ASSOCIATION**
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

February 3, 2011

**Via Electronic Mail:**

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

**Re: Proposed Definition of Fiduciary Regulation**

Ladies and Gentlemen:

Managed Funds Association ("MFA")[1] appreciates the opportunity to respond to the Department of Labor's (the "DOL" ) proposed regulation redefining an investment advice fiduciary under section 3(21) of the Employee Retirement Income Security Act of 1974 ("ERISA"). MFA strongly supports the DOL's goal of protecting benefit plans and their participants, and we recognize that imposing fiduciary status on certain service providers to plans furthers that goal. We are concerned, however, that the DOL's proposed definition of "fiduciary" may be broader than intended and inadvertently could capture many market participants that Congress and the DOL have explicitly determined should not be deemed fiduciaries under ERISA. As a consequence, we believe that the proposed rule could limit options for plans, an unintended, harmful consequence for plans and their participants and contrary to the goal of protecting plans. MFA is committed to working with policy makers and regulators to achieve smart, effective regulation and we respectfully submit our comments on the DOL's proposed rule in that spirit.

Before discussing the specifics of the DOL's proposed rule, it is important to note that hedge funds and other alternative investment vehicles are a valuable component of the investment portfolio for sophisticated investors, including plans. The properly managed addition of hedge funds to a portfolio provides diversification, risk management, and returns that are not correlated to traditional equity and fixed income

[1] MFA is the voice of the global alternative investment industry. Its members are professionals in hedge funds, funds of funds and managed futures funds, as well as industry service providers. Established in 1991, MFA is the primary source of information for policy makers and the media and the leading advocate for sound business practices and industry growth. MFA members include the vast majority of the largest hedge fund groups in the world who manage a substantial portion of the approximately $1.9 trillion invested in absolute return strategies. MFA is headquartered in Washington, D.C., with an office in New York.

markets. These are critical benefits that help plans generate sufficient returns to meet their obligations.

The critical importance of hedge funds and other alternative investments as part of a plan's diversified portfolio was noted by Joseph A. Dear, Chief Investment Officer of the California Public Employees' Retirement System, in his written testimony before the Senate Banking Subcommittee on Securities, Insurance and Investment on July 15, 2009.[2] In that testimony, Mr. Dear stated that the performance of alternative investments:

> translates into substantial value added to the pension fund over a sustained time period. It makes realization of our target rate of return feasible. The consequences to our beneficiaries, their government employers and taxpayers of our not meeting this objective are substantial and real: lower wages, higher contribution rates and higher taxes. Can these performance benefits be delivered through other investment products? No.

The value that hedge funds add to plan portfolios is also demonstrated through the significant investments made by plans and endowments in hedge funds. Plans and endowments in every state invest in hedge funds because of the benefits to their investment portfolios.

Finally, hedge funds provide one of the best examples of alignment of interests within the financial community. Because the typical fee structure for a fund includes a performance fee whereby the manager receives a share of the total returns the fund generates for its investors, hedge fund managers are motivated to produce attractive risk-adjusted returns for their investors. Moreover, if hedge funds experience losses, those same performance fees do not start again until the fund earns enough in investment returns to get back to its earlier levels. These so-called "high water marks," along with performance fees and the lack of any government safety net, explain in large part the excellent risk management practiced by the hedge fund industry. For the reasons discussed below, we believe that, as drafted, the proposed regulation could have the unintended consequence of impairing the ability of plans to invest in hedge funds and other pooled investment funds because many funds are not structured in a manner to be able to comply with the rules applicable to ERISA fiduciaries. We urge the DOL to reconsider aspects of the proposed regulation to avoid this harmful consequence to plans.

**Overview**

As noted above, MFA strongly supports investment advisers having fiduciary obligations to their clients, and we believe advisers that provide investment advice to benefit plans as clients should be subject to a fiduciary standard. We believe, however, that the proposed regulation potentially extends fiduciary obligations too far by making

[2] Available at http://banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=e83f7ca1-6f94-4854-8aa9-ef0ac11b4bb0.

persons who provide asset valuations to plans, or who are advisers under the Investment Advisers Act of 1940 (the "Advisers Act"), fiduciaries under ERISA, regardless of whether there is an agreement between the parties. We believe that the language in the proposed regulation goes far beyond the scope of current law and regulation and could make a wide variety of market participants into fiduciaries under ERISA, in some cases contrary to explicit determinations made by Congress and the DOL. Further, the proposed regulation does not seem to fully account for the costs that these changes could impose on plans, and we urge the DOL to consider these potentially significant costs before finalizing its rule. As discussed in more detail below, we believe that proposed regulation raises the following key issues:

- the proposed regulation could be interpreted in a manner that is inconsistent with Congressional mandates and potentially reverses current law regarding the fiduciary status of managers, advisers, and service providers to pooled investment funds, even if the DOL did not intend such a result;
- the language regarding appraisals in the proposed rule goes far beyond the DOL's stated concerns and could significantly affect a pooled investment fund's operations;
- the proposed regulation is ambiguous and appears to suggest that any adviser could be a fiduciary, regardless of its relationship with a plan; and
- the selling exception is narrowly drafted and could preclude normal fund marketing activity.

In light of these concerns about the potentially broad implementation of the proposed regulation, we urge the DOL to clarify that general partners, managing members, investment advisers, fund administrators, and other service providers to pooled investment funds that do not hold plan assets will not be deemed to be fiduciaries under ERISA as a result of the rule. We also urge the DOL to consult with the Securities and Exchange Commission (the "SEC") and the Commodity Futures Trading Commission (the "CFTC") on the coordination of standards and requirements among the relevant statutory regimes, especially in light of recent legislative and regulatory initiatives from each of these regulators and the potential effect of this proposed regulation on the capital markets.

**Application of Proposed Regulation to Non-Plan Asset Funds**

The proposed regulation is not explicitly limited in scope to persons providing services to plans and plan asset vehicles. Read literally, the general partner, managing member, and adviser to a fund that is not deemed to hold plan assets under ERISA (a "Non-Plan Asset Fund"), and persons providing valuation services to a Non-Plan Asset Fund, may become a fiduciary under the proposal as drafted. While it is unclear whether the DOL intended to include such parties within the scope of the proposed regulation, we respectfully submit that such an interpretation would be inconsistent with Congressional mandates regarding the imposition of fiduciary obligations on general partners, managing members, advisers, and service providers to Non-Plan Asset Funds.

Congress has spoken repeatedly on when a pooled investment fund holds plan assets and, therefore, the manager of a fund should be deemed a fiduciary to the fund. We believe that these Congressional determinations -- as well as the existing DOL regulations and guidance regarding pooled investment funds -- set appropriate standards to determine the scope of entities that should be subject to fiduciary obligations under ERISA. As drafted, the proposed regulation could indirectly reverse those Congressional determinations by making any person who provides a "recommendation" as to the value of an asset a fiduciary, regardless of whether the fund is subject to the fiduciary requirements of ERISA, regardless of the intention of the parties, and regardless of whether any agreement with the plan exists. The proposed regulation could have that result even if the person providing input into valuations with respect to the assets of a Non-Plan Asset Fund did not know a plan was invested in the fund.[3]

Congress most recently spoke to this issue when it enacted the Pension Protection Act of 2006, which amended section 3 of ERISA by adding new subsection (42). New section 3(42) provides that "the assets of any entity shall not be treated as plan assets if, immediately after the most recent acquisition of any equity interest in the entity, less than 25 percent of the total value of each class of equity interest in the entity is held by benefit plan investors."[4] Section 3(42) of ERISA and the DOL's regulations clearly demonstrate that advisers and service providers to Non-Plan Asset Funds are not fiduciaries to benefit plans and, therefore, are not subject to the provisions of section 406 of ERISA.

Under DOL regulations, when a benefit plan invests in the equity securities of another entity that is not registered as an investment company and whose securities are not publicly offered, then the assets of that entity are considered "plan assets" for purposes of ERISA, unless the "[e]quity participation in the entity by benefit plan investors is not significant."[5] The regulation goes on to define equity participation as "significant" if, "25 percent or more of the value of any class of equity interests in the entity is held by benefit plan investors."[6]

The DOL has issued further guidance supporting this position in Interpretive Bulletin 75-2[7] and Interpretive Release 75-3,[8] which indicate a clear interpretation that

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[3] We think this result would be inconsistent with clear Congressional intent established over the last 25 years. From 1979 through 1986, the DOL proposed and reproposed regulations defining the circumstances under which a pooled fund would hold plan assets. Those proposals were very controversial and were met with significant market concern. In response to that concern, in 1985, Congress prohibited the DOL from issuing any regulation defining plan assets in the private equity and real estate areas that would require such a fund to fall below certain defined thresholds specified by Congress in P.L. 99-272. The 1986 plan asset regulation reflected Congress' intentions and, over the following 25 years, the general partners, managing members, advisers, and other service providers to these funds were not subject to the ERISA fiduciary rules.
[4] 29 U.S.C. §1002(42).
[5] 29 CFR §2510.3-101(a)(2).
[6] 29 CFR§2510.3-101(f).
[7] 29 CFR §2509.75-2. In Interpretive Bulletin 75-2, the DOL stated that an investment in an entity such as a Non-Plan Asset Fund will not make subsequent transactions between a party in interest and the entity a prohibited transaction under section 406. The Interpretive Bulletin continues, "This general proposition, as

general partners, managing members, advisers, and service providers to Non-Plan Asset Funds should be treated similarly to service providers to registered investment companies; namely, such service providers should not be considered fiduciaries to a benefit plan that invests in the fund. As noted above, in adopting amendments to ERISA in the Pension Protection Act, Congress also signaled its clear intention to eliminate any burden or cost on pooled funds in which ERISA assets were not significant to avoid the imposition of those restrictions on other investors.

It is also important to recognize that, for advisers to pooled investment funds, the adviser-client relationship is between the adviser and the fund, not between the adviser and specific investors in the fund. This relationship between adviser and fund is a key characteristic of pooled vehicles, as distinguished from individual advisory relationships. This distinction is important from an investor protection perspective because investors in private investment funds require, and appreciate the need for, all investors in a pooled investment vehicle to receive consistent and uniform treatment. Moreover, an adviser to a private investment fund would not be able to manage the fund with a separate fiduciary duty to each individual investor in the fund. For example, an adviser would not be able to exercise its proxy voting responsibilities on an investor-by-investor basis, as investors are likely to have different views as to how they would choose to vote on various issues.

In recognition of this key feature of pooled investment funds, Congress less than 6 months ago expressly limited the SEC's authority to define the term "client" by prohibiting the SEC from defining the term for purposes of section 206(1) and (2) of the Advisers Act to include investors in a private investment fund if the fund has an advisory agreement with the adviser.[9] Additionally, section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act") amends section 211 of the Advisers Act to provide a similar limitation that the SEC, when it issues rules under the Advisers Act regarding an adviser's fiduciary duty to customer, may not define "customer" to include investors in a private investment fund if the fund has an advisory agreement with the adviser. Thus, the Dodd-Frank Act plainly manifests Congress's clear position regarding the fiduciary obligations of an adviser to a private, pooled investment fund: the adviser's client is the fund and the adviser's fiduciary obligations are to the fund, not to individual investors in the fund. Though the Dodd-Frank Act specifically focuses on an adviser's fiduciary obligations under the Advisers Act, we believe that the same framework should apply to the determination of an adviser's

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applied to corporations and partnerships, is consistent with section 401(b)(1) of the Act, relating to plan investments in investment companies registered under the Investment Company Act of 1940."

[8] 29 CFR §29.2509.75-3. Interpretive Release 75-3 provides the DOL's interpretation of section 3(21)(B) of ERISA. In the Release, the DOL states its view that section 3(21)(B) is an elaboration of section 401(b)(1) of ERISA and Interpretive Release 75-2. Release 75-3 provides elaboration on the principle that assets of an investment company should not be deemed plan assets solely because a plan has invested in the shares of an investment company. The Release states, "[c]onsistent with this principle, the [DOL] interprets this section to mean that a person who is connected with an investment company, such as the investment company itself, its investment adviser or its principal underwriter, is not deemed to be a fiduciary of or party in interest with respect to a plan solely because the plan has invested in the investment company's shares."

[9] Section 406 of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

fiduciary obligations under ERISA, namely the fiduciary obligation should be at the fund level.

Because the language in the proposed regulation is drafted so broadly, we are concerned that it could be interpreted in a way that is inconsistent with the Congressional intent established in these laws, as well as within the DOL's own regulations and guidance with respect to Non-Plan Asset Funds. We are particularly concerned about any interpretation of the proposed regulation that would make general partners, managing members, adviser, and service providers to Non-Plan Asset Funds fiduciaries based on the day-to-day activities they provide to Non-Plan Asset Funds. Accordingly, we urge the DOL to make clear in any final regulation that nothing in the regulation will cause a person to become a fiduciary because of any recommendation regarding the value of the Non-Plan Asset Fund or any of its assets.

**Appraisals**

Under current law, pricing services, custodians, and others who provide estimates of value generally are not fiduciaries for purposes of ERISA. We understand that the proposed regulation is intended, in part, to designate a new category of service providers as fiduciaries under ERISA – namely, appraisers and companies that give fairness opinions, even in the absence of any arrangement, agreement, or understanding that the service provider is providing individualized "advice." We have already noted our concern that the regulation should not apply to general partners, managing members, advisers, and service providers to Non-Plan Asset Funds. We also have concerns about the proposed regulation's impact with respect to funds that are deemed to hold plan assets, for example, hedge funds that do not meet the 25% test set out in section 3(42) of ERISA ("Plan Asset Funds").

<u>Effects on General Partners, Managing Members, and Advisers to Plan Asset Funds</u>

Under the proposed regulation, solely because a Plan Asset Fund sends out periodic performance reporting, the fund's general partner, managing member, and adviser may be deemed a fiduciary with respect to the assessment of value to every plan investor in the Plan Asset Fund. Such an interpretation would create uncertainty as to whether the fees charged on the value of assets would violate the prohibited transaction provisions of ERISA. Moreover, uncertainty regarding the scope of this provision could create a disincentive for fund managers to provide more comprehensive and frequent information to fund investors, a result that is contrary to the goal of protecting plan investors.[10]

[10] The proposed regulation contains an exemption for valuations provided for purposes of reporting required by ERISA or the Internal Revenue Code. The exemption does not apply if the valuation includes assets for which there is not a generally recognized market and which serves as a basis on which a plan may make distributions to plan participants and beneficiaries. We believe that this limited exemption generally would not apply to the types of valuation information typically provided to investors in pooled investment vehicles.

We believe the broad language in the provision relating to appraisals appears to go far beyond any abuse or enforcement issue that the DOL has identified and could have far reaching costs to plans, funds, and the capital markets. The proposed regulation, as drafted, could add significant costs and burdens to plans seeking to invest in pooled investment funds without additional protection of plan investors in Plan Asset Funds.[11] Accordingly, we urge the DOL to consider a more narrowly tailored approach with respect to determining which persons that provide valuations to a Plan Asset Fund, and ultimately to an investing plan, should be considered a fiduciary.

Effects on Service Providers to Plan Asset Funds

We note that the DOL's economic analysis does not include any analysis on the proposal's inclusion of this new category of service providers as fiduciaries. We are concerned that it could impose significant costs on or even preclude certain custody, prime brokerage, and fund administration agreements typically entered into by Plan Asset Funds. For example, the appraisal provision could make it impossible for Plan Asset Funds to enter into swaps, to the extent that, the rule makes a counterparty a fiduciary when it provides the daily mark required by the Dodd-Frank Act.[12] This is because, if the swap counterparty is deemed a fiduciary, the dealer would be precluded from participating in the swap transaction when it is acting as a fiduciary with respect to the assets involved in the swap transaction.

Each of the service providers or counterparties that provides information regarding the value of an asset also could be a fiduciary under the proposed rule as it is currently drafted, which could invalidate their asset-based fee compensation. Thus, this provision could affect the compensation of every fund manager and prime broker, custodian or fund administrator, as many of the existing agreements likely would violate the prohibited transaction provisions of ERISA, if applicable.[13] Such additional costs to Plan Asset Funds would ultimately be borne by investors in the fund, thereby increasing the costs to plans that invest in Plan Asset Funds. Faced with potentially prohibitive costs or the inability to find suitable service providers in the first place, funds may be reluctant -- or even unable -- to take investments from plans, which would greatly limit plans' alternative investments options. The cost to plans of these lost opportunities and limited choices could be significant.

Plan investors will not benefit from these rules if funds are unable to retain service providers at a reasonable cost. If service providers involved with the appraisal or

[11] We note that this result would be inconsistent with the treatment of fund administrators, prime brokers, pricing services, and custodians under other fiduciary regimes. See, *e.g.*, Section 202(a)(11) of the Advisers Act, which explicitly excludes custodians from the definition of "adviser."
[12] See page 12 below for a more detailed discussion regarding the potential implications of the proposed regulation on dealers who are required to provide marks on derivatives contracts under the Dodd-Frank Act.
[13] Further, any service providers deemed a fiduciary would need to be bonded, have fiduciary liability insurance, and raise their fees in order to cover the cost of potential litigation regarding the values provided to Plan Asset Funds.

valuation of a fund's assets note that there is no available price for an asset, or disclaim a price for an asset, it will be far more difficult to strike a net asset value for the fund and transact investments and redemptions. There are many examples of such hard-to-value assets, including private equity holdings, real estate holdings, and so-called side-pocket investments.[14] As a result of the increased difficulty in striking a net asset value, investors likely would receive less information, less timely information (since it is unlikely that funds would go to the expense of hiring fiduciary appraisers for every hard to value asset monthly, or even quarterly). Further, because subscriptions and redemptions in pooled investment require a determination of net asset value, to the extent that net asset values are determined less often, subscription and redemption rights may also become less frequent, to the detriment of plan investors.

**Other Changes in the Standard**

The current regulation requires that, in order for a person providing investment advice to be deemed a fiduciary under ERISA, the advice must be provided on a regular basis, where there is a mutual agreement, arrangement, or understanding that the advice will form a primary basis for the investment decision. It does not cover the selection of managers or the appraisal of property. Under current law, individuals are fiduciaries by their actions or by properly delegated authority, and not because of mere title, or registration under other law. Under current law, individuals know that they are fiduciaries and when they are fiduciaries, and they know the identity of the plans relying on them. The proposed rule could be interpreted as effectively changing that existing standard, which likely will create significant uncertainty for market participants.

In contrast to current law, the DOL's proposed regulation could impose fiduciary status on any person who makes investment recommendations, *regardless of whether those recommendations are individualized*, and *regardless of whether there is a mutual agreement, arrangement, or mutual understanding that the recommendations are intended as investment advice tailored to the plan*. The language in the proposed regulation does not include a requirement that the parties have a mutual agreement or understanding regarding the advice being provided. The language in the proposed regulation also replaces the standard that the advice be a primary basis on which the investment decision will be made, with only the requirement that the plan "may consider" the advice. Finally, for persons that are "investment advisers," as defined in section 202(a)(11) of the Advisers Act or that are otherwise a fiduciary under ERISA (*i.e.*, a person with discretion over the management of plan assets or a person with discretion over plan administration), the language does not require that the person provide tailored advice to a plan to be a fiduciary. As discussed in detail below, we encourage the DOL to modify this new provision by: (i) explicitly reinstating the requirement that the parties

[14] For example, a valuation firm may be engaged by a hedge fund manager to fair value assets in a side pocket to which a private pension fund investor has exposure. By definition, these investments are hard to value and at best, where there is no willing buyer and seller with respect to the investment, any estimate is just that: a good faith estimate. If a valuation firm is deemed a fiduciary under the proposed regulation, it could be difficult for a fund to find someone willing to provide such an estimate when it may be held liable for the estimate.

have a mutual agreement, arrangement, or understanding regarding the nature of the advice being provided; (ii) replacing the "may be considered" standard with a "significantly influence" standard; and (iii) clarifying the scope of the regulation with respect to advice that is not tailored to a plan, so as not to include public communications made by investment advisers and persons who are otherwise ERISA fiduciaries.

We believe this approach would provide greater certainty to market participants as it would establish a clear framework in which service providers and plans can agree on the scope of service and the extent to which the plan will rely on the service provider. Market participants would be subject to great uncertainty and unknown risk of liability if a person can become a fiduciary under ERISA without agreeing to provide tailored advice to a plan for its reliance. The uncertainty and potential for a person to unknowingly become subject to fiduciary obligations under ERISA is likely to limit the investment options for plans as many market participants may simply choose to avoid plans (and Plan Asset Funds) rather than potentially being subject to an unknown liability.

Mutual Understanding

The proposed regulation establishes several new tests to determine whether a person is a fiduciary to a plan. We have already discussed three of these: persons who provide valuations of assets, all investment advisers, and all of a plan's existing fiduciaries. One of the other new tests for defining "fiduciary" eliminates the current regular basis and mutual understanding requirements, and eliminates the requirement that the advice be a primary basis on which the plan will make its investment decision. The amended formulation removes certainty and clarity from the definition.

Agreements, arrangements and understandings are by definition mutual -- there are two people party to the understanding, agreement or arrangement. The most subjective of these three terms – understanding -- is made even more subjective by eliminating the modifier "mutual." We believe the regulations should be based on both parties understanding when a person becomes a fiduciary (as under current law). We are concerned that eliminating the term "mutual" in this provision creates uncertainty whether a plan could elect on its own to make another person a fiduciary. Under these circumstances, an unhappy investor could use the definition's ambiguity to argue that the fund's general partner "advised" it to invest, or a counterparty to a fund trade was a fiduciary, and that the trades should be reversed. No service provider will have a clear understanding of the plan's expectations regarding the service provider's obligations.

We understand that staff of the DOL considers the elimination of the word "mutual" to be merely editorial; however, we believe that there is uncertainty regarding whether the amendment could be interpreted as a substantive change. To avoid confusion and uncertainty among market participants, we urge the DOL to revise the proposal by reinstating the term mutual.

Advice that "May Be Considered"

Another change to the current rule is that advice need not be a primary basis for a plan's decision making but merely "may be considered." We respectfully submit that this formulation is overly broad because any and all information provided to a plan is information that may be considered. As such, this formulation could apply to all information conveyed to the plan, regardless of whether it was a recommendation or merely factual information and regardless of whether the information was "tailored" to a plan or simply descriptive of many plans with certain risk appetites or characteristics. The formulation in the proposed regulation would create significant uncertainty and an incalculable risk of liability for market participants.[15]

We note that the preamble to the proposed rule states that the regulation is intended to capture persons that significantly influence the decisions of plan fiduciaries and have a considerable impact on plan investment. We think that the term "significantly influence" would be a more appropriate standard than "may be considered," particularly in light of the DOL's view expressed in the preamble that this is what the language is intended to cover.[16] We urge the DOL to consider using this language in its test to determine when advice should be deemed fiduciary advice.

Tailored Advice

We note that, under the broad language in the proposed regulation, an adviser could be deemed a fiduciary of a plan by virtue of information that the adviser provides at conferences, meetings open to the public, and research materials made available to the public. Under the proposal as it is currently drafted, public recommendations may be deemed fiduciary advice, regardless of the forum or the listener base, and in spite of the fact that it is not tailored to a particular plan or pursuant to an agreement of the parties. The language in the proposed regulation does not even require that the investment adviser know the identity of the entities relying on or considering the recommendations.

As an example of the potential impact of this provision, suppose an adviser issues research reports regarding particular markets or types of instruments or makes public statements that include recommendations regarding the value of securities. If the adviser were deemed a fiduciary to any plan that happened to hear or read the public statements by the adviser, then any pooled investment fund managed by the adviser could be off limits to every plan that heard or read the recommendations, unless the DOL provided a prohibited transaction exemption that would allow a plan to invest in a fund managed by a fiduciary. Under this scenario, plans could be prohibited from investing in the adviser's funds even if the adviser had no relationship with the plan.

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[15] We respectfully submit that the DOL's cost analysis does not consider the costs of exemption applications or the costs of transaction reversal and excise taxes if a service provider unwittingly becomes a fiduciary. Especially in the case of principal transactions, the 15% annual excise tax on the entire principal amount involved may be significant.

[16] 75 FR 65265.

While the DOL may not have intended this type of far-reaching result, we believe that the broad language in the proposed regulation creates uncertainty as to the potential scope of recommendations that will be deemed fiduciary advice. Accordingly, we encourage the DOL to amend this part of the proposed rule.

**Exceptions**

The Selling Exception

The proposed rule provides an exception for persons, or their agents, selling securities or other property.[17] It only applies if the person "selling" can demonstrate that the recipient of the advice knows -- or reasonably should know under the circumstances -- that such person (a) is providing the advice or making the recommendation in its capacity as counterparty, agent, or appraiser; (b) has interests that are adverse to the interests of the plan or its participants or beneficiaries; and (c) is not undertaking to provide impartial investment advice.

We are concerned that the exception may not adequately cover the marketing activities of pooled investment funds, such as hedge funds. We recommend that the DOL revise the exception to cover explicitly the selling of services and investment products. It should not be limited to counterparties, agents, or appraisers since a fund and its investment adviser are not likely to qualify as any of the above. The DOL should also make clear that the exception covers the selling of services, regardless of whether the client is a "new" client or whether the client is already receiving services from the service provider, fiduciary, or otherwise. As part of routine due diligence, plans ask significant, detailed questions about investment approach, investment options, strategies, and other areas when deciding whether to make an investment in a particular fund. Under the proposed regulation, any of these answers could be later categorized by an unhappy investor as investment advice, even when the plan has its own investment consultant acting as a fiduciary that analyzes responses from many different funds. A fund's marketing activities should not create the basis for a fiduciary relationship with a plan because such a result would hamper the flow of information that a fund provides when potential investors are conducting due diligence.

Furthermore, the selling exception in the proposed rule requires that the seller warn the plan that its interests are adverse. We urge the DOL to revise the proposal to delete the term "adverse." In our view, it should be sufficient if the marketer makes clear that it is providing marketing services for the fund, and not impartial investment advice.

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[17] The exception reads as follows: "For purposes of this paragraph (c), a person shall not be considered to be a person described in paragraph (c)(1) of this section with respect to the provision of advice or recommendations if, with respect to a person other than a person described in paragraph (c)(1)(ii)(A), such person can demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in its capacity as a purchaser or seller of a security or other property, or as an agent of, or appraiser for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice."

We would have no objection if there were a requirement that the marketer state that it has a financial interest in the outcome.

The exception should also make clear that it covers counterparties (including valuation agents who provide valuations for both parties and not just the dealer) in swaps, which are bilateral agreements and may not be securities or property.[18] The selling exception should also cover a variety of lending and credit arrangements, which are extensively used by pooled investment funds.[19] Without appropriate exceptions, fund access to these products could be limited, as prime brokers, lenders, and borrowers may determine that the exception is not sufficiently broad. Finally, it should cover contractual rights and the exercise of those rights, including on default. To the extent that a bilateral agreement allows a counterparty to require more collateral or a counterparty or issuer to exercise certain rights if a particular condition is met, the exercise of rights could be deemed fiduciary recommendations. Fund counterparties, as well as those from whom funds buy structured products may refuse to deal with any Plan Asset Fund because of the risk that the counterparty could be deemed a fiduciary. That would be a harmful result for fund investors and potentially limit the investment options for plans.[20]

<u>The Dodd-Frank Act</u>

In addition to broadening and clarifying the selling exception, we urge the DOL to create an exception for any information required to be provided to a plan or its independent fiduciary in connection with the offering and sale of swaps under section 731 of the Dodd-Frank Act and related SEC and CFTC rules. Without such an exception, the disclosure that a swap dealer makes to a Plan Asset Fund may cause the dealer to be a fiduciary, and invalidate the swap transaction as a prohibited transaction under section 406(a)(1)(A) and section 406(b) of ERISA.[21] Without a clear exception, the DOL's proposed regulation could eliminate plans and many pooled investment funds from the swaps market, a consequence that Congress clearly intended to avoid in the Dodd-Frank Act.[22] Congress also clearly intended that a swap counterparty would not be deemed an adviser or fiduciary if the plan has its own investment professional. Despite that clear distinction, the proposed rule could eliminate swaps from a fund's investment choices if

[18] We note that section 731(h) of the Dodd-Frank Act requires the SEC and the CFTC to impose business conduct standards on major swap participants and swap dealers, which may address the DOL's concerns about protecting plan investors involved in derivatives markets.
[19] Examples of such arrangements include short sales, options, structured products, futures, settlement accommodations and overdraft coverage.
[20] We note a somewhat curious potential consequence of this rule. The disincentives in this proposal -- the lack of certainty, the narrowness of the selling exception, the "inadvertent fiduciary" status which could limit fund access to dealers and products -- could have the result of fewer funds that will take plan money after the fund reaches the 25% limit and fewer non-plan investors willing to invest in a fund that is subject to ERISA.
[21] It is unclear whether the SEC and CFTC rules will look through a pooled vehicle, under the special entity rules.
[22] We also respectfully request the DOL's confirmation that the requirement in the Dodd-Frank Act that a counterparty make a determination that a plan's independent fiduciary is or is not experienced and qualified will not make it a fiduciary under the proposed regulation and will not constitute the power to appoint under Part I(a) of PTE 84-14.

the dealer becomes a fiduciary to a Plan Asset Fund solely by providing information required by the Dodd-Frank Act.[23]

The Proposed Regulation's Definition of Fees

The proposed rule defines fee for the first time in language that is not entirely clear. The proposed definition of fees in the proposed regulation includes the following language: "It includes fees and commissions based on multiple transactions involving different parties." This sentence is not explained in the preamble, and we are concerned that the language could be interpreted to require aggregating many unrelated transactions resulting in fiduciary status for unwitting service providers. It is critical for market participants to fully understand the scope of new or changed requirements in regulatory proposals. Accordingly, we encourage the DOL to provide some examples of the fee arrangements that the proposal is addressing and allow a further period for public review of and comment on those examples.

**Summary of Adverse Effect on Plans that Invest in Private Pooled Investment Funds**

As described above, without significant changes to or clarification of certain provisions in the proposed regulation, private pooled investment funds with plan investors could be subject to significant restrictions, many of which we believe are unintended consequences of the proposed regulation. General partners, managing members, advisers, and other service providers to Non-Plan Asset Funds could be deemed fiduciaries under the proposed regulation, despite a clear Congressional mandate that such entities not be deemed fiduciaries under ERISA.

Plan Asset Funds may not be able to engage in swaps, solely because the duties imposed by the Dodd-Frank Act could make dealers fiduciaries under the DOL's proposed regulation.[24] The trading partners available to Plan Asset Funds could be significantly restricted because of uncertainty whether research or market color provided by an adviser or an affiliate of the adviser is deemed to be fiduciary advice.

Plans may be limited in their ability to invest in hedge funds, private equity funds, and real estate funds as general partners and advisers seek to avoid fiduciary status and appraisers may refuse to provide services to funds if plans are investors in those funds. Normal marketing activities to plans could be hampered by advisers seeking to avoid fiduciary status because of their selling activities.

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[23] We note that the same issue arises with structured notes or other investment products where the issuer is required to provide a daily value and take action when a particular value is reached and encourage the DOL to consider an appropriate exception for these transactions.

[24] Prime brokers also may refuse to provide services for funds, forcing these accounts off of efficient platforms for trading, cash management, lending and other services. Because all of these services require that the prime broker not be a fiduciary, prime brokers will weigh carefully whether the proposed rule will cause their services to be deemed fiduciary services.

**Conclusion**

On behalf of its members, MFA respectfully urges the DOL to reconsider its proposed changes to the definition of fiduciary regulation, reassess its economic analysis, and repropose the regulation or clarify the scope of the regulation, particularly with respect to pooled investment funds and the general partners, managing members, advisers, and other service providers to those funds. We respectfully request an opportunity to testify at the DOL's hearing on March 1, 2011, and request that the public record remain open for comments on the regulation until at least thirty days after that hearing.

If you have any questions regarding any of these comments, or if we can provide further information with respect to these or other regulatory issues, please do not hesitate to contact Stuart J. Kaswell or me at (202) 730-2600.

Respectfully submitted,

/s/ Richard H. Baker

Richard H. Baker
President and CEO