April 12, 2011
[Additional Signatories Added on April 15, 2011]

Via Email to: e-ORI@dol.gov

Office of Regulations and Interpretations
Employee Benefits Security Administration (EBSA)
200 Constitution Avenue NW, Room N-5655
Washington DC 20210

Re: Public Hearings on Definition of 'Fiduciary'

This comment letter is sent in response to issues raised during the March public hearings on proposed changes in the rules governing when a person or firm who advises an ERISA pension plan is considered to be a 'fiduciary.' It is submitted on behalf of participants in the Fiduciary Duty Working Group of the Network for Sustainable Financial Markets (NSFM). NSFM is an international, non-partisan and non-profit organization comprised of financial market professionals, practitioners and academics. We seek to focus research and debate on issues relating to financial market stability and health of the economy, including retirement security and pension fund sustainability.*

We strongly support EBSA's initiative to update the definition of 'fiduciary' in light of fundamental changes in the market environment since the original ERISA rules were written thirty-five years ago. In that regard, we submit the following comments.

Investment Consultants and Advisors Exercise Effective Controlling Influence

Many NSFM participants have worked with pension governing boards. Given complexity of most investment issues now faced by governing fiduciaries and the protection from fiduciary liability afforded by following advice of third party experts, we have seen advisors and consultants exercise a de facto controlling influence over decisions of pension governing boards. The January 2011 Government Accountability Office (GAO) Report, *401(k) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest,* cites interviews with industry experts who also advised that pension sponsors rely heavily on service providers who structure their engagements so as to be exempt from the current EBSA fiduciary definition.

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* Additional information on NSFM, including previous public consultation comments that were incorporated into the OECD's Guidelines for Pension Fund Governance, is available at www.sustainablefinancialmarkets.net.

In addition to the evidence of controlling influence described above, behavioral dynamics associated with an advisory or consulting relationship virtually guarantee that expert advice will strongly influence decisions made by a governing fiduciary. This is likely to occur regardless of any contract disclaimers, the temporary nature of the advisory relationship or other legal fictions adopted to avoid fiduciary responsibility. Duke University behavioral economics professor Daniel Ariely gives an enlightening description of factors which influence financial decisions in his book, *Predictably Irrational: The Hidden Forces that Shape our Decisions.* Among the behavioral tendencies likely to be at work in the pension fund advisory relationship is 'anchoring,' whereby advice from an outside expert serves as a reference point that anchors discussion and decision making.

We recommend that the EBSA take real world behavioral dynamics into consideration when conducting its rulemaking. Investment consultants and advisors that exert de facto influence over fiduciary decisions should be treated as fiduciaries.

ERISA's Duty of Loyalty was Intended to Cover Investment Consultants and Advisors

Growing complexity of the markets, expanded reliance on investment advisors and consultants, and the increased influence of service providers have made an updated definition of fiduciary responsibility more important than ever. Increased delegation by trustees and other changes in the pension industry since the 1970s have effectively diluted protections afforded to pension participants by the duty of loyalty. The EBSA's proposed rule would ensure that application of the duty of loyalty catches up with recent trends toward greater delegation to and reliance on investment consultants and advisors. We believe that any added costs associated with the rule would be more than offset by reduced risk and additional returns from improved reliability of investment advice.

The duty of loyalty was intended to set a high bar. ERISA fiduciary standards are based on trust law and incorporate its strict approach toward the duty of loyalty. Comments to the Restatement of Trusts, Second, §78 explain that *"the policy of the trust law is to prefer (as a matter of default law) to remove altogether the occasions of temptation rather than to monitor fiduciary behavior and attempt to uncover and punish abuses . . . The inherent subjectivity and impracticability of second-guessing a trustee's application of business judgment or exercise of fiduciary discretion are aggravated by the opportunities and relative ease of concealing misconduct . . . efforts to prevent or detect actual improprieties can be expected to be inefficient if not ineffective."*

Furthermore, the legislative history of ERISA makes it clear that the Secretary of Labor is only authorized to waive protections from practices and relationships that present *"potential threats to the security and preservation"* of pension funds if the waiver is *"consistent with the purposes of the Act and determined to be in the interests of pension plan participants."* (See Senate Report on P.L. 93-406 in 3 U.S. Cong. & Adm. News, at page 4868.) Given the real world experience cited by the GAO and our observations described above, we question whether the existing definition of 'fiduciary' still serves Congress' intent. Although some advisors and consultants still have business models built on outdated views of the duty of loyalty contained in the current

rule, the EBSA is required to protect the interests of pension plan participants over the interests of service providers.

We support EBSA's proposal to extend the definition of 'fiduciary' to implement ERISA's intent that pension participants and beneficiaries be strictly protected from conflicting business pressures on investment advisors and consultants. Since it may take some time for pension industry business models to readjust, a deferred effective date might be set. Alternatively, the EBSA might consider adopting an approach that shifts the burden of proof to the defendant once EBSA (or a private litigant) has made a prima facie showing of a breach of fiduciary duty by a third party expert, where the alleged breach grew out of improper advice provided by an investment advisor or consultant that disclaims it was acting as a fiduciary.

We appreciate the opportunity to provide views of individual NSFM participants and commend the EBSA for updating its rules on this important issue.

Sincerely,

Co-Chairs of the Network for Sustainable Financial Markets Fiduciary Duty Working Group
Ann Byrne, Chief Executive Officer, Australian Council of Superannuation Investors
Frank Jan de Graaf, Professor of International Business, Hanze University of Applied Sciences
Keith Johnson, Retired Chief Legal Officer, State of Wisconsin Investment Board
Prof. Cynthia Williams, University of Illinois College of Law

The following Network for Sustainable Financial Markets participants join in this submission:[†]

Keith Ambachtsheer, International Centre for Pension Management, Rotman School of Management, University of Toronto

Peter Chapman, Executive Director, Shareholder Association for Research and Education

Greg Chipman, Managing Director, CJC Global; Director, Responsible Investment Association Australasia; Co-Chair, NSFM Wealth Management Working Group

Gordon L Clark, FBA DSc, Halford Mackinder Professor of Geography, Oxford University Centre for the Environment

Dr. Andrew M. Clearfield, Former Director of International Corporate Governance, TIAA-CREF

Stephen Davis, Senior Fellow, Millstein Center for Corporate Governance and Performance, Yale School of Management

John Fullerton, Founder and President, Capital Institute

[†] Participants are signing as individuals and not on behalf of any organization. Affiliations are provided for identification purposes only. Information on the Network for Sustainable Financial Markets and its participants is available at www.sustainablefinancialmarkets.net.

James P. Hawley, Ph.D., Professor and Director, Elfenworks Center for the Study of Fiduciary Capitalism, School of Economics and Business, Saint Mary's College of California

Catherine Howarth, Chief Executive, FairPensions

Adam M. Kanzer, Managing Director & General Counsel, Domini Social Investments

Sean Kidney, Chair, The Climate Bond Initiative

Maxime Le Floc'h, Responsible Investment Analyst

Steve Lydenberg, Founding Director, Initiative for Responsible Investment, Harvard University

James McRitchie, Publisher, CorpGov.net (Corporate Governance)

Michael Musuraca, Former New York City Pension Funds Trustee

Steve Podmore, Founder & CEO, Transform Capital Management, Ltd.

Dr. Janis Sarra, Faculty of Law, University of British Columbia

Charles Scanlon, Participant, Network for Sustainable Financial Markets

Raj Thamotheram, Responsible Investment Specialist; Board President, Network for Sustainable Financial Markets

Matteo Tonello, Research Director, Corporate Leadership, The Conference Board

Stephen Viederman, Former President, Jessie Smith Noyes Foundation; Finance Committee Member, Christopher Reynolds Foundation

Prof. Ed Waitzer, Janislowsky Dimma Mooney Chair in Corporate Governance, Schulich School of Business and Osgoode Hall Law School, York University, Toronto

David Wood, Director, Initiative for Responsible Investment, Harvard University