Morgan Stanley

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Assistant Secretary Jeanne Klinefelter Wilson
Employee Benefit Security Administration
Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

Re: Application No. D-12011, ZRIN 1210-ZA29, Proposed Exemption entitled "Improving Investment Advice for Workers & Retirees"

Dear Secretary Wilson:

On behalf of Morgan Stanley, Morgan Stanley Smith Barney LLC and Morgan Stanley & Co. LLC (collectively "Morgan Stanley"), this comment letter responds to request for comments on the U.S. Department of Labor ("Department") proposed class exemption entitled "Improving Investment Advice for Workers & Retirees" (the "Exemption").

We appreciate the opportunity to provide comments to the Department on the Exemption. As a general matter, Morgan Stanley supports and encourages the Department's efforts to align the Exemption with the standards of conduct required under the securities laws. This letter offers our comments on the Department's interpretations of the historic five-part test of fiduciary status, seeks clarity on certain aspects of the Exemption's conditions for rollover advice, and offers suggested changes to certain of the Exemption's conditions to better align it with the securities laws and to encourage widespread usage of the Exemption.

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Morgan Stanley Background Information

Morgan Stanley is a leading full-service global financial services firm.[1] Since our founding in 1935, Morgan Stanley has been a client-focused organization providing a range of financial services and advice to individuals, corporations and institutions. Our employee code of conduct stresses the primacy of client interests over those of the company or individual employees, and our five "Core Values," including "Put Clients First," guide our business approach.[2]

[1] Morgan Stanley (NYSE: MS), through its subsidiaries and affiliates, provides products and services to a large and diversified group of clients and customers, including corporations, governments, financial institutions and individuals. Morgan Stanley Smith Barney LLC (doing business as "Morgan Stanley Wealth Management") is registered as a broker-dealer and investment adviser with the SEC and a member of FINRA. Morgan Stanley & Co. LLC is registered as a broker-dealer with the SEC, and a member of FINRA and NYSE, among others.
[2] The remaining Core Values are "Do the Right Thing," "Lead with Exceptional Ideas," "Give Back," and "Commit to Diversity and Inclusion."

Morgan Stanley's wealth management division, Morgan Stanley Wealth Management ("Wealth Management"), has approximately 15,399 financial advisors throughout the United States, servicing wealth management accounts with approximately $2.7 trillion in client assets. Wealth Management provides services to individual retirement accounts ("IRAs") and qualified retirement plan accounts through both brokerage accounts with transaction based pricing for effecting and executing trades (e.g., commissions and selling concessions), and through investment advisory accounts where customers pay a fee for investment advice and other services based on the value of assets in the account.

In accordance with our Core Values, Morgan Stanley strongly supported the U.S. Securities and Exchange Commission ("SEC") Regulation Best Interest ("Reg BI") rulemaking (including clarifications to the investment adviser standard of conduct) because we believe investment recommendations and advice provided to retail investors should be in the investor's best interests, regardless of whether the recommendation or advice is provided by a broker-dealer or an investment adviser. We also believe that it is essential that the standards be consistently constructed and applied across regulatory regimes so that retail investors have the benefit of harmonized standards for all of their accounts (including taxable and retirement accounts) when working with a financial professional.

<u>Interpretation of the "Five Part Test"</u>

We appreciate that the Department has acknowledged the effect of the United States Court of Appeals for the Fifth Circuit's *Chamber of Commerce* decision by amending the Code of Federal Regulations to officially reinstate the "five-part test" for determining whether investment advice is fiduciary advice for retirement plans and accounts. However, we are concerned by certain statements about the elements of the five part test in the Exemption's preamble. As we will elaborate herein, the Department's revised interpretation, as provided in the preamble, could, in many cases, be viewed as expanding the definition of investment advice under ERISA, similarly to the vacated 2016 Fiduciary Rule, and effectively undermine its own efforts in reinstating the five part test.

Our specific views on the Department's interpretive guidance are as follows:

<u>Regular basis</u>. The Department states that *"advice to roll over Plan assets can occur as part of an ongoing relationship or an anticipated ongoing relationship that an individual enjoys with his or her advice provider."* While we agree that the regular basis prong would more likely be satisfied where there is a preexisting advice relationship between a retirement investor and a financial institution, we do not agree that the mere existence of a preexisting relationship would automatically satisfy the regular basis part of the test. Instead, we believe, consistent with the Fifth Circuit's decision, that the primary question is whether the preexisting relationship indicates that there is "a special relationship of trust and confidence between the fiduciary and his client."[3] Of course, whether such a relationship has been established will depend on the facts, circumstances and understandings of the parties and would, therefore, need to be evaluated on a case-by-case basis.

[3] *U.S. Chamber of Commerce v. U.S. Department of Labor*, No. 17-10238, 5 (5th Cir. March 15, 2018).

The Department goes on to say that *"advice to roll assets out of the Plan into an IRA where the advice provider will be regularly giving financial advice regarding the IRA in the course of a more lengthy financial relationship would be the start of an advice relationship that satisfies the 'regular basis' requirement. In these scenarios, there is advice to the Plan - meaning the Plan participant or beneficiary - on a regular basis."* This suggests that the Department believes the regular basis prong could be satisfied before the relationship between the retirement investor and the financial institution is established (or whether it ever actually develops) based on the parties' anticipation at the time of the rollover recommendation. It also conflates advice given to a participant who is part of an ERISA plan with advice provided to the owner of the IRA, which are two separate plans under the statutory construction of ERISA and the Code and express terms of the five-part test. We believe that this is an overly board interpretation and will result in investor confusion and reduction of investor choice. We believe it would be highly unlikely for the parties to be in a "relationship of trust and confidence" when the financial institution and professional are in a sales relationship with the investor and are trying to encourage the investor to hire them. Moreover, this interpretation would subject financial institutions to hindsight second guessing as to the nature of the future anticipated relationship. We ask that the Department clarify that "regular basis" cannot be established based on the anticipated nature of a future relationship. Alternatively, we ask the Department to clarify that a fiduciary can step out of its fiduciary role with a client for purposes of explaining and selling new products, services and relationships, where the client acknowledges the conflicts under which the investment profession is operating.

<u>Mutual understanding</u>. 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, although such statements are appropriately considered in determining whether a mutual understanding exists."* Morgan Stanley, like many financial institutions, discloses that certain communications and services are not intended to be fiduciary investment advice (e.g., educational materials, investment and research reports, marketing materials, and brokerage services). While we appreciate the Department's view that disclaimers are not always determinative (particularly where it may be incorporated in otherwise unrelated boilerplate contractual language), we request that the Department specifically acknowledge that financial institutions can rely on clear and prominent disclosures intended to be understood by the retirement investor that a communication or service is not fiduciary in nature. In particular, where the financial institution and retirement investor enter into a written agreement that clearly and prominently provides that a services arrangement (including transactional brokerage recommendations) is not intended to result in the provision of fiduciary investment advice, we believe that the mutual understanding prong would not be satisfied absent other facts.

<u>Primary basis.</u> The preamble states that, *"[w]hen financial service professionals make recommendations to a Retirement Investor, particularly pursuant to a best interest standard such as the one in the [Reg BI], or another requirement to provide advice based on the individualized needs of the Retirement Investor, the parties typically should reasonably understand that the advice will serve as at least a primary basis for the investment decision."* Dually-registered broker dealers and investment advisers are subject to multi-jurisdictional standards of care, including Reg BI, the Investment Advisers Act of 1940, applicable state law, and other entities. We believe that this interpretation is too broad and will leave financial institutions open to the risk that they could be deemed to be fiduciaries merely by complying with Reg BI or "another requirement". This interpretation also seems to conflate two prongs of the five-part test

("primary basis" and "individualized") into a single prong. In fact, not all individualized advice is reasonably understood to be a primary basis for an investment decision, particularly where such advice is provided by a broker-dealer or insurance agent acting clearly in a sales role. We are concerned that this interpretation reintroduces elements of the Department's previous rulemaking efforts, which the 5th Circuit found to be overly broad.

Rollover guidance

Morgan Stanley welcomes the long awaited guidance from the Department on rollover recommendations. However, there are two important ancillary issues that are related to the use of the proposed Exemption.

1. Clarity on use of Exemption for discreet transactions.

Please confirm that the Exemption can be used in the following circumstances:

- Rollover to Advisory Program. A financial institution offers advisory services (discretionary and non-discretionary) to IRAs for asset-based compensation that does not vary based on such advice and thus does not require a prohibited transaction exemption. The financial institution can rely on the Exemption (assuming it satisfies the Exemption's conditions) solely for the recommendation to roll over the retirement investor's plan account to an IRA enrolled in the advisory program, and need not rely on the Exemption for any investment advice provided through the program.

- Rollover to Brokerage IRA. A financial institution offers brokerage services to IRAs, including investment recommendations. The financial institution and the retirement investor agree in writing that the financial institution and its financial professionals will not be providing fiduciary investment advice as part of this service model. The financial institution can rely on the Exemption solely for the recommendation to roll over the retirement investor's plan account to a brokerage IRA, and need not rely on the Exemption for any transactional compensation received in connection with transactions in the account.

- ERISA Section 3(38) Investment Managers. A financial institution serves as an investment manager pursuant to section 3(38) of ERISA to a qualified retirement plan and selects and monitors the plan's menu of designated investment alternatives. While the financial institution cannot rely on the Exemption for its discretionary services to the plan, it can rely on the Exemption when providing fiduciary investment recommendations regarding plan distribution options to plan participants.

2. Rollover recommendation documentation requirements should be eliminated or simplified.

The preamble states that a prudent recommendation to roll over from a plan to an IRA *"would necessarily include consideration and documentation of the following: the Retirement Investor's alternatives to a rollover, including leaving the money in his or her current employer's Plan, if permitted, and selecting different investment options; the fees and expenses associated with both the Plan and the IRA; whether the employer pays for some or all of the Plan's administrative* *expenses; and the different levels of services and investments available under the Plan and the IRA."*

While documenting the basis for a recommendation has long been considered a best practice, the Department has not, until recently, imposed specific documentation requirements under Section 404(a) of ERISA, or in its class exemptions. We are concerned that these specific requirements create unnecessary risks of foot-faults in technical compliance with the Exemption's conditions, even where the Exemption's principles-based impartial conduct standards are otherwise satisfied.

Moreover, we note that it appears that the Department expects financial professionals to reallocate plan investments to an "ideal asset allocation" when comparing the costs and benefits of staying in the plan and rolling over to the IRA. This seems to ignore that the retirement investor would not have the benefit of the financial professional's expertise and advice in allocating his or her plan assets if the choice is made to stay in the plan.

Furthermore, the preamble states, *"[t]he Investment Professional and Financial Institution should make diligent and prudent efforts to obtain information about the existing Plan and the participant's interests in it."* Then, *"[i]f the Retirement Investor is unwilling to provide the information, even after a full explanation of its significance, and the information is not otherwise readily available, the Investment Professional should make a reasonable estimation of expenses, asset values, risk, and returns based on publicly available information and explain the assumptions used and their limitations to the Retirement Investor."* In our experience, retirement investors are highly unlikely to retrieve this information for consideration. As such, financial institutions will need to have a readily available system in place to estimate plan information that could be costly and burdensome, and may not in all cases result in accurate comparisons.

We further believe that the Department's requirements here unnecessarily deviate from the securities laws in general, and the requirements of SEC's Reg BI in particular, which while recognizing the potential significance of a rollover recommendation, do not require such proscriptive documentation.

We request that the Department remove this requirement and instead allow financial institutions to develop their own procedures, which may include requesting the information from participants, estimating the information, or developing a hybrid approach—in each case, appropriately disclosing the methodology and assumptions used in comparing costs and fees.

<u>Additional Comments on the Exemption</u>

<u>Written acknowledgement of fiduciary status.</u> The Exemption would require that the financial institution acknowledge, in writing, that it will act as a "fiduciary" with respect to any investment advice it may deliver to the retirement investor. We are concerned that this acknowledgement will create unnecessary confusion for retirement investors and respectfully request that it be eliminated. If a financial institution chooses to rely on the Exemption for a discreet transaction (e.g., a rollover recommendation), it may be unclear to the retirement investor that the financial institution is not acting as a fiduciary with respect to other aspects of their relationship (including investment education, marketing materials, reports, and brokerage recommendations). Moreover, while we acknowledge that the Code and ERISA are separate statutory and regulatory regimes from those under state and federal securities laws, we note that

the SEC expressly provided that broker-dealers are not fiduciaries, while investment advisers are. Acknowledging fiduciary status under ERISA and the Code is likely to confuse investors as to the standards that apply under the securities laws. Additionally, we note that certain states have developed (or are in the process of developing) their own "fiduciary" conduct standards that can impose additional burdens based on a "contractual fiduciary duty". We are concerned that the Exemption's fiduciary acknowledgement could inappropriately trigger these state law obligations. Finally, we suggest that, similar to many other prohibited transaction class exemptions (i.e., PTE 84-24), this Exemption should be available to inadvertent fiduciaries, where the other applicable conditions are met.

Delivery of disclosure should be harmonized with Reg BI. The Exemption requires disclosure to be delivered *"prior to engaging in a transaction pursuant to this exemption."* whereas Reg BI requires delivery of its disclosure to be done *"prior to or at the time of the recommendation."* We understand that the Department wishes to align the requirements of the Exemption as much as possible with those of Reg BI and therefore request that the Department add "or at the time of" to its disclosure requirement. This will allow financial institutions to efficiently harmonize their disclosure responsibilities.

Correction methodology. We respectfully request that the Department consider including an appropriate self-correction methodology to the Exemption so that inadvertent errors do not automatically result in prohibited transactions if corrected within a reasonable time after discovery. We believe allowing financial institutions to correct inadvertent errors will foster more widespread use of the Exemption.

We thank the Department for considering these comments on the Exemption.

Sincerely,

Anne W. Tennant

Anne W. Tennant
General Counsel of Morgan Stanley Wealth Management