FINANCIAL SERVICES INSTITUTE | VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS AND INDEPENDENT FINANCIAL ADVISORS

VIA Federal eRulemaking Portal

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Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
Federal eRulemaking Portal
Application No. D-12011

Re: Improving Investment Advice for Workers and Retirees (Docket ID number: EBSA–2020–0003)

To Whom It May Concern:

On July 7, 2020, the Department of Labor (the Department) published its request for public comment on an ERISA proposed class exemption entitled Improving Investment Advice for Workers & Retirees[1] (the Proposed Exemption or Exemption). In addition, the Department issued a technical amendment that restored to the Code of Federal Regulations its 1975 investment advice regulation (consisting of a five-part test to determine when a person is acting as an ERISA investment advice fiduciary) and its 1996 investment education guidance. In the preamble to the Proposed Exemption, the Department also indicates that its 2005 Advisory Opinion on rollover advice is no longer valid and that investment advice fiduciaries who recommend a rollover from an employee benefit plan are subject to the fiduciary duties imposed by Title I of ERISA as well as the prohibited transactions provisions in Title I and the Internal Revenue Code of 1986 (the Code).

The Financial Services Institute[2] (FSI) appreciates the opportunity to respond to this important request for comment. FSI members support the Department's Proposed Exemption that would enable investment advice fiduciaries to continue providing their essential services to retirement investors while receiving a broad range of otherwise prohibited compensation types[3] and payments from third parties in connection with transactions involving employee benefit retirement plans and retirement accounts and annuities (IRAs). FSI supports the breadth and flexibility of the

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[1] Dep't of Labor, "Improving Investment Advice for Workers and Retirees," 85 Fed. Reg. 40834 (July 6, 2020), available at https://www.federalregister.gov/documents/2020/07/07/2020-14261/improving-investment-advice-for-workers-and-retirees.

[2] The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

[3] "Professionals could receive a wide variety of payments that would otherwise violate the prohibited transaction rules, including, but not limited to, commissions, 12b–1 fees, trailing commissions, sales loads, markups and mark-downs, and revenue sharing payments from investment providers or third parties." 85 Fed. Reg. at 40836.

Proposed Exemption, which is not tied to any particular investment product and is equally available to an array of financial professionals including registered investment advisers, broker-dealers, insurance companies, banks (collectively referred to as "Financial Institutions") and their respective employees or agents (collectively referred to as "Investment Professionals"). The proposed class exemption covers the type of real-life transactions, such as IRA rollovers, that are critical to the financial health of Americans and these transactions benefit from the advice of a financial services professional. While the Department describes, in the preamble to the Proposed Exemption, the Department's position on rollover transactions, FSI understands that the Proposed Exemption is not limited to, and does not hinge upon, use in a rollover setting.

FSI supports a uniform standard of conduct and applauds the Department's approach to ensure that the Proposed Exemption would require fiduciary investment advice to be provided in accordance with Impartial Conduct Standards that align with the Securities and Exchange Commission's (SEC) Regulation Best Interest (Regulation BI), which is now effective, as of June 30, 2020, and imposes a best interest obligation on broker-dealers when making recommendations of securities and investment strategies to retail customers.[4] The Impartial Conduct Standards also align with registered investment advisers' fiduciary duty under the Investment Advisers Act of 1940, as amended.

We do, however, have concerns with the Proposed Exemption.

1. Notably, we are concerned that the disclosure requirement concerning ERISA "fiduciary" status under the Proposed Exemption will be both confusing and misleading to retirement investors.
    - This requirement will be confusing and misleading particularly when a best interest standard, aligned with Regulation BI, separately applies to firms and professionals utilizing the Exemption. By using the term "fiduciary," such disclosure implies there is something more or different than the best interest standard.
    - Further, the disclosure requirement is unworkable in situations where the Department determines that an Investment Professional is a "retroactive fiduciary" based on the later formation of an ongoing advice relationship.
    - Finally, a statement by Financial Institutions and Investment Professionals that they are fiduciaries (for purposes of Section 4975 of the Code) might be misunderstood to imply a legal obligation to an IRA owner that would create a private right of action enforceable by the IRA owner.
2. FSI appreciates the Department's transparency in providing its views on when advice to rollover plan assets to an IRA could be considered fiduciary investment advice, but asks that the Department reconsider those views and their practical consequences.
3. We also have a number of other more technical comments and suggestions.
    - The Exemption should be effective on publication.
    - The temporary enforcement policy should remain in effect after publication.
    - Fiduciary advice is not co-extensive with the scope of Regulation BI.
    - Reasonable compensation should be determined under section 408(b)(2) processes.
    - The Department's position on complex investments should be refined.
    - Best execution should remain a section 404(a) duty rather than a condition of the Exemption.

[4] Sec. & Exch. Comm'n, Regulation Best Interest: The Broker-Dealer Rule, 17 C.F.R § 240 (2019).

- No further guidance is needed on proprietary products and limited investment menus.
- The policies and procedures requirement should remain principles-based.
- The CEO certification requirement should be eliminated.
- The ineligibility provisions of the Proposed Exemption can be improved.

Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the US, there are more than 160,000 independent financial advisors, which account for approximately 52.7 percent of all producing registered representatives.[5] These financial advisors are self-employed independent contractors, rather than employees of the Independent Broker-Dealers (IBD).[6]

FSI's IBD member firms provide business support to independent financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners and job creators with strong ties to their communities. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans. Their services include financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide Main Street Americans with the affordable financial advice, products, and services necessary to achieve their investment goals.

FSI members make substantial contributions to our nation's economy. According to Oxford Economics, FSI members nationwide generate $48.3 billion of economic activity. This activity, in turn, supports 482,100 jobs including direct employees, those employed in the FSI supply chain, and those supported in the broader economy. In addition, FSI members contribute nearly $6.8 billion annually to federal, state, and local government taxes. FSI members account for approximately 8.4% of the total financial services industry contribution to U.S. economic activity.[7]

FSI Supports the Proposed Exemption

As discussed above, FSI and its members have a deep and abiding interest in the retirement security of working Main Street Americans. Those investors are the reason for, and their financial security is the purpose of, our member firms and their independent financial advisors. Accordingly, FSI has been vitally interested in the Department's investment advice project since it commenced in October 2010. We have provided written comments to the Department at every opportunity to do so and participated in both of the public hearings the Department conducted on earlier proposals.

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[5] Cerulli Associates, Advisor Headcount 2016, on file with author.

[6] The use of the term "financial advisor" or "advisor" in this letter is a reference to an individual who is a registered representative of a broker-dealer, an investment adviser representative of a registered investment adviser firm, or a dual registrant. The use of the term "investment adviser" or "adviser" in this letter is a reference to a firm or individual registered with the SEC or state securities division as an investment adviser.

[7] Oxford Economics for the Financial Services Institute, The Economic Impact of FSI's Members (2016).

FSI strongly opposed the Department's earlier proposals, but not out of any disagreement with their objectives. We have long advocated for a carefully-crafted, uniform fiduciary standard of conduct that:

- Is applicable to all professionals providing personalized investment advice to retail clients,
- Protects affordable choice for investors among investment professionals, and
- Is workable, in the context of the very heavy regulation to which investment professionals are otherwise subject.

FSI opposed the Department's prior proposals because, as executed, they would harm retirement investors by reducing access to retirement advice and increasing its costs, disrupting the retirement services industries, and causing a surge in unnecessary litigation.

In contrast, FSI is pleased to support the Proposed Exemption. The Department has carefully constructed a compliance solution for conflicted investment advice that:

- Is uniform for all financial service providers and agnostic among their business models;
- Does not disrupt the cost structure for investors;
- Leaves the choice of the provider that best serves each retirement investor to that investor, supported by key disclosures to inform that choice; and
- Undertakes to align with the primary regulation for providers and not to invent new causes of action that were not established by Congress.

As such, the Proposed Exemption would result in enhanced retirement security for working Americans through affordable access to and choice among professional advice, with safeguards against conflicts inherent in that advice that are uniform across providers but accommodating of their primary regulation.

A. Long-Standing Research Supports the Proposed Exemption.

The research is very clear that, notwithstanding incremental costs and any effects of conflicts, assistance from investment professionals enhances the financial security of retirement investors. To see how this might occur, consider how our members assist clients, particularly low-income clients or those with a less developed financial education, with retirement security in the context of their overall financial picture.

- Our financial advisors emphasize the importance of commencing and retaining retirement savings and encouraging employers to adopt plans and individuals to participate in those plans and/or IRAs. For example, independent broker dealers, their affiliated investment adviser firms and their financial advisors have been instrumental in promoting retirement savings to segments of our population underrepresented in the retirement system.

- Financial advisors help clients weather market volatility, where inexperienced retail investors often make impulsive and ill-informed decisions like buying securities at market highs and selling at market lows.

- Financial advisors offer their skill and expertise to help clients navigate major financial pressures imposed by medical concerns, bankruptcy, deaths in the family, and caring for aging family members.

- Financial advisors assist clients in providing for other types of financial needs, such as life insurance, to provide security to clients' family members as well as lifetime income and longevity protection in retirement.
- Financial advisors protect investors from cashing out their retirement accounts for short-term needs and help prevent retirement asset "leakage".
- Finally, investors need professional financial advisors to assist them with decisions related to estate and tax planning and making their assets last through their retirement.

Accordingly, it is unsurprising that research from a variety of sources has shown that investors who work with financial advisors save more and are better prepared for their retirement, net of any "drag" from that relationship. The following is a sampling of that research:

- According to a 2012 study by the Investment Funds Institute of Canada and a 2010 survey by the ING Retirement Research Institute, individuals who spent at least some time working with a financial advisor had saved, on average, more than twice the amount for retirement than those that had not worked with an advisor.[8]
- An April 2014 study by Quantria Strategies found that retirement savings balances are 33% higher for individuals who have access to financial advice; employees are less likely to take cash withdrawals out of their retirement savings if they discuss their distribution options with a financial advisor; and limiting access to this assistance could increase annual cash outs of retirement savings for employees leaving a job by $20-32 billion, thus reducing the accumulated retirement savings of affected employees by 20-40%.[9]
- A study released in 2015 by Oliver Wyman found that investors working with a financial advisor had a minimum of 25% more assets than non-advised individuals, irrespective of age and income levels. The data was particularly notable with regards to a key demographic of retirement savers (individuals aged 35-54 with $100,000 or less in annual income); the study found that those in that demographic that worked with a financial advisor had 38% more assets than those who did not work with a financial advisor.[10]
- A 2012 survey conducted by LIMRA found that investors working with a financial advisor are more likely to be saving for retirement at higher rates (defined as contributing more than 7% of their salary to a retirement plan) with 61% of investors who worked with an advisor saving at the higher rates compared to 36% of investors that were not working with a financial advisor.[11]

[8] Jon Cockerline, The Investment Funds Institute of Canada, New Evidence on the Value of Financial Advice (2012), available at https://www.ific.ca/wp-content/uploads/2013/08/New-Evidence-on-the-Value-of-Financial-Advice-November-2012.pdf/1653/; ING Retirement Research Institute, Working with an Advisor: Improved Retirement Savings, Financial Knowledge and Retirement Confidence 6 (2010), available at http://voyacdn.com/file_repository/5151/help_wanted_wp.pdf.
[9] Quantria Strategies, Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings (Apr. 2014), available at http://quantria.com/DistributionStudy_Quantria_4-1-14_final_pm.pdf.
[10] Oliver Wyman, The Role of Financial Advisors in the US Retirement Market 6, 16 (July 2015), available at http://fsroundtable.org/wp-content/uploads/2015/07/The-role-of-financial-advisors-in-the-US-retirement-market-Oliver-Wyman.pdf.
[11] See LIMRA, Advisors Positively Influence Consumers' Behavior and Sentiment Toward Preparing for Retirement (July 11, 2012), http://www.limra.com/Posts/PR/News_Releases/LIMRA__Advisors_Positively_Influence_Consumers__Behavior_and_Sentiment_Toward_Preparing_for_Retirement.aspx.

- A 2014 study by Prudential found that African-Americans with a financial advisor were significantly more likely to participate in employer sponsored retirement plans, have a savings account, life insurance, long-term care insurance, annuities, and mutual funds. That same study also found that African Americans who worked with a financial advisor were more financially confident than those who did not.[12]

- A 2013 Morningstar study found that by working with a financial advisor, a retiree can be expected to generate 22.6% more certainty-equivalent income.[13] This has the same impact on expected utility as an annual return increase of 1.59%, which represents a significant improvement in portfolio efficiency for a retiree.[14]

- A 2016 Vanguard study found that with advisors, investors can add about 3% in annual value over time, compared to what they would get by not securing an advisor. In the study, Vanguard's research department analyzed approximately 58,000 self-directed IRA accounts over a six-year period and found that the average investor who made "even one" exchange over this period underperformed the benchmark target-date funds by 1.50% annually. [15]

- A study released by Envestnet in 2014 and updated in 2019 found that advisors add significant value, specifically in the areas of tax loss harvesting (approximately 1.00% annual value added) and investment portfolio construction (active or passive).[16]

B. The Proposal is Faithful to ERISA.

The Department will no doubt receive complaints that the Proposed Exemption "dilutes" or is otherwise unfaithful to ERISA. Any such complaints are ill-informed, because they rest on selective memory of the ERISA fiduciary governance scheme.

First, of course, the Proposed Exemption has no effect on the statutory fiduciary standards of section 404(a). Investment professionals who are section 3(21)(A)(ii) fiduciaries to ERISA plans are bound by statute to discharge their duties solely in the interest of plan participants and beneficiaries, and, inter alia,

- For the exclusive purpose of providing benefits to participants and their beneficiaries, and defraying reasonable expenses of administering the plan;
- With the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims; and
- By diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so.

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[12] The Prudential Insurance Company of North America, The African American Financial Experience (2014), available at http://www.prudential.com/media/managed/aa/AAStudy.pdf.
[13] Certainty-equivalent is defined as a guaranteed return that an investor would accept, rather than taking a chance on a higher, but uncertain, return.
[14] David Blanchett & Paul Kaplan, Morningstar Investment Management, Alpha, Beta, and Now . . . Gamma 16 (Aug. 28, 2013), available at http://corporate.morningstar.com/ib/documents/PublishedResearch/AlphaBetaandNowGamma.pdf.
[15] Francis M. Kinniry Jr., Michael A. DiJoseph, Yan Zilbering, and Donald G. Bennhoff, Vanguard, Putting A Value On Your Value: Quantifying Vanguard Advisor's Alpha 16 (Sept. 2016), available at https://www.vanguard.com/pdf/ISGQVAA.pdf.
[16] Envestnet, Capital Sigma: The Advisor Advantage (2019), available at https://www.investpmc.com/sites/default/files/documents/PMC-CAP-SIGMA.pdf.

The Department has no authority to grant variations from these statutory care and loyalty standards, and the Proposed Exemption does not do so. If anything, the Exemption would extend the ERISA standard, through its impartial conduct provisions, to investment advice fiduciaries for IRAs or other non-ERISA arrangements subject to Code section 4975, to whom the section 404(a) standards are not otherwise subject.[17]

In addition, any such complaints neglect that section 408(a) is as much a part of ERISA as section 406(b). The broad prohibitions of section 406(b) are tempered by the Department's authority to provide exemptions from those prohibitions when it is administratively feasible, in the interest of plans and participants, and protective of participant rights. With respect to financial services in particular, Congress recognized specifically that

> some transactions which are prohibited (and for which there are no statutory exemptions) nevertheless should be allowed in order not to disrupt the established business practices of financial institutions which often performs fiduciary functions in connection with these plans consistent with adequate safeguards to protect employee benefit plans. For example, while brokerage houses generally would be prohibited from providing, either directly or through affiliates, both discretionary investment management and brokerage services to the same plan, the conferees expect that the Secretary of Labor and Secretary of the Treasury[18] would grant a variance with respect to these services (and other services traditionally rendered by such institutions), provided that they can show that such a variance will be administratively feasible and that the type of transaction for which an exemption is sought is in the interest of and protective of the rights of plan participants and beneficiaries. Thus, variances might be granted to brokers or their affiliates to act as investment managers if the Secretary determines that such arrangements are in the interests of plan participants and beneficiaries and that satisfactory safeguards are provided, including e.g., such protections as the monitoring of the investment manager's decisions by a person with appropriate investment experience, as specified by the Secretaries, who is not affiliated with the broker.[19]

The Proposed Exemption has been purposefully and carefully constructed, in the circumstances of conflicted investment advice (as distinguished from the more difficult case of conflicted investment management), to do exactly what Congress intended. In fact, it better effectuates the intent of Congress in this respect than the Department's prior proposals.

Discussion

FSI appreciates the opportunity to comment on the Proposed Exemption. Our comments focus, primarily, on two areas: 1) the disclosures required to investors under the Proposed Exemption; and 2) the Department's candid guidance and insight on its views concerning rollover advice in the preamble to the Proposed Exemption. First, as financial institutions and financial professionals work with clients to educate them on Regulation BI's obligations and other applicable standards of conduct, providing the disclosure contemplated under the Proposed Exemption would lead to retail investor confusion and, in certain cases, would be misleading with respect to a broker-dealer's resulting standard of conduct under the Exemption. Second, the

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[17] We understand the impartial conduct standards as stated to be objective rather than subjective standards, and it would be helpful for that understanding to be confirmed in the preamble to the final Exemption.
[18] Prior to the Reorganization Plan of 1978, exemption authority was shared between the Departments of Labor and the Treasury.
[19] H.R. REP. NO. 93-1280, at 309-310 (1974)(Conf. Rep.).

Department should clarify through guidance following approval of the Exemption the scope, coverage, and application of its position on rollover advice to ensure that the regulated community understands the type of transactions the Department intends to cover. This is of particular importance for so-called "gating interactions" or "hire-me" conversations when a financial professional first interacts with a prospective retirement investor regarding whether the investor should engage the provider and, if so, which of the services offered from the provider the investor may select. These topics are discussed in greater detail below.

I. The Proposed Exemption's Disclosure Obligation: The Department Should Eliminate the Written "Fiduciary" Acknowledgement under the Proposed Class Exemption to Avoid Investor Confusion and To Further Align with, and Gain Efficiencies from, Disclosures Already Provided in Accordance with Regulation BI.

A. Introduction

The Proposed Exemption permits Financial Institutions and Investment Professionals, as well as their affiliates and related entities, to receive reasonable compensation resulting from potentially conflicted investment advice, but requires, among other criteria, written disclosure prior to any transaction pursuant to the Exemption. This disclosure requirement covers two main areas – first, disclosure that the Financial Institution (and its Investment Professionals) are fiduciaries under ERISA and/or the Code and, second, that the Financial Institution provide an accurate written description of the services to be provided and their material conflicts of interest. FSI compliments the Department for approaching conflicts in a fashion consistent with Regulation BI and leveraging efficiencies by allowing other regulatory disclosures to satisfy this requirement under the Exemption. This Exemption's disclosure, however, also requires acknowledgement, in writing, that the Financial Institution and its Investment Professionals are fiduciaries under ERISA and/or the Code. The Department requested comment on the Proposed Exemption's disclosure approach.

B. A Disclosure that the Financial Institution and its Investment Professionals Are Fiduciaries under ERISA and the Code is Confusing and Misleading to Investors.

The Department seeks to design the disclosure obligations in this Proposed Exemption to protect Retirement Investors by enhancing the quality of information they receive and FSI supports this important goal. Section II(b)'s requirement that, prior to engaging in any transactions pursuant to the Exemption, the Financial Institution must acknowledge, in writing, that it is acting as a fiduciary under ERISA (or the Code) with respect to any covered transaction, however, will lead to investor confusion and even be misleading (resulting in disqualification under the Exemption), particularly in the IRA setting where ERISA's enforcement standards do not apply. A critical objective of disclosures is to ensure that retail customers are furnished clear and accurate information needed to make an informed decision. While broker-dealers with retail investors are also required, as of June 30, 2020, to provide disclosures about services provided and conflicts of interest on Form CRS and pursuant to the disclosure obligation in Regulation BI, the SEC "eliminat[ed] the word 'fiduciary' and requir[ed] firms—whether broker-dealers, investment advisers, or dual registrants—to use the term 'best interest' to describe their applicable standard of conduct" to "make this information clearer to retail investors."[20]

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[20] Form CRS Relationship Summary; Amendments to Form ADV, 84 FR 33492, 33499 (July 12, 2019) (Form CRS Relationship Summary Release).

In particular, for broker-dealers, FSI is concerned that the fiduciary status disclosure required by Section II(b) will cause confusion. As noted in studies commissioned by the SEC,[21] investors found the term "fiduciary" confusing and retail investors will further find this disclosure – that the investment professional is a fiduciary under ERISA or the Code – even more confusing in light of the information and disclosures provided in Form CRS and in connection with Regulation BI. By using the term "fiduciary," such disclosure is even misleading, suggesting there is something more or different than the best interest standard outlined in Regulation BI. The Proposed Exemption's Impartial Conduct Standard includes the best interest standard. "This best interest standard would allow Investment Professionals and Financial Institutions to provide investment advice despite having a financial or other interest in the transaction, so long as they do not place the interests ahead of the interests of the Retirement Investor, or subordinate the Retirement Investor's interests to their own."[22] This standard of conduct is intentionally consistent with Regulation BI. An additional statement in disclosure to the investor indicating that the Financial Institution is acting as a fiduciary under ERISA will cause investor confusion when the best interest standard, aligned with Regulation BI, applies to those utilizing the Proposed Exemption. The Department should not expand the disclosure requirement further and should consider eliminating this fiduciary disclosure obligation to avoid investor confusion.

Most retail investors will not find the "investment advice fiduciary" or the ERISA fiduciary concept intuitive, especially when the nature of the ongoing relationship with the advisor is based on the best interest standard of conduct outlined under Regulation BI and associated disclosures that may have already been received as part of that investment professional relationship. In many instances, for existing investor relationships, the timing of already-issued Form CRS and Regulation BI disclosures completed in connection with recent implementation of these new disclosure requirements will confuse investors who later receive an ERISA fiduciary disclosure concerning, for example, a rollover transaction. The Department notes that this "requirement can be satisfied through any disclosure, or combination of disclosures, required to be provided by other regulators so long as the disclosure required by Section II(b) is included."[23] Furthermore, to the extent the Department finds a Financial Institution's or Investment Professional's disclosure misleading, this disqualifies the investment advice fiduciary from use of the Exemption.

Even putting aside the timing, the functional fiduciary concept under ERISA, is not a well-understood term or concept to start, and even less so in the context of IRAs where it serves as a tax definition rather than as a designation of legal status. Investment advice fiduciaries under ERISA (Section 3(21)(A)(ii) and Section 4975(e)(3)(B) of the Code) denote those who perform certain functions to include a person who "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property" of a plan or plan participants. Qualifying as a "fiduciary," in turn, triggers the prohibited transaction rules under both ERISA and the Code, which then prohibit conflicted transactions unless a statutory or regulatory exemption applies. Being an investment advice fiduciary has a unique statutory meaning and purpose under ERISA and the Code that will not be meaningful or easily translated to retail investors, especially when the investment advice fiduciary qualifies for the Proposed Exemption.

Finally, while the Department has been clear that its intent is not to create new private rights of action for IRA owners, this is the principal place where the proposal undermines that intent.

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[21] The Commission's Office of the Investor Advocate engaged the RAND Corporation to conduct investor testing of the proposed relationship summary.
[22] 85 Fed. Reg. at 40843.
[23] Id. at 40844.

Fiduciary status generally connotes a relationship of trust that entails duties of care and loyalty enforceable by the party to whom those duties are owed. In contrast, for IRA owners, section 4975 fiduciary status has legal consequence only with respect to the determination of any excise tax that may be owed to the Internal Revenue Service (IRS). That is, under the statute, enforcement of the prohibited transaction rules with respect to IRAs is exclusively assigned to the IRS. We are very much concerned that a statement by Financial Institutions and Investment Professionals that they are fiduciaries for section 4975 purposes might be over read to imply a legal obligation to the IRA owner that is enforceable by the IRA owner. Indeed, given the usual legal consequences of fiduciary status, it may be accurate but misleading to disclose to IRA owners that our members are acting as fiduciaries.

For the foregoing reasons, we strongly urge the Department to omit from the disclosure required under the Proposal any statement on fiduciary status, particularly for IRA owners. Similarly, the Department should not expand the scope of disclosures to include the impartial conduct standards or any other matter. In general, adding more to the disclosure to include the fiduciary's obligations under the Exemption to provide advice in accordance with the Impartial Conduct Standard would not alleviate confusion and will add to it instead. Studies have identified that lengthy, legalistic disclosures are frequently not understood by investors.[24] More specifically, any additional disclosures would increase the risk that compliance with the Exemption would inadvertently provide a basis for private claims by IRA owners, e.g., that the simple recitation of the impartial conduct standards might be leveraged into a contract or quasi-contract cause of action by IRA owners.

C. The Timing of the Fiduciary Disclosure Requirement for the Proposed Exemption is Unworkable in Instances when the Department Determines that an Investment Professional is a "Retroactive Fiduciary".

The fiduciary disclosure obligation is also unworkable in instances where, under the Department's newly-articulated view of the "regular basis" prong of the five-part test, an Investment Professional becomes a "retroactive fiduciary." The disclosure requirement serves to illustrate the challenges with the Department's view in the preamble suggesting that an Investment Professional can be deemed an investment advice fiduciary based on subsequent events after a rollover transaction. The Department provides guidance on two parts of the five-part test in the preamble, in connection with the discussion of rollover advice. More specifically on the "regular basis" determination – based on analysis of "all the surrounding facts and circumstances" as with each prong in the test – can arise from a pre-existing advice relationship or from a "retroactive finding." An advice relationship that results in a "springing" or "retroactive" fiduciary status will prove particularly confusing for retail investors and risk the Investment Professional's ability to use the Proposed Exemption. If the advice relationship had not met the "regular basis" threshold at the time of the rollover, but becomes one based on the later formation of an ongoing advice relationship, the Exemption's disclosure obligation becomes applicable on a backdated basis. This is an untenable outcome, and a further reason to omit acknowledgement of fiduciary status from the disclosure.

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[24] See e.g., Recommendation on Disclosure Effectiveness As approved by SEC Investor as Purchaser Subcommittee (Apr. 6, 2020) available at https://www.sec.gov/spotlight/investor-advisory-committee-2012/disclosure-effectiveness-recommendation.pdf.

II. The Department's New Positions under the Five-Part Test are Problematic and Require Separate Reconsideration.

FSI appreciates that the Department announced its new thinking on the application of the five-part test, in particular, in the rollover setting. FSI recognizes and understands that, while in the preamble and outside the scope of the comment process, the Department is addressing what has been a dramatic shift in the retirement space since ERISA was enacted in 1974, in that employer-sponsored defined benefit plans are far less common and replaced, instead, with participant-directed 401(k) plans and the growth of IRAs. Given the level of asset transfer from ERISA-covered plans to IRAs occurring with the aging of the baby boom generation, the Department's decision to reconsider its rollover position is understandable at the policy level. Nonetheless, the Department's new interpretations are problematic in a number of respects.

A. <u>The Department's Position Rewrites Existing Law.</u>

The Department's position on rollovers is a significant departure from the pre-2016 understanding of the five-part test, without regard to the Deseret advisory opinion.[25] In cases where the financial professional has an ongoing relationship with the retirement investor unrelated to the rollover assets, for example, or where the rollover advice retrospectively proves to be the initial step of a continuing relationship with respect to the investment of the IRA, the Department is prepared to assert that the "regular basis" requirement is satisfied and the rollover advice is fiduciary investment advice if the five-part test is otherwise met.

Other commentators are concerned that these new positions functionally rewrite the five-part test in a manner inconsistent with Chamber of Commerce vs. Department of Labor (5th Cir. 2018), and we share those concerns.

B. <u>The Department's Position Creates Practical Compliance Problems.</u>

If the Department's new stance is given effect, then non-exempt prohibited transactions involving rollovers no doubt were committed on Tuesday, June 30, 2020, the day after the Department publicly released its new position, by financial institutions and professionals who had no prior idea the Department considered them fiduciaries. And they also occurred on Sunday, June 28, 2020, the day before that announcement.

It is, of course, not feasible to operate a retroactive compliance system upon the retroactive assertion of fiduciary status. In addition, as we noted above, should a Financial Institution or Investment Professional choose to cover itself and attempt to follow the exemption with every rollover transaction, the disclosures and other provisions of the exemption could prove to be false or misleading in the event the rollover advice is not part of a regular basis of advice. Similar issues are presented in the case where a financial adviser has been providing ongoing advice outside of ERISA plan assets. Any financial professional could inadvertently – and potentially retroactively - become a fiduciary simply by discussing rollovers with their client, particularly if the adviser is not in the business of serving ERISA plans. Again, if financial professionals wish to cover themselves they would have to provide disclosures and comply with other features of the exemption with regard to all of their retail clients, something which would again be misleading and inappropriate in terms of their primary regulator's requirement.

Also, we note that there is no direct discussion of the treatment of "hire me" or "gating interactions" in the preamble or otherwise. The Department acknowledges that rollover advice

[25] Department Advisory Opinion 2005-23A (withdrawn), available at https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/advisory-opinions/2005-23a.

can be a one-time transaction that would not result in a regular basis relationship. The Department should provide similar confirmation that an Investment Professional does not become an investment advice fiduciary, under the five-part test, when engaging in the type of conversations that occur when he or she first interacts with a client. As written, gating interactions appear to remain outside the reach of the five-part test. Discussions with a prospective retirement client prior to the opening of an account are a necessary part of a retirement client being able to explore and compare who to hire to eventually provide investment advice for him or her. Reading the preamble, we understand that the Department does not attempt to sweep these types of interactions, through discussion or example, into those that would, under the five-part test, render the financial professional an investment advice fiduciary.

These very real practical challenges of this new interpretive position require further consideration by the Department. Legal and practical issues must be fully resolved before a re-interpretation of this magnitude becomes effective.

C. The Department Should Address Retirement Income Education.

On a related point, our members thought well of the clarification to IB 96-1 incorporated in the vacated regulation to the effect that retirement income education is not fiduciary investment advice. This position was consistent with our members' longstanding reading of IB 96-1. In an environment where 10,000 working Americans are retiring daily, this sort of education remains vitally important. For the avoidance of uncertainty, we suggest that the Department consider sub-regulatory guidance, in connection with the publication of the final Exemption or otherwise, confirming that retirement income education is not fiduciary advice.

III. Additional Comments

In addition to our principal comments above, we have the following, more technical comments, which include requests for clarification or confirmation.

A. The Exemption Should be Effective on Publication.

The Proposed Exemption should be effective on the date of its publication in the Federal Register. There is no reason in policy or practice to defer the effective date of an alternative compliance solution that does not displace any existing solution. Since our members are already observing Regulation BI, it is entirely possible that some of them will be in a position to rely on the Exemption in less than 60 days after publication, and will find it prudent to do so particularly in light of the Department's new position on rollover advice. For these reasons, the Department should make the Exemption effective on publication.

B. The Temporary Enforcement Policy Should Remain in Effect After Publication.

We commend the Department for extending its temporary enforcement policy articulated in Field Assistance Bulletin 2018-02. For the reasons stated in the preamble, that policy should remain in effect after final adoption of the Proposed Exemption. In addition, because of the important differences between the compliance conditions expressed in that policy and those of the Proposed Exemption – notwithstanding their core similarities – any future change in that policy should be announced with ample advance notice to adapt to that change. We also encourage the Department to observe, as is its usual and effective practice, a compliance assistance period following the effective date of the Exemption, as a transition to granular compliance with the Exemption.

C. Fiduciary Advice is Not Co-Extensive with the Scope of Regulation BI.

As the Department is aware, our members may have interactions that are deemed fiduciary investment advice for purposes of ERISA but are outside the ambit of Regulation BI – notably, fiduciary investment advice (i) to plan sponsors outside of the micro-plan setting or (ii) that does not involve a securities transaction or investment strategy. Accordingly, to rely on the Exemption in these circumstances, our members will need to amplify the practices, policies and procedures they adopted under Regulation BI to encompass these additional interactions. While those amplifications may be modeled on Regulation BI, there may well also be variations; for example, Regulation BI compliance is centered on the needs and circumstances of a particular individual retail investor, and is inapt in certain respects for recommendations provided at the plan level without reference to any specific investor. We encourage the Department to acknowledge the need for and approve such variations in the preamble to a final Exemption.

D. Reasonable Compensation Should be Determined under Section 408(b)(2) Processes.

Under the Proposed Exemption, compensation may not exceed "reasonable compensation within the meaning of ERISA section 408(b)(2) and Code section 4975(d)(2)." This is of course a conventional requirement in the statutory exemptions of ERISA, as well as the Department's class exemptions including in the vacated Best Interest Contract Exemption (BICE).

Under section 408(b)(2), the longstanding practice is that the definitive judgment on reasonable compensation is made by the independent plan fiduciary engaging the service provider, which is the party in the best position to make that determination as a matter of policy and on the facts. In support of that practice, the Department requires disclosures to an independent plan fiduciary under section 408(b)(2) to better inform that decision making. Because the service provider is the party that requires the relief provided by the exemption, the provider is of course mindful of that requirement in pricing its services and may provide supporting materials for that pricing to aid the independent plan fiduciary in making its determination. In a departure from this well-established practice, the BICE effectively switched the responsibility for reasonable compensation to the investment advice fiduciary, to determine for itself that its own compensation was reasonable. In practice, this switch proved to be enormously difficult and expensive to implement with any degree of confidence.

We read the reference to section 408(b)(2) in the Proposed Exemption to incorporate not only the substance of but also the established process under that provision, and to retain the conventional responsibilities for reasonable compensation determinations. We request confirmation of that reading in connection with the final adoption of the Exemption.

On a related point, we also request confirmation that the disclosure required by the Proposed Exemption may be included with the disclosure provided to responsible plan fiduciaries under ERISA Reg. §2550.408b-2, as applicable.

E. The Department's Position on Complex Investments Should be Refined.

The Department was careful to say that no condition of the Proposed Exemption requires a monitoring obligation on the part of Financial Institutions and Investment Professionals, which generally was left to agreement among the parties as to the scope of services to be provided. This approach aligns with Regulation BI. As it did under the BICE, however, the Department went farther than Regulation BI and warned that unusually complex or risky investments may require ongoing monitoring to protect the retirement investor's interest, and that an investment advice fiduciary may violate the best interest standard of the Exemption if it recommended such an investment "without a mechanism in place for monitoring."

We find this position on complex investments problematic for four reasons.

- On this point, the Department appears to say that compliance with Regulation BI is insufficient to satisfy the best interest standard of the Proposed Exemption. For all the reasons supporting the alignment of the Proposed Exemption and Regulation BI, it would be an error to deviate from that alignment in this or any other particular circumstance.
- Regular monitoring and review of investments is always an element of good fiduciary practice under ERISA. While the Department has made it clear it has particular concerns with complex investments, it is hard to justify why the best interest responsibility of fiduciary advisers should be different in this case than, for example, for mutual funds, which also should be regularly monitored in a process that may require outside professional support.
- In the case of our members that are registered with the SEC as broker-dealers but not as registered investment advisers, any commitment to provide continuous monitoring may constitute a violation of the securities laws. To the extent the preamble discussion implies that the investment advice fiduciary recommending the investment must commit to provide the monitoring, it appears to set up a choice for firms that are not dually registered of violating ERISA or the securities laws.
- If a plan is not currently holding a complex investment, the monitoring mechanism envisioned by the Department may not be "in place" at the time the best interest standard must be satisfied, i.e., at the time the investment advice is provided. Plainly it would be unreasonable to require that mechanism to be "in place" prior to the time the monitoring is needed or even before the investment is acquired.

If the Department persists with the approach of the Proposed Exemption, it should clarify that fiduciary advice to purchase a complex investment may need to include advice that the plan or IRA owner establish and maintain an appropriate monitoring mechanism, which need not be (i) provided or even offered by the Financial Institution or Investment Professional providing that advice, or (ii) in place at the time the advice is provided. There is no more that a Financial Institution or Investment Professional can do, since by definition they are not in a position to compel a retirement investor to follow that advice.

F. Best Execution Should Remain a Section 404(a) Duty Rather Than a Condition of the Exemption.

The Department's longstanding position is that the fiduciary standards of ERISA include an obligation to obtain the most favorable terms for plan investment transactions, i.e., the duty of "best execution." According to the Department, this duty includes obtaining the best price for a transaction taking into account the cost of commissions, and considering the quality and reliability of execution. Under the ERISA fiduciary construct, there always will be a fiduciary with investment responsibilities that include the duty of best execution.

That having been said, best execution is not an appropriate condition for the relief provided by the Proposed Exemption.

- Very often, and perhaps most often, the Financial Institution or Investment Professional (even if subject to best execution requirements under the securities laws) will only be providing recommendations, and will have no responsibility on the facts for the execution of any advice accepted by the retirement investor. Execution will be the responsibility of the directed trustee or custodian holding the investor's retirement account, or the retirement platform provider, or another provider engaged for the purpose of placing and executing trades. It cannot be the case that the reliance of the Financial Institution and Investment Professional on the Exemption is conditioned on the performance of an unrelated financial services provider, or requires them to insert themselves unnecessarily into a process for which the retirement investor has otherwise made arrangements solely to comply with the Exemption.

- It is important to understand that the best execution requirement under the securities laws is not a fixed standard, but an evolving one. As markets evolve so do securities regulators' views in this space and their understanding of this standard, often in an enforcement setting without advance guidance to the industry, determines "best execution." For example, in recent SEC enforcement actions concerning perceived inadequate disclosures of 12b-1 fees, the SEC has taken the position that receipt of these fees without adequate disclosure also violated best execution obligations.[26] In addition, even well-intentioned broker-dealers executing trades can become subject to best execution violations under FINRA rules, in certain cases, because of technology mishaps that result in inadvertently delayed executions. If best execution is included as a condition of the Exemption, then even the best intentions and efforts to satisfy the securities law requirements could, after the fact, undo compliance with the Exemption.

For these reasons, we urge the Department to leave best execution as a section 404(a) duty of the responsible fiduciary, and not to incorporate it as a condition for section 406 relief under the Exemption.

G. No Further Guidance is Required on Proprietary Products and Limited Investment Menus.

The preamble discussion of proprietary products and limited investment menus is sufficient guidance on these matters under the Exemption.

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[26] SEC Share Class Selection Disclosure Initiative, Division of Enforcement Announcement, available at https://www.sec.gov/enforce/announcement/scsd-initiative (see footnote 3)

H. The Policies and Procedures Requirement Should Remain Principles-Based.

We support the Department's principles-based approach to the policies and procedures requirement of the Proposed Exemption. While a more prescriptive approach could provide more certainty, the multiplicity of the types of financial services firms with differing business models that may require the relief provided by the Exemption precludes that approach.

I. The CEO Certification Requirement Should be Eliminated.

In connection with the retrospective annual review, the Proposed Exemption requires an annual certification by the Financial Institution's chief executive officer (CEO) that (i) the CEO has reviewed the written report of the Institution's annual compliance review, (ii) the Institution has in place policies and procedures "prudently designed" to comply with the Exemption, and (iii) the Institution has in place a "prudent process" to modify these policies and procedures as business, regulatory and legislative changes and events dictate and to periodically test the effectiveness of the policies and procedures, the timing and extent of which is "reasonably designed" to ensure continuing compliance with the Exemption.

As the preamble reflects, this requirement is modeled on FINRA Rule 3130, with which our members of course have substantial practical experience. We understand the intended cultural impact and accountability the certification requirement is intended to create. We can also attest from the practical experience of our members that, as the preamble recognizes, the CEO uniformly relies on the Institution's chief compliance officer (CCO) and compliance systems in making this certification. As such, the certification itself in practice is an inefficient formalism, and should be eliminated from the Proposal.

Should the Department determine to retain the certification:

- The certification should be provided by the CCO rather than by the CEO, for the reasons discussed above;

- The substance of the certification should be conformed to the certification specified in FINRA Rule 3130(c), i.e., that the Financial Institution has in place processes to:

  > (A) establish, maintain and review policies and procedures reasonably designed to achieve compliance with [the pertinent law]; (B) modify such policies and procedures as business, regulatory and legislative changes and events dictate; and (C) test the effectiveness of such policies and procedures on a periodic basis, the timing and extent of which is reasonably designed to ensure continuing compliance with [the pertinent law].

  In particular, the proposed certification has not just been "adapted to focus on the conditions of the exemption," as the preamble states. It has also been modified to substitute undefined prudence standards for the reasonableness standards of Rule 3130. We can conceive of no reason why the Exemption should not align with the FINRA rule on this point, nor has the Department provided any such reason; there is no indication why the Department found the FINRA formulation to be insufficient, and no guidance on what more the Department expects of our members in making this change;

- The final preamble should clearly state that the officer providing the certification takes on no ERISA or other legal status that confers personal liability in respect of the Institution's compliance with the Exemption; and

- While section II(d)(5) of the Proposed Exemption provides for access to the annual report, certification and supporting data only by the Department, it is unclear whether section IV(a) inconsistently makes those records available to other persons. Section IV(b)(1) should be expanded to exclude from examination by persons described in section IV(a)(2)-(4) such records as may be maintained pursuant to section II(d).

J. The Ineligibility Provisions of the Proposed Exemption Can be Improved.

In commenting on the ineligibility provisions, we have a concern arising from the experience of banks and securities firms with the comparable provisions of PTE 84-14 (the QPAM exemption), and in particular (i) the challenges under that exemption presented by criminal convictions of, most often, overseas affiliates for conduct entirely unrelated to QPAM activities and (ii) the time and resources required from the Department as well as from affected firms to address those challenges. The refinement in the ineligibility provisions of the Proposed Exemption that the conviction arise out of "such person's provision of investment advice to Retirement Investors" is an essential improvement over PTE 84-14. We propose additional improvements for the Department's consideration.

Although it is not perfectly clear from the text of the Proposed Exemption, our reading is that the conviction of any member of a Control Group of one of the specified crimes in respect of investment advice to Retirement Investors would make all the members of the Control Group ineligible for the relief provided by the Exemption for a ten-year period, absent the granting of a petition by the Department permitting continued reliance. If that is correct, it is important to understand that, with respect to our members, it is relatively common for an independent broker-dealer firm to be a member of a diversified financial services enterprise, or for several independent broker-dealer firms to have common ownership but to be managed separately with each having its own business model and professional culture.

- It presumes too much to conclude that the guilt of one member of the Control Group inherently taints all of its other members in such circumstances. We understand from the preamble that the Department's concern is that, without this provision, an ineligible Financial Institution would be able to evade that ineligibility by transferring its business to an existing or newly created affiliate. We suggest that the Department address that concern directly rather than indirectly. Such an approach would also support investor choice, to the extent that any replacement fiduciary adviser selected by the investor happened to be an affiliate of the ineligible institution.

- Also, we believe it would serve the Department's purposes if an ineligible Financial Institution was purchased by a new Control Group with different management. Given the pace of consolidation in the independent broker-dealer industry specifically and the financial services industries generally, that circumstance should be anticipated and approved in the final Exemption as a cure for ineligibility.

In addition, while we appreciate the notion that bad actors should be precluded from relying on the Exemption immediately on conviction without regard to any appeal, it is difficult to defend that approach from a due process perspective, particularly given the recent experience of the over-prosecution of financial crimes leading to reversals on appeal. We ask that the Department reconsider that point and trigger ineligibility on a final criminal conviction after any initial appeal.

IV. FSI Does Not Request a Hearing on the Proposed Exemption

Given the scope and tenor of our comments, we do not request a hearing on the Proposed Exemption.

Indeed, we believe that a hearing will be unnecessary for the Department to appropriately assimilate the range of views that no doubt will be offered on the Proposed Exemption. While this notice and comment process is formally a distinct proceeding, it is the culmination of a series of proceedings commencing in October 2010 that has included thousands of comment letters and five days of public hearings in connection with the October 2010 proposed redefinition of ERISA investment advice; the April 2015 proposed redefinition of ERISA investment advice and related exemptions; and the four extraordinary requests for public comments following the publication of the final rule and exemptions in 2016. In these multiple opportunities for public input, every legal, regulatory, economic and policy consideration related to the need for and scope of the relief proposed in the Exemption has been explored and argued again and again. The only new matter presented by the Proposed Exemption is the technical terms of relief and, against this background, the written comment process will expeditiously and fully apprise the Department of the views of commentators of all persuasions and any factual evidence they might offer on the proposal.

Should the Department determine to proceed to a public hearing, FSI will request to appear at the hearing in support of the Proposed Exemption.

Conclusion

We are committed to constructive engagement in the regulatory process and welcome the opportunity to work with the Department on this and other important regulatory efforts.

Thank you for considering FSI's comments. Should you have any questions, please contact me at (202) 803-6061.

Respectfully submitted,

David T. Bellaire, Esq.

Executive Vice President & General Counsel