

August 6, 2020

Via Electronic Filing

Office of Exemption Determinations
Employee Benefits Security Administration
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210
Attention: Improving Investment Advice for Workers and Retirees

**Re: Improving Investment Advice for Workers and Retirees (ZRIN 1210-ZA29,
Application No. D-12011)**

Ladies and Gentlemen:

The Investment Adviser Association (**IAA**)¹ appreciates the opportunity to comment on the Department's proposed class exemption from certain prohibited transaction restrictions of the Employee Retirement Income Security Act of 1974, as amended (**ERISA**) and the Internal Revenue Code of 1986, as amended (**Code**).² The Proposed Exemption would provide relief from the restrictions of ERISA Sections 406(a)(1)(A), (D), and 406(b) and Code Sections 4975(c)(1)(A), (D), (E), and (F) for the receipt of prohibited compensation in connection with the provision of non-discretionary investment advice.

The IAA strongly supports the goal of ensuring that clients receive investment advice that is in their best interest. Although virtually all of the IAA's members are discretionary investment managers, the Proposed Exemption would be applicable to some aspects of their activities. We therefore appreciate the Department's efforts to provide certainty in this area and to align the scope of the Proposed Exemption with the SEC's interpretation regarding fiduciary duty under the Investment Advisers Act of 1940, as amended (**Advisers Act**).³

¹ The IAA is the largest organization dedicated to advancing the interests of investment advisers registered with the Securities and Exchange Commission (**SEC**). For more than 80 years, the IAA has been advocating for advisers before Congress and U.S. and global regulators, promoting best practices and providing education and resources to empower advisers to effectively serve their clients, the capital markets, and the U.S. economy. The IAA's member firms manage more than \$25 trillion in assets for a wide variety of individual and institutional clients, including pension plans, trusts, mutual funds, private funds, endowments, foundations, and corporations. For more information, please visit www.investmentadviser.org.

² *Improving Investment Advice for Workers & Retirees*, 85 Fed. Reg. 40834 (July 7, 2020), available at <https://www.govinfo.gov/content/pkg/FR-2020-07-07/pdf/2020-14261.pdf> (**Proposed Exemption**).

³ *Commission Interpretation Regarding Standard of Conduct for Investment Advisers*, Rel. No. IA-5248 (June 5, 2019) (**Advisers Act Fiduciary Duty Interpretation**), available at <https://www.sec.gov/rules/interp/2019/ia-5248.pdf>.

The IAA provides the following comments with respect to certain aspects of the Proposed Exemption:

- The Department should confirm that a request by an adviser to “hire me” is not fiduciary investment advice.
- The Exemption should cover all types of digital advice.
- The Exemption should permit greater flexibility for overseeing compliance with policies and procedures.
- The Department should modify the scope of principal transactions covered by the Exemption.

The IAA hopes that these comments are helpful to the Department in finalizing the Exemption.

I. The Department Should Confirm That a Request by an Adviser to “Hire Me” Is Not Fiduciary Investment Advice

The Proposed Exemption makes clear that the definition of fiduciary investment advice is contained in the same five-part test that has been in place for many years. Specifically, the Department confirmed that its 1975 regulation defining investment advice using this test remains in effect and directed that it be re-codified in the Code of Federal Regulations.⁴ The IAA understands this decision as the Department’s response to the vacatur of its prior changes to this regulation. In order to avoid departing from the fundamental requirement that a fiduciary investment adviser have a relationship of trust and confidence *at the time the advice is provided*,⁵ the IAA encourages the Department to clarify that it does not intend to interpret the five-part test to treat an investment adviser as a fiduciary *before it enters into a relationship with a client*.

The preamble to the Proposed Exemption (**Preamble**) indicates that the Department intends to interpret the five-part test broadly, particularly as it relates to recommendations to roll over from a plan to an IRA. The Preamble indicates that, in the IRA context, a recommendation to roll over that takes place at the beginning of a relationship between a plan participant and an adviser may meet the “regular basis” prong of the five-part test. The Preamble discussion in this regard is limited to the context of an account type, or “rollover” recommendation. The IAA believes that the Department highlighted rollovers to provide clarity in this very important area.

⁴ 85 Fed. Reg. at 40839.

⁵ *Chamber of Commerce of the United States of America, et al. v. U.S. Department of Labor*, 885 F.3d 360, 370 (5th Cir. 2018), available at <http://www.ca5.uscourts.gov/opinions/pub/17/17-10238-CV0.pdf>, (“Fiduciary status turns on the existence of a relationship of trust and confidence between the fiduciary and client.”)

We are concerned that the Preamble does not clearly distinguish between prospective clients and existing clients. Specifically, we are concerned that the Preamble could be read to encompass within the five-part test a recommendation by an adviser that a retirement investor, including a participant that wants to engage in a rollover transaction, hire the adviser to provide on-going services before there is a relationship between the adviser and prospective client. We do not believe that this was the Department's intent, since such an interpretation would contradict the Advisers Act Fiduciary Duty Interpretation with which the Department expressly sought to align the Proposed Exemption.

As the Department is aware, in 2019 the SEC issued its Standards of Conduct rulemaking package.⁶ Included in that package was the Advisers Act Fiduciary Interpretation, which was intended by the SEC to reaffirm and clarify the fiduciary duty of investment advisers under the Advisers Act. As discussed in the interpretation, investment advisers have always had an overarching fiduciary duty that applies to the entire scope of their relationship with their clients. The interpretation also describes duties of care and loyalty for investment advisers that are consistent with the duties outlined by the Department as conditions of the Proposed Exemption, and the IAA appreciates this consistency.

In the Advisers Act Fiduciary Duty Interpretation, the SEC explicitly distinguished obligations of advisers to *existing* clients from those with respect to *prospective* clients. In doing so, the SEC stated:

In addition, with respect to prospective clients, investment advisers have antifraud liability under section 206 of the Advisers Act, which, among other things, applies to transactions, practices, or courses of business which operate as a fraud or deceit upon prospective clients, including those regarding investment strategy, engaging a sub-adviser, and account type. We believe that, in order to avoid liability under this antifraud provision, an investment adviser should have sufficient information about the prospective client and its objectives to form a reasonable basis for advice before providing any advice about these matters. *At the point in time at which the prospective client becomes a client of the investment adviser (e.g., at account opening), the fiduciary duty applies.* Accordingly, while advice to prospective clients about these matters must comply with the antifraud provisions under section 206 of the Advisers Act, *the adviser must also satisfy its fiduciary duty with respect to any such advice (e.g., regarding account type) when a prospective client becomes a client.*⁷

⁶ See *SEC Adopts Rules and Interpretations to Enhance Protections and Preserve Choice for Retail Investors in Their Relationships With Financial Professionals*, SEC Press Release 2019-89 (June 5, 2019), available at <https://www.sec.gov/news/press-release/2019-89>.

⁷ Advisers Act Fiduciary Duty Interpretation at n. 42 (emphasis supplied).

The IAA agrees with the SEC that the adviser's fiduciary duty begins *when a prospective client becomes a client*. Therefore, the IAA urges the Department to clarify that the Proposed Exemption and the Department's interpretation of the regulation defining when a person is a fiduciary by reason of providing investment advice are consistent with the SEC's approach on this point.⁸ We believe the Department could easily address this by clarifying that a person does not become an investment advice fiduciary merely because that person recommends themselves to provide fiduciary services or engages in related discussions, including with respect to the adviser's offerings. As we have previously commented, an adviser should be able to market its services to prospective investors, including plan fiduciaries and IRA owners, without becoming a fiduciary under ERISA and the Code.⁹ The reality of the adviser selection process is that an adviser must demonstrate how the adviser expects to invest the assets in order to distinguish itself from the other advisers the investor may be considering. In the pre-agreement context, the investor is usually considering the services of multiple potential advisers and often benefits from granular-level comparisons of the differences. In order to best apprise investors of the different options available, advisers should have the flexibility to fully describe and distinguish their offerings. This free flow of information will best promote the interests of retirement investors by enabling them to understand and distinguish the services of various candidate advisers, and permit advisers the flexibility to be as responsive and provide as much information as they desire in pre-agreement discussions.

In addition, the first prong of the five-part test is that a person must "render advice as to the value of *securities or other property*, or make recommendations as to the advisability of investing in, purchasing, or selling *securities or other property*."¹⁰ The Proposed Exemption, however, would cover "compensation received as a result of investment advice as to persons the Retirement Investor may hire to serve as an investment advice provider or asset manager."¹¹ The Preamble does not explain how this would satisfy the five-part test. For purposes of clarity around the five-part test, we recommend that the Department clarify that coverage under the exemption *does not* alter the investment advice definition.

⁸ The Proposed Exemption also includes a requirement for an investment adviser to seek to obtain the best execution of an investment transaction reasonably available under the circumstances. We appreciate that the best execution requirement would apply as required by the federal securities laws. We request that the Department explicitly clarify that it will interpret the best execution requirement consistent with the then-current SEC interpretation of that obligation.

⁹ See Letter from Karen L. Barr, IAA President and Chief Executive Officer, *Response to Department's Request for Information Regarding the Fiduciary Rule and Prohibited Transaction Exemptions* (RIN 1210-AB82) (Aug. 7, 2017), available at <https://higherlogicdownload.s3.amazonaws.com/INVESTMENTADVISER/aa03843e-7981-46b2-aa49-c572f2ddb7e8/UploadedImages/publications/170807cmnt.pdf>.

¹⁰ 85 Fed. Reg. at 40834 (emphasis supplied).

¹¹ *Id.* at 40838.

II. The Exemption Should Cover All Types of Digital Advice

The Proposed Exemption excludes certain transactions from coverage. For instance, transactions resulting from certain types of digital advice, which the Department refers to as “robo-advice,” are excluded from coverage, even if all of the conditions of the Proposed Exemption are met and the advice provided is fiduciary investment advice.¹² Not all robo-advice is excluded. Rather, the Proposed Exemption would exclude only transactions “that result from robo-advice arrangements that do not involve interaction with an Investment Professional.”¹³ The IAA is perplexed by this approach. First, it is inconsistent with the approach taken by the SEC. Second, it would be difficult to work with and is inconsistent with the otherwise principles-based approach of the Proposed Exemption. Third, it is inconsistent with approaches taken by the Department and Congress with respect to exemptions generally.

As the Department is aware, in 2017, the SEC staff issued guidance regarding the provision of digital advice (also known as “robo-advice”).¹⁴ In this guidance, the SEC staff noted that it “has been monitoring and engaging with robo-advisers to evaluate how these advisers meet their obligations under the [Advisers Act].”¹⁵ The guidance further explained that, after this study, the staff believed that it would be helpful to robo-advisers to receive guidance regarding meeting legal obligations under the Advisers Act. The guidance then specifically focused on the substance and presentation of disclosures about the robo-adviser and its services, the robo-adviser’s obligation to obtain information from clients to support its advice, and the adoption and implementation of effective compliance programs for robo-advisers.¹⁶ Subsequently, in the Advisers Act Fiduciary Duty Interpretation, the SEC specifically noted that:

This Final Interpretation also applies to automated advisers, which are often colloquially referred to as ‘robo-advisers.’ Automated advisers, like all SEC-registered investment advisers, are subject to all of the requirements of the Advisers Act, including the requirement that they provide advice consistent with the fiduciary duty they owe to their clients.¹⁷

¹² *Id.* at 40841.

¹³ *Id.*

¹⁴ Division of Investment Management *Robo-Advisers*, IM Guidance Update 2017-02 (Feb. 2017), available at <https://www.sec.gov/investment/im-guidance-2017-02.pdf> (**IM Robo-Adviser Guidance**).

¹⁵ *Id.* at 1.

¹⁶ *Id.* at 2.

¹⁷ Advisers Act Fiduciary Duty Interpretation at n. 27, citing IM Robo-Adviser Guidance (describing SEC staff guidance as to three distinct areas under the Advisers Act that automated advisers should consider, due to the nature of their business model, in seeking to comply with their obligations under the Advisers Act).

The IAA agrees with the SEC's determination that robo-advisers are investment advisers covered by the same duties and obligations as other types of investment advisers. Therefore, we ask the Department to remove the exclusion for certain types of robo-advice.

Unlike the SEC's approach, which acknowledges that robo-advice is investment advice, the Proposed Exemption excludes from its coverage transactions based on robo-advice given without the involvement of an Investment Professional. This approach would be very difficult for advisers to work with. As noted by the SEC in its guidance, there are numerous types of robo-advice. In some cases, robo-advice is delivered exclusively on-line. In other cases, an Investment Professional also interacts with the client. Sometimes, an Investment Professional is available, but the client doesn't always need or want an interaction with an Investment Professional. Some robo-advice products include chat features – some of those chats are automated and others involve a chat with an Investment Professional. The Department's approach would be difficult to apply and would result in instances in which two otherwise identical transactions would be treated differently under the Proposed Exemption.

In the Preamble, the Department notes that a statutory exemption under ERISA Sections 408(b)(14) and 408(g) is available for computer model programs involving investment advice.¹⁸ The statutory exemption is the Department's sole justification for excluding some robo-advice from the Proposed Exemption. First, we note that the existing exemption is not widely used because it is largely viewed as unworkable. Second, and more importantly, neither the Department nor Congress has taken the view that the existence of a single exemption covering a transaction means that no other exemptions covering that transaction should be available. In addition to covering robo-advice, ERISA Sections 408(b)(14) and 408(g) cover conflicts involving investment advice by an Investment Professional. Yet the Department did not decline to propose the Proposed Exemption on this basis. Similarly, in the same 2006 legislation where Congress added ERISA Sections 408(b)(14) and 408(g), it also added multiple other exemptions, including ERISA Section 408(b)(17), a statutory exemption covering many of the same transactions as PTE 84-14, the Qualified Professional Asset Manager (**QPAM**) exemption. Notwithstanding this fact, the Department amended the QPAM exemption in 2010, without deciding to rescind the rest of the QPAM exemption as unnecessary in light of the fact that Congress had added Section 408(b)(17) four years earlier.

For the reasons outlined above, the IAA believes that the Exemption should include all forms of digital investment advice that meet the definition in the five-part test.

¹⁸ 85 Fed. Reg. at 40841.

III. The Exemption Should Permit Greater Flexibility for Overseeing Compliance with Policies and Procedures

The Proposed Exemption would require that Financial Institutions conduct an annual retrospective review reasonably designed to assist in detecting and preventing violations of the Impartial Conduct Standards and the Financial Institution's policies and procedures. As proposed, the annual retrospective review would have to be certified by the firm's Chief Executive Officer, or equivalent.

Investment advisers are already required to undertake an annual review under the Advisers Act Compliance Program Rule (Rule 206(4)-7). Among other things, this rule requires that a registered investment adviser, on at least an annual basis, review its policies and procedures to determine their adequacy and the effectiveness of their implementation. According to the SEC's final release describing Rule 206(4)-7, the review "should consider any compliance matters that arose during the previous year, any changes in the business activities of the adviser or its affiliates, and any changes in the Advisers Act or applicable regulations that might suggest a need to revise the policies or procedures."¹⁹ Just as the Proposed Exemption does not dictate a mechanism for meeting the disclosure conditions, the IAA urges the Department to adopt a more principles-based approach to oversight of and compliance with the requirement to meet the standard of care and conduct conditions through adopting policies and procedures, rather than requiring a certification by the firm's Chief Executive Officer. Doing so would allow firms to determine the appropriate approach to oversee compliance with the Exemption's conditions using the structure of their current compliance programs.

IV. The Department Should Modify the Scope of Principal Transactions Covered by the Exemption

The Proposed Exemption would be available only with respect to certain principal transactions – those meeting the definition of a "Covered Principal Transaction." The IAA understands the Department's concerns regarding principal transactions, which present clear conflicts of interest. For principal transactions constituting the purchase *by* a Financial Institution of securities *from* a Plan or IRA, the Proposed Exemption would cover any type of security. However, principal transactions involving sales from the Financial Institutions would be limited to certain categories of securities. The proposed list excludes initial public offerings of closed-end registered investment companies. We believe that the Department should modify the scope of the exemption to include these offerings, because these investments are offered at inception as principal transactions. These offerings are currently available to retirement investors and investors in these offerings are protected by the requirements of ERISA and the federal securities laws.

¹⁹ *Compliance Programs of Investment Companies and Investment Advisers*, Release No. IA-2204 (Dec. 17, 2003), available at <https://www.sec.gov/rules/final/ia-2204.htm>, at Section II.B.1.

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We appreciate the Department's consideration of our comments and would be happy to provide any additional information that may be helpful. Please contact Sarah Buescher, IAA Associate General Counsel, or the undersigned at (202) 293-4222 if we can be of further assistance.

Respectfully Submitted,

/s/ Gail C. Bernstein

Gail C. Bernstein
General Counsel