July 21, 2015

Via Electronic Filing

Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, DC 20210

Re: Definition of the Term "Fiduciary" (RIN 1210-AB32)

Ladies and Gentlemen:

The Investment Adviser Association[1] appreciates the opportunity to comment on the Department's expanded definition of "fiduciary" in the context of providing investment advice to retirement plans or their participants or beneficiaries (the "Proposed Regulation").[2] The IAA's members are investment advisers registered with the Securities and Exchange Commission, and as such provide fee-based asset management to their clients as fiduciaries under the Investment Advisers Act of 1940 (the "Advisers Act") and—with respect to their retirement plan clients—as fiduciaries under ERISA.

The IAA has long advocated that financial professionals providing investment advice about securities be required to act as fiduciaries in the best interest of their clients. Thus, we support the Department's goal to "better protect[] plans, participants, beneficiaries, and IRA owners from conflicts of interest, imprudence, and disloyalty."[3] We fully understand the basic concerns underlying the Proposed Regulation that millions of Americans—many of whom lack financial expertise—are now responsible for directing their own investments and must "depend on investment advice for guidance on how to manage their savings to achieve a secure retirement."[4] The Department has expressed particular concern regarding advice to individuals on rolling over their retirement assets into an IRA and recommendations regarding investments

[1] The IAA is a not-for-profit association that represents the interests of investment adviser firms that are registered with the Securities and Exchange Commission. For more information, please visit our web site: www.investmentadviser.org. The terms "investment adviser" and "adviser" throughout our comments refer to SEC-registered investment advisers.

[2] *Definition of the Term "Fiduciary;" Conflict of Interest Rule—Retirement Investment Advice*, 80 Fed. Reg. 21928 (Apr. 20, 2015), available at http://www.gpo.gov/fdsys/pkg/FR-2015-04-20/pdf/2015-08831.pdf.

[3] *Id.* at 21929.

[4] *Id.* at 21930.

within an IRA.[5] These individual retirement investors deserve to receive advice that is in their best interests.

While we support the Department's goals in this initiative, we have several concerns with the Proposed Regulation as drafted. As a preliminary, overarching matter, we are concerned that the Department's position on how to address conflicts of interest appears to be based in part on an overly simplistic focus on cost. For example, an option under consideration might encourage fiduciaries to limit the range of available investments to low-fee (typically passively managed) investment options as a means to address potential conflicts of interest. The Department's approach to a potential streamlined exemption and parts of its economic analysis suggest that it intends to promote passive over active management.

As fiduciaries, investment advisers consider a number of criteria about their clients and any potential investment recommendations in addition to fees, including client objectives, portfolio holdings, strategy, and risk-adjusted performance. The selection of investments and investment style should be left to the judgment of investment professionals based on all relevant criteria and circumstances related to both the investor and the potential investments. As long as the professional is required to act transparently and in the client's best interest, it is both inappropriate and inconsistent with any fiduciary standard that applies to investment advisers today, as well as the duty described in the Proposed Regulation, to prescribe what those fiduciaries may recommend.

We also submit a number of comments and recommendations on the substance of the Proposed Regulation. Given that investment advisers are ERISA fiduciaries under the current definition, the Proposed Regulation for the most part would not affect investment advisers, when they provide investment advice to ERISA clients for a fee under an investment management agreement. Nevertheless, as drafted, the Proposed Regulation could prematurely attach fiduciary status and trigger technical prohibited transactions prior to the establishment of an investment advisory relationship.

We do not believe that the Department intended to attach fiduciary status to fee-based investment advisers under these circumstances. Accordingly, we have set forth below a number of suggestions to clarify that fiduciary status for such advisers begins only when the adviser has established an investment advisory relationship with a specific client and a specific investment mandate involving specific assets. In addition, we seek clarification as to how the Proposed Regulation would apply to recommendations of SEC-registered investment advisers, the provision of services to or marketing conversations with other financial services entities, and the operation of the financial reports and valuation carve-out.

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[5] *Id.* at 21938 ("Advisers to ERISA-covered plans are already required to adhere to the fundamental standards of prudence and loyalty, and can be held accountable for violations of the standards. Rather, the primary impact of the 'best interest' standard is on the IRA market.").

Finally, we recommend an effective date that is at least two years after publication of the final rule. The potential implications of the proposal are far-reaching, and investment advisers and other plan service providers will need to assess the potential fiduciary status of numerous entities. In addition, they will need to put into place systems to implement any resulting changes going forward.

I. Background

A. Investment Advisers' Disclosures to All Clients

The IAA's members are investment advisers registered with the SEC, and must satisfy fiduciary responsibilities to their clients under the Advisers Act.[6] This principles-based fiduciary standard applies to all of the adviser's clients, including ERISA plans and IRA owners. We have long maintained that all persons providing investment advice about securities to clients (regardless of the level of the client's sophistication) should be subject to the same high standard of care – the well-established fiduciary duty standard under the Advisers Act. This federal fiduciary standard requires investment advisers to act in the best interests of clients. The Advisers Act and the fiduciary standard provide an extensive framework for conduct and compliance, and impute an overarching duty on the part of investment advisers to put the interests of their clients first.[7]

Virtually all IAA members provide investment management services to their ERISA-covered plan and IRA clients on a discretionary basis. Discretionary investment advisers to plans are fiduciaries under section 3(21)(A)(i) of ERISA, and must satisfy fiduciary responsibilities both under the Advisers Act and under ERISA with respect to the assets they manage. Investment advisers that provide nondiscretionary investment advice to ERISA plans and IRA owners also are fiduciaries under section 3(21)(A)(ii) and therefore subject to both regimes.

In the typical arrangement between an investment adviser and each of its clients, including ERISA plans and IRA owners, the parties enter into a written contract that states a formula under which the adviser's compensation will be determined, generally a straightforward percentage of the assets under management, typically referred to as a "fee-based" arrangement. In addition, all advisers must specifically describe how they are compensated for advisory

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[6] This fiduciary duty has been upheld by the U.S. Supreme Court and reiterated by the SEC in various pronouncements over the years. *SEC v. Capital Gains Research Bureau*, 375 U.S. 180 at 186 (1963); *see, e.g., In re: Arleen W. Hughes*, Exchange Act Release No. 4048 (Feb. 18, 1948).

[7] *See, e.g.*, Letter from David G. Tittsworth, Executive Director, IAA, to Securities and Exchange Commission, dated July 3, 2013, available at https://investmentadviser.org/eWeb/docs/Publications_News/CSCurrent/130703cmnt.pdf (regarding the SEC's consideration of standards of conduct for broker-dealers and investment advisers providing personalized investment advice to retail customers).

services, provide a fee schedule, and describe conflicts of interest along with how they address such conflicts. This disclosure appears in Part 2 of Form ADV, a narrative disclosure brochure that is required under SEC rules to be provided to a client at or prior to the beginning of the advisory relationship.[8]

B. Additional Information and Disclosures for ERISA Plans

An ERISA plan generally will issue a request for proposal (RFP) from potential investment advisers, often with the assistance of a pension consultant.[9] In responding to the RFP, advisers provide detailed information about their experience, services and compensation. The process often includes a "finals presentation" in which potential advisers participate in substantive discussions with the consultant and/or potential client about their proposed engagement. After the plan selects an investment adviser through the RFP process, the parties extensively negotiate an agreement, typically with the assistance of counsel. The negotiations address numerous aspects of the relationship, and the form of agreement is often provided by the client, not the adviser. Therefore, clients establishing these accounts are well-versed as to the terms of the agreements, which reflect the client's or firm's original agreement and any negotiated changes to that agreement. The process is typically an arms-length process that more closely resembles an ordinary commercial transaction than a fiduciary relationship of trust and impartiality.

Beginning in 2012, an adviser's disclosures to the responsible ERISA plan fiduciaries must include the information required under the Department's rule under section 408(b)(2) of ERISA in order to avoid prohibited transaction concerns in the provision of services. These disclosures generally must be provided reasonably in advance of entering into the contract and updated promptly to reflect any subsequent changes. They must include a description of the services to be provided to the plan by the adviser and a description of all direct compensation, either in the aggregate or by service, that the adviser reasonably expects to receive in connection with the services, as well as other details about the arrangement.[10]

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[8] Parts 1 and 2A of Form ADV are filed through the Investment Adviser Registration Depository (IARD) and available to the public electronically at http://www.adviserinfo.sec.gov/IAPD/Content/IapdMain/iapd_SiteMap.aspx. In addition, Part 2A generally must be provided to clients and prospective clients at the time of or before entering into a contract, and must be promptly updated when the information becomes materially inaccurate. Part 2B, which also must be provided to clients, requires information about the specific employees giving advice to individual clients, including additional information about their compensation, and whether they receive any additional compensation, such as a sales award, for providing advisory services.

[9] The pension consultant may also request the adviser to provide information for the consultant's database regarding the adviser's qualifications, capabilities, and investment strategies.

[10] Although the 408(b)(2) disclosures are not required to be provided to IRA owners, much of the information required under the 408(b)(2) regulation nonetheless is provided to IRA clients in the Form ADV and the investment management agreement.

This information generally also must be provided to an individual participant who hires an adviser to provide advice concerning the individual's account within a plan rather than to the plan as a whole. Collectively, these disclosures fully inform the client as to the adviser's services and compensation prior to the advisory relationship.

II. Role of a Fiduciary: Treatment of Active Management

The Department appears to promote the superiority of low-fee (passively managed) investments as compared to higher-fee (actively managed) investments. In the preamble to the Proposed Regulation, the Department requests comment as to whether it should propose an additional "streamlined" prohibited transaction exemption that would apply to "high-quality, low-fee investments" and contain far fewer conditions than the proposed Best Interest Contract (BIC) Exemption.[11] This concept suggests that the Department favors passive over active management, given that lower-fee mutual funds, for example, tend to be those that are indexed to a particular benchmark and do not provide active management. In addition, the separate economic analysis of the benefits of the Proposed Regulation compares the fees currently paid by retirement investors to the fees available in index funds, implying that the Department favors passively managed funds.[12]

We submit that the Department should not base the availability of exemptive relief from the prohibited transaction rules on prescriptive limits on the investments available to fiduciaries. Doing so puts the Department in the untenable position of substituting its own judgment on investments for those of the fiduciary. The selection of investments and management style should be left to the judgment of plan fiduciaries and investment professionals based on all relevant criteria and circumstances related to both the investor and the potential investments. An investment professional considers a number of relevant criteria regarding each investment option, including expenses, historical performance data, benchmarks, investment objectives, portfolio holdings, turnover, relative risk, and risk-adjusted performance. As long as the professional is required to act transparently and in the client's best interest, it would be both inappropriate and inconsistent with the fiduciary duty in the Proposed Regulation and the Advisers Act to prescribe what those fiduciaries may recommend. Investment advisers, which are fiduciaries under the federal securities laws and ERISA, are in a better position than regulators to make these substantive investment decisions.[13]

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[11] 80 Fed. Reg. at 21948.

[12] *See, e.g., Fiduciary Investment Advice: Regulatory Impact Analysis* at 85-86. We also note similar issues in the Department's video accompanying the proposal. *See* http://www.dol.gov/featured/protectyoursavings/. Such a simplistic analysis does not take into account, among other things, the range of retirement clients' risk tolerances, non-retirement assets, and investment horizons.

[13] The Department considered including specific requirements concerning investment theories in connection with its regulation on participant investment advice under sections 408(b)(14) and 408(g) in 2010, but correctly concluded, based on public comment, that such requirements were not appropriate. *See* Investment Advice—Participants and Beneficiaries, 76 Fed. Reg. 66136, 66141 (Oct. 25, 2011). *See also* Letter from Karen L. Barr, General Counsel, IAA, to the Department of Labor, dated May 5, 2010.

Further, we maintain that the least expensive option is not necessarily the best option for each investor. A variety of approaches and styles can be appropriate components of the mix of investments in a retirement client's portfolio. Active management is unquestionably a generally accepted investment strategy. In addition, active management allows more flexibility, as appropriate, to hedge, engage in risk management, adjust to volatility or sideways markets, respond to interest rate changes, and deliver expert, sub-specialized management in niche markets, such as emerging and small-cap markets.[14] Conversely, investing solely in passively managed funds may not result in better overall performance over time and could lead investors to miss opportunities for better risk-adjusted returns or more appropriate diversification.

Accordingly, the Department should not offer an exemption requiring that investments by ERISA plans and IRAs be limited to low-fee, passively managed investments. Such an exemption may over-incentivize reliance on passive management that may not be in the best interests of clients. In addition, the Department's commentary should not include language or analysis that implicitly favors passive management.

III. Scope and Practical Concerns

The Proposed Regulation addresses the prong of the ERISA fiduciary definition that does not require discretionary authority or control and is generally inapplicable to discretionary investment advisers. The proposal nevertheless raises issues for discretionary and non-discretionary fee-based investment advisers, already ERISA fiduciaries under the current formulation with respect to their existing clients, to the extent that it may be interpreted to create a fiduciary relationship under ERISA and the Code before the adviser begins to provide its services to the ERISA plan or IRA owner. We do not believe that the Department intended this result, given the policy basis for the current proposal.

SEC-registered investment advisers fully recognize their fiduciary status under the Advisers Act and ERISA at the time that they enter into investment management agreements with their ERISA plan and IRA clients and begin providing investment advice concerning plan assets. Prior to entering into the agreement, the client has received the adviser's Form ADV, Part 2A and, with respect to ERISA clients, the disclosures required under ERISA section 408(b)(2), and has reviewed and agreed to the investment management agreement. To attach fiduciary status prior to this time could raise prohibited transaction issues before the adviser has provided any services to the client or received any compensation. We submit that additional protections and disclosures are not necessary in this context, especially in light of the straightforward fee structures typical of such arrangements.

Accordingly, we have set forth below a number of suggestions that would clarify the timing of fiduciary status for investment advisers under the Proposed Regulation. We also

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[14] *See, e.g.,* discussion of academic studies in Jones, Robert C. and Russ Wermers. 2011. "Active Management in Mostly Efficient Markets." *Financial Analysts Journal,* vol. 67, no. 6 (November/December 2011).

request clarification concerning (1) recommendations of SEC-registered investment advisers; (2) investment advice to financial services entities that are themselves ERISA fiduciaries by virtue of providing investment advice; and (3) valuation of plan investments.

A. The Revised Definition of Fiduciary is Overly Broad and Could Cover Activities by Investment Advisers Before They Provide Any Services to ERISA Clients

The proposed amendments to the definition of fiduciary would include as fiduciary activity any "recommendation as to the management of securities or other property." This language could be read to sweep within its scope a "recommendation" that the ERISA client hire the adviser to manage securities or other property. More specifically, our primary concern relates to the proposed definition of "recommendation" as "a communication that … would reasonably be viewed as a *suggestion* that the advice recipient engage in or refrain from taking a particular course of action."[15]

This language is so broad that a response to a request for proposal (RFP) or other presentation to a prospective client could potentially be covered by the definition.[16] Furthermore, the definition could sweep in other types of conversations between advisers and potential clients, including casual discussions during the sales process, such as the adviser's provision of "market color." Even the act of providing information to a plan consultant's database could trigger ERISA fiduciary status, if providing such information to a consultant were to be deemed a recommendation to hire the adviser.

Similarly, investment advisers or their affiliates might become ERISA fiduciaries if their marketing or wholesaling activities directed to intermediaries are deemed to be "recommendations," under the broad definition of that term, and the intermediary is a fiduciary to an ERISA plan or IRA client. As a practical matter, for example, a mutual fund distributor will have no way of knowing whether its interaction with an intermediary will contribute to that intermediary's decision to make a recommendation to an ERISA plan or IRA client, and cause the distributor to become an inadvertent fiduciary.

We do not believe this result was intended.[17] It would prematurely attach ERISA fiduciary status and create technical prohibited transactions that could prevent the advisory

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[15] 80 Fed. Reg. at 21960 (emphasis added).

[16] We also note that the "recommendation of a person" language in proposed § 2510.3-21(a)(1)(iv) could be interpreted to extend to advisers recommending themselves in pre-contract discussions.

[17] We appreciate that the Department responded to concerns expressed in our comments on the Department's 2010 proposal that pre-contract discussions should not be covered and that the Proposed Regulation does not "automatically assign fiduciary status to investment advisers." 80 Fed. Reg. at 21932. *See* Letter from Kathy D. Ireland, Associate General Counsel, IAA, to the Department of Labor, dated February 2, 2011. Unfortunately, the revised definition has not resolved this issue.

relationship from moving forward. This result would also be inconsistent with the ordinary ways in which ERISA plan fiduciaries carry out their responsibilities. For example, ERISA plan fiduciaries regularly issue RFPs as part of their fiduciary responsibility to research and compare potential investment advisers before selecting a particular manager. We maintain that ERISA fiduciary status should not attach if an investment adviser responded to a plan's RFP by discussing the investment philosophy and the types of investments it might recommend if the plan were to hire the adviser.[18] At this point in time, the adviser would not be "rendering investment advice for a fee," because it would not have established a relationship with the plan, and would not receive compensation for this activity.[19]

The incongruity of characterizing an adviser as an ERISA fiduciary at that moment is highlighted by focusing on those who fail to win the plan's business. Plan fiduciaries typically solicit responses to RFPs from multiple advisers in order to compare them. The plan fiduciary, however, will not choose all of these advisers to manage plan assets. Only the investment advisers with which the plan ultimately enters into investment management agreements should be ERISA fiduciaries and only at the time that such advisers actually manage the assets. The other advisers do not have any relationship with the plan, manage its assets, or receive any compensation; therefore, none of the advisers should be considered fiduciaries under ERISA prior to the plan's selection of an adviser.

Similarly, an adviser that already has an established ERISA fiduciary relationship with a plan client, or an affiliate of that adviser, may provide general investment-related information or commentary on matters beyond the scope of their existing relationship on an ad hoc basis, via educational newsletters or client conferences, or may discuss potential future services, sometimes as part of the client's consideration of a number of investment advisers. These discussions may take place in the context of client consideration of assigning the adviser an additional mandate, adding assets to an existing mandate, or changing investment guidelines. We note that, although the adviser is an ERISA fiduciary with respect to the plan assets under its management, it (or its affiliate, as applicable) would not be an ERISA fiduciary by virtue of these activities with respect to <u>other</u> assets of the plan, as provided in paragraph (c) of the Proposed Regulation.[20]

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[18] In addition, the adviser would not at this point (or in the context of discussing potential additional mandates described below) have sufficiently detailed information about the plan's current investments to provide investment advice.

[19] We also note that an adviser may meet initially with a potential advisory client about his or her investments before knowing whether the investments under discussion include ERISA or IRA assets.

[20] Paragraph (c) of the Proposed Regulation (and paragraph (c)(2) of the current regulation), provide that

> A person who is a fiduciary with respect to a plan by reason of rendering investment advice (as defined in paragraph (c)(1) of this section) for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or having any authority or responsibility to do so, <u>shall not be deemed to be a fiduciary regarding any assets of the plan with respect to which such person does not have any discretionary authority, discretionary control or discretionary responsibility, does not exercise any</u>

The Department has also recognized this concept in the regulation under ERISA section 408(b)(2), which states that a prohibited transaction under section 406(b)(1) does not occur if the fiduciary does not use any of the authority, control or responsibility that makes such person a fiduciary to cause a plan to pay additional fees.[21] This is the case when an investment adviser is pitching future services—it is making a proposal to the plan fiduciary and does not have the authority to hire itself. The independent fiduciary makes the decision to engage the adviser. As in the RFP example above, the adviser may never manage the additional assets and therefore may never receive a fee based on the additional assets. In addition, if hired for the new mandate, the adviser would be required to provide new disclosures under section 408(b)(2); therefore, the client would be fully informed in advance of any change in fees that would result from the additional services.[22] The Department should clarify this issue, as set forth below.

1. The Proposal Should Be Amended to Address Pre-Contract Discussions

We request that the Department modify its proposal to clarify that fee-based SEC-registered investment advisers do not fall within the definition of "fiduciary" under ERISA prior to the establishment of a relationship with a specific client under a specific mandate to manage a particular account or set of assets as evidenced by an investment management agreement (generally, "pre-contract" discussions).[23] The Department could accomplish this result in two ways. First, it could apply the proposed revisions to the definition of fiduciary only to the types of activities to which the proposal is addressed (*e.g.*, commission- and other transaction-based

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> authority or control, does not render investment advice (as defined in paragraph (c)(1) of this section) for a fee or other compensation, and does not have any authority or responsibility to render such investment advice.

(emphasis added). As the remainder of this provision notes, the adviser may still be a party in interest and subject to co-fiduciary responsibilities with respect to the other plan assets.

[21] In particular, Examples 1 and 4 in 29 C.F.R. § 2550.408b-2(f) conclude that an investment adviser engaging in discussions to provide additional services for additional fees or to increase its fees do not raise prohibited transaction issues.

[22] 29 C.F.R. § 2550.408b-2(c)(v)(B)(*1*) thus anticipates that services and fees may change during the course of the service provider's contract and requires disclosures of such changes as soon as practicable but generally no later than 60 days after the service provider is informed of the change. This protocol suggests that changes to service agreements are routine and nothing in the regulation under section 408(b)(2) suggests that such changes raise prohibited transaction concerns.

[23] For the balance of this letter, the term "pre-contract" refers both to discussions before the adviser has a contract with an ERISA or IRA client and discussions with an existing client concerning an additional mandate, additional assets to be added to an existing mandate, or changes to investment guidelines.

activities that may be confusing to ERISA clients and IRA owners) and not to fee-based investment advisory services.[24]

Second, the Department could address this issue in the carve-outs to the definition of fiduciary. According to the preamble to the Proposed Regulation, "carve-outs are for communications that the Department believes Congress did not intend to cover as fiduciary 'investment advice' and that parties would not ordinarily view as communications characterized by a relationship of trust or impartiality."[25]

We submit that the discussions described above as "pre-contract" are not fiduciary under a similar rationale—the parties would not ordinarily view such communications as indicating a relationship of trust or impartiality. The Department therefore should clarify the non-fiduciary nature of these discussions either by modifying the existing "counterparty" carve-out or by adding a specific carve-out for pre-contract discussions relating to fee-based investment advisory services.

The "counterparty" carve-out in section (b)(1)(i) of the Proposed Regulation in its current form does not appear to cover the provision of services, given that it describes a transaction rather than the provision of services and uses the term "counterparty," which is not a term that typically applies in the context of a services agreement. To the extent that it may apply, it is limited to plans of a certain size and those that hire independent fiduciaries with responsibility for managing at least $100 million in plan assets.

We strongly submit that a carve-out for investment advisory services (regardless of whether the Department amended the counterparty carve-out or established a new carve-out) should not be limited to clients and fiduciaries of a certain size. The carve-out should apply to all clients, given that no investment advisory relationship would exist during pre-contract discussions, regardless of the nature of the client, and the fees paid under the actual contract would be straightforward and fully disclosed.

2. If Preliminary Discussions Trigger Fiduciary Status and No Carve-Out Applies, Then the Department Should Provide a Separate, Streamlined Exemption for Such Discussions

To the extent that the Department determines that the amended definition of "fiduciary" applies to fee-based investment advisers prior to their providing investment advisory services to a client and chooses not to cover such services under a carve-out, then we request that the Department develop a streamlined prohibited transaction class exemption that would permit pre-

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[24] For example, the Department could amend the definition of "recommendation" to exclude pre-contract conversations/information by fee-based investment advisers that will be ERISA fiduciaries once hired. We would also suggest amending proposed § 2510.3-21(a)(1)(iv) to refer to a recommendation of <u>another</u> person.

[25] 80 Fed. Reg. at 21941.

contract or pre-mandate discussions. For example, if the Department determined to apply the carve-out to only certain ERISA and IRA clients, then an exemption might be necessary to allow pre-contract discussions with respect to the remaining categories of clients.

We wish to stress, however, that creation of a new exemption would not be the best means for the Department to address the issue. The most logical and efficient approach from a policy standpoint would be for the Department to address our scope concerns through changes to the Proposed Regulation, a revised "counterparty" or seller's carve-out, or a new carve-out for pre-contract discussions. An exemption should not be needed because pre-contract discussions are not fiduciary in nature and should not be treated as such.[26]

The Department has included in its proposal a new prohibited transaction exemption, the BIC Exemption, to provide a structure under which those entities that became fiduciaries under the proposed amendments could receive commissions and other sales compensation. This proposed exemption, however, was not specifically designed to address pre-contract discussions concerning investment advisory services and contains a number of conditions that are either unnecessary or inappropriate for an advisory relationship.[27] As noted in the first section of the proposed exemption, it addresses prohibitions under ERISA and the Code against fiduciary advisers' receipt of "compensation that varies based on their investment recommendations," and "compensation from third parties in connection with their advice."[28] Neither of these issues arises in the context of pre-contract discussions of fee-based advisory services.

Furthermore, the covered transactions under the proposed BIC Exemption are limited to "compensation for services provided in connection with a purchase, sale or holding of an Asset by a Plan, participant or beneficiary account, or IRA, as a result of the Adviser's and Financial Institution's advice."[29] Furthermore, the conditions to the exemption include "transaction disclosures," which require various charts, website disclosures, and information to be made available upon request to the Department—all of which relate to the costs of purchasing, selling or holding particular assets and not to fee-based advisory services.

Thus, the BIC Exemption would not be appropriate for investment advisers with respect to pre-contract discussions of fee-based advisory services.[30] As noted above, a fee-based

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[26] Prematurely attaching fiduciary status in pre-contract discussions would raise difficult issues even if prohibited transaction relief were available. For example, the application of the prudent-man rule, co-fiduciary responsibility, and ERISA requirements would be problematic in this context.

[27] Furthermore, even with respect to sales activities, we believe that the conditions are unnecessarily complex.

[28] 80 Fed. Reg. at 21983.

[29] *Id*. at 21984.

[30] Further, the BIC exemption is too narrow with respect to the range of investments (defined as "Assets") that fee-based fiduciaries may appropriately employ. ERISA and IRA clients should have access to information concerning the full range of investments.

investment adviser already provides its services subject to a "best interests" fiduciary duty and pursuant to a written investment management agreement; therefore much of the rest of the proposed BIC Exemption would be unnecessary in this context.

Rather than trying to apply the BIC exemption in this context, the DOL should create a separate exemption that takes into account and, where necessary and not duplicative, builds on the extensive disclosures already provided by investment advisers during the period prior to their entering into investment advisory contracts with their clients. The conditions to such an exemption could include requirements to provide Form ADV and 408(b)(2) disclosures to both ERISA clients and IRA owners (as well as the proposed text of the investment management agreement) prior to the execution of the investment management agreement.[31] Such an exemption should make clear that it is permissible for advisers to include the 408(b)(2) disclosures in their Form ADV disclosure brochures, as this will be more manageable for both advisers and their clients.

Similarly, the proposed BIC Exemption would not appear to cover recommendations of registered investment advisers, including through referral programs and managed accounts.[32] These arrangements are already subject to the disclosure and fiduciary obligations under the Advisers Act, including its best interest standard. The Department should design a modified BIC exemption tailored to such arrangements, that could include the "best interests" standard as well as fee structures that mitigate conflicts.

B. Provision of Advisory Services to Other Fiduciaries

In addition to their services as asset managers to ERISA and other clients, SEC-registered investment advisers (or their affiliates) may provide non-discretionary advisory services to other financial services entities, some of which might be fiduciaries under ERISA. These services could include opinions, model portfolios, recommendations, and other advice that the entity may utilize, as it sees fit, in providing services to its ERISA clients.

Under the current regulation, fiduciary status for investment advice is based upon providing advice to a plan. The Proposed Regulation, however, would expand this to include advice to plan fiduciaries; therefore, advisers to financial services entities might trigger fiduciary

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[31] Another potential model for such an exemption could be the final regulation on investment advice to participants and beneficiaries under sections 408(b)(14) and 408(g). This model may be analogous in that fee-based investment advisers' compensation is level regardless of the specific investments chosen for the client, and the required disclosures in the existing participant investment advice regulation could be tailored to this context. 29 C.F.R. § 2550.408g-1.

[32] Managed accounts are often referred to as "wrap" accounts that combine investment management with brokerage commissions for one asset-based fee. Investment advisers that are compensated under a wrap fee program for sponsoring, organizing, or administering the program, or for selecting, or providing advice to clients regarding the selection of, other investment advisers in the program must provide their wrap fee program clients a separate brochure describing the program (Appendix 1 of Form ADV, Part 2A).

status even though such entities would not need the protections that the proposal is designed to provide. We urge the Department to either except this type of advice from the definition of fiduciary or to create a carve-out, for the reasons discussed below.

For example, in certain wrap fee arrangements, investment advisers provide non-discretionary advisory services in the form of generic model portfolios ("model providers") to the program sponsor or an overlay portfolio manager for its use in managing client accounts. The program sponsor or overlay manager generally has investment discretion and is therefore a fiduciary under ERISA with respect to plan and IRA clients. In this context, the model provider's only client is the financial services entity, the model provider only has contractual privity to the entity, and the model provider does not individualize its advice to a specific ERISA plan or IRA owner. Because the program sponsor or overlay manager already serves as an ERISA fiduciary with respect to the plan or IRA, we believe that imposing fiduciary responsibility on the model provider would not provide any additional protections to these clients. Furthermore, it is not clear how adviser model provider would be able to comply with ERISA's fiduciary responsibility provisions with respect to such underlying clients; indeed, it has no information about them (including their identities).

We recommend that the Proposed Regulation be revised to add a carve-out for this and similar situations in which an adviser provides investment advice to another financial services entity. For example, the Department could except from the definition of fiduciary, or create a specific carve-out for, investment advice to a financial services entity where the advice is not individualized to a specific ERISA plan or IRA owner.

C. Valuation Activities

The Proposed Regulation would add to the definition of fiduciary certain valuation activities in connection with specific transactions "involving the acquisition, disposition, or exchange" of securities or other property, subject to a carve-out in proposed subsection (b)(5)(iii) for valuations provided solely for purposes of compliance with reporting and disclosure requirements.[33]

The application of the Proposed Regulation is unclear, however, as to the status of routine information provided to plans and plan fiduciaries in addition to the information included in the carve-out. For example, advisers to funds may provide quarterly statements and performance reports to all fund investors, including ERISA plans. As a threshold matter, such information does not appear to fall within the proposed definition of fiduciary, because it is not provided in connection with a transaction. In carving out statements of value "solely for purposes of

[33] 80 Fed. Reg. at 21958. We appreciate the Department's response to the concerns raised by the IAA in its 2011 comment letter about the provision of valuation services directly to funds by adding the carve-out in proposed subsection (b)(5)(ii). Our current concerns relate to information provided to parties other than the funds, particularly plans and plan fiduciaries.

compliance," however, the Proposed Regulation suggests that other routine statements of value might fall within the definition, even though they do not relate to a specific transaction. This limitation could discourage advisers from providing information to ERISA plan clients other than that specifically required.

This issue could arise in a number of circumstances. For example, we are concerned that this language could be interpreted to attach fiduciary status to investment advisers providing investment advice to non-plan-asset vehicles in which ERISA plans invest, if they provide valuation information beyond that required under statute or regulation to the plans that invest in the fund.[34] This language also could raise uncertainty in the context of a separately managed account under which the adviser manages the assets of a single plan, if the adviser provided quarterly statements and performance information. Similar issues would arise if the plan's custodian, rather than the adviser, had valuation responsibilities under the arrangement, but the adviser provided input to the custodian as to the value of certain holdings in connection with quarterly statements provided to the plan.

We submit that the Department should clarify the scope of both the fiduciary definition and the valuation carve-out, and their inter-relation. Specifically, the Department should clarify that providing routine valuation information, regardless of whether it is required information, is not covered by the definition of fiduciary, in order to allow investment advisers to provide such information without triggering fiduciary status. Under this formulation, the carve-out in subsection (b)(5)(iii) would not be necessary.

IV. Transition Issues

Given the far-reaching changes that the final rule may produce and the continued uncertainty under the proposal concerning exactly which types of activities by investment advisers might be covered, the effective date of the proposed changes should be further extended to at least two years after publication of the final rule. This is necessary in order for advisers and other ERISA fiduciaries to assess the impact of the new rule, not only with respect to themselves, but also as to the plans' other parties in interest, especially in the context of prohibited transactions. Certain prohibited transaction exemptions, such as the statutory exemptions in sections 408(b)(15) (relating to certain block trades) and 408(b)(17) (relating to service providers), include conditions requiring that the party in interest in the transaction <u>not</u> be a fiduciary. The final rule, therefore, in broadening the universe of ERISA fiduciaries, could automatically limit the applicability of these and other exemptions that currently allow various transactions.

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[34] Under the Department's regulation defining plan assets, a collective investment vehicle with less than 25% in assets from benefit plan investors does not hold plan assets for purposes of ERISA; therefore, an adviser to such a fund generally is not a fiduciary to the plans that invest in such a vehicle. 29 CFR § 2510.3-101(f)(1).

Until the regulation is finalized, and clarification is provided on the issues raised in this letter, as well as issues affecting other service providers, plan fiduciaries and the financial services industry will not be able to assess its impact fully. Furthermore, after the regulation is finalized and clarified, plan fiduciaries will need time to apply the rule to their existing relationships and arrangements. Among other things, plan fiduciaries will need to identify new ERISA fiduciaries, and, in some cases, their affiliates.[35] Plan fiduciaries also should be given sufficient time to identify fellow fiduciaries in light of their co-fiduciary responsibilities under section 405(a) of ERISA. Finally, the final regulation will likely require data collection and conforming changes to service providers' systems; therefore, the effective date should recognize that service providers will require sufficient lead-time to work with their technology professionals to effect the required changes after they are identified.

V. Conclusion

We appreciate the opportunity to provide our views on these issues. Please do not hesitate to contact the undersigned if we may provide additional information or clarification regarding these matters.

Respectfully submitted,

-s- Kathy D. Ireland

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[35] *See, e.g.,* ERISA section 408(b)(17).