April 17, 2017

*Via Electronic Filing*

Attention: Fiduciary Rule Examination
Office of Regulations and Interpretations
Employee Benefits Security Administration
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: Comments Regarding Fiduciary Rule Examination (RIN 1210-AB79)

Ladies and Gentlemen:

The Investment Adviser Association (the "IAA")[1] appreciates the opportunity to provide comments to assist the Department of Labor (the "Department") in its examination of the fiduciary duty rule ("Fiduciary Rule") and related exemptions pursuant to the Presidential Memorandum dated February 3, 2017[2] and as described in the proposed rule to extend the applicability date, dated March 2, 2017,[3] and the final rule extending the applicability date of the Fiduciary Rule and related exemptions to June 9, 2017.[4] The IAA strongly supports a fiduciary standard and has long advocated that financial professionals providing investment advice about securities to clients be required to act as fiduciaries in the best interest of their clients.

The IAA's members are investment advisers registered with the SEC, and as such are fiduciaries under the Investment Advisers Act of 1940. SEC-registered investment advisers are subject to a robust fiduciary standard that applies to all adviser clients, whether or not such clients are "plans" under ERISA or the Internal Revenue Code or are individuals who participate in such plans or Individual Retirement Accounts ("IRAs"). In addition, virtually all of the IAA's members are fee-based discretionary investment managers and, as such, *are already fiduciaries*

[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. The IAA's membership consists of more than 600 firms that collectively manage approximately $20 trillion for a wide variety of individual and institutional investors, including pension plans, trusts, investment companies, private funds, endowments, foundations, and corporations. For more information, please visit our web site: www.investmentadviser.org. The term "investment adviser" or "adviser" throughout our comments refers to SEC-registered investment advisers.

[2] The President directed the Department to examine the Fiduciary Rule "to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice." *Memorandum for the Secretary of Labor: Fiduciary Duty Rule,* 82 Fed. Reg. 9,675 (Feb. 7, 2017).

[3] 82 Fed. Reg. 12319 (Mar. 2, 2017).

[4] 82 Fed. Reg. 16902 (Apr. 7, 2017).

*under ERISA* and subject to prohibited transaction provisions of the Code with respect to their ongoing relationships with their retirement plan and IRA clients.

The Fiduciary Rule and exemptions, as interpreted by the Department, nevertheless will have significant, unwarranted – and, in some cases, unintended – consequences for advisers that are already ERISA fiduciaries because the Rule applies to pre-contract and sales discussions with prospective clients.[5] Indeed, the application of the Rule in this respect may adversely affect the ability of investors to assess and access high-quality retirement information and advice. Accordingly, we urge the Department to re-propose the Rule and exemptions to carve out such pre-contract discussions from the Rule's application under the circumstances discussed below. The IAA wishes to be clear that our request for a re-proposal does not reflect any desire on our part to diminish investor protections. To the contrary, IAA members see first-hand the need for high-quality fiduciary advice and are committed to the fiduciary standard and to acting in the best interest of clients. The IAA urges the Department to re-propose the Rule in order to give the Department an opportunity to craft a better rule that will meaningfully improve investors' access to advice and ability to save for retirement.

## Executive Summary

The IAA appreciates the Department's willingness to improve the Fiduciary Rule and related exemptions and requests that the Department review the scope of the Rule consistent with the Presidential Memorandum.[6] The IAA believes that the Department can craft a revised rule that is consistent with the policy goals of both promoting access to investment advice and promoting a fiduciary standard for persons advising retirement clients about investments. In order to accomplish this, the Department should re-propose the Fiduciary Rule and, if necessary, the related exemptions to permit the IAA and others to provide technical comments and practical advice. A re-proposal would also give the Department the chance to incorporate and ameliorate the unintended effects of the nearly 70 FAQs issued to date and to address numerous outstanding questions more comprehensively.

In reviewing and proposing revisions to the Rule, we encourage the Department to address the fundamental concern that IAA has repeatedly expressed – that an adviser should not be treated as a fiduciary before entering into a relationship with a client. In this regard, the Department has failed to identify abuses in the sales context by persons, like investment advisers,

[5] We use the term "pre-contract" to refer both to discussions before the adviser has a contract with an ERISA or IRA client and discussions with existing clients concerning additional mandates or additional assets.

[6] In making these comments, the IAA is mindful of the impact of the recently-published extension of the Applicability Date of the Fiduciary Rule and related exemptions. Although the Department indicated that the Fiduciary Rule is "among the least controversial" aspects of its initiative, we continue to think that the Department has not adequately considered the negative impacts of the Rule's application to the pre-contract stage of an advisory relationship. Indeed, while we agree with the Department about the benefits of the Impartial Conduct Standards, fiduciary investment advisers continue to be perplexed as to how to apply such standards *before they have a client.*

*who are seeking out fiduciary relationships, rather than trying to avoid such relationships*. Thus, the Department should amend the definition of "recommendation" to exclude pre-contractual conversations involving an SEC registered, fee-based adviser, acting as such, who will be a fiduciary once the client engages the adviser. To the extent that the Department does not amend the definition of "recommendation" in this way, any re-proposed or revised rule should: (1) adopt a broader, more practical, "hire me" exception to the fiduciary definition; (2) broaden and clarify the "independent fiduciary exception"; and (3) clarify that intra-company conversations do not trigger fiduciary status.

The Department should also reexamine the Streamlined Conditions of the Best Interest Contract Exemption ("Streamlined BIC") to provide a workable approach in those particular situations where an investment adviser is viewed as a fiduciary in establishing a client relationship and therefore needs an exemption. Specifically, the Streamlined BIC should be broadened to accommodate any adviser that will provide advisory or discretionary fiduciary services pursuant to an exemption or other arrangement (including receipt of soft dollars and fee offsets, waivers, or rebates) under which third party or other payments are permissible under ERISA and Department guidance.

We understand that the Department also may make significant changes to the full Best Interest Contract Exemption ("BIC Exemption"), including possibly removing or restructuring the contract requirement. If this were to happen, it is possible that instead of a "full" BIC Exemption and a Streamlined BIC Exemption, the final exemption would include a single set of conditions. While IAA members generally would not expect to rely on the full BIC Exemption, and so do not comment on potential changes to it, the IAA would strongly object if a unified BIC Exemption resulted in *additional* conditions being placed on those firms that intended to use the Streamlined BIC. Any revisions to the BIC Exemption must *improve* Streamlined BIC, not make it more like the full BIC Exemption, which is inapt for investment advisers.

## I. The Department Should Amend the Definition of "Recommendation" to Exclude Pre-Contract Discussions and General Sales Conversations by Investment Adviser Fiduciaries.

The final Fiduciary Rule significantly expands the concept of "investment advice," in part through its definition of "recommendation." A "recommendation" is broadly defined as "a communication that, based on its content, context, and presentation, would reasonably be viewed as a *suggestion* that the advice recipient engage in or refrain from taking a particular course of action."[7] The Rule in effect also treats the fee an adviser receives for its fiduciary advisory services after it's hired as a fee for the "recommendation" an adviser makes that a client hire the adviser in the first place, or a suggestion that adviser makes about strategies it would deploy if

[7] Fiduciary Rule § (b)(1), 81 Fed. Reg. 20946 at 20,997 (Apr. 8, 2016) (emphasis added).

hired.[8] The IAA believes that this approach is inconsistent with the common understanding of fee for service arrangements.

A result of this broad definition is that many communications that have long been non-fiduciary in nature will be covered by the Rule. The definition reaches beyond the recommendations provided in the course of a traditional relationship or interaction between a financial services provider and its client – which, for investment advisers, is fiduciary in nature – to encompass sales conversations, responses to RFPs, investment education, and ordinary course interactions among financial institutions and intermediaries, even though clients do not, in fact, pay a fee for these "recommendations."

Attaching fiduciary status to sales conversations and other pre-contract interactions will adversely impact investors' ability to retain appropriate investment advisers to provide them financial advice. In the pre-contract context, the client is usually considering the services of multiple potential advisers and often benefits from granular-level comparisons of the differences. In order to best apprise the client of the different options available, advisers should have the flexibility to fully describe and distinguish their offerings without the unnecessary burden of making sure they somehow do not act as fiduciaries when doing so – even though the objective of the conversation is to advocate for their services. 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-contractual discussions. Prospective clients should be able to obtain the information they need to make an informed choice among prospective advisers. Indeed, investment advisers are required to provide extensive information to clients on the SEC's disclosure document (Form ADV) at or before the inception of the relationship. In addition, where an investment adviser acts as a fiduciary with respect to an ERISA plan, it is required under ERISA regulations to provide a disclosure at the outset of the client relationship which acknowledges the adviser's fiduciary status and provides information about the adviser's services and compensation.[9]

The rule also injects needless confusion into the relationship between an investment adviser and potential client. There are many examples of this confusion, but one of the most common will likely involve the adviser selection process. Adviser clients often interview several advisers before deciding which adviser provides the best combination of services for the client's needs. Under the Rule, multiple advisers may interview with a prospective client and provide virtually identical communications covering the adviser's services, fees, communication style and expectations. When the client selects the successful candidate, that adviser will be deemed a fiduciary *from the time of the interview,* while the other advisers will not. The only meaningful distinction among the candidates is that the successful candidate has won the business and acts as a fiduciary when it begins to provide advisory services. It is at that point that the adviser is providing fiduciary services and should be subject to the duties of care and loyalty under ERISA,

[8] *Id*. at §(g)(3).

[9] 29 C.F.R. §2550.408b-2(c)(1).

the Investment Advisers Act or both. During the interview process, successful and unsuccessful candidates are all merely providing information to facilitate the establishment of a fiduciary relationship. This is not the type of communication that should trigger fiduciary status. None of these advisers should be considered ERISA fiduciaries *prior* to the client's selection. Imposing fiduciary status on advisers during the time when an adviser and its potential client are exchanging information to determine the benefits and costs of establishing a fiduciary relationship is an unnecessary and inefficient approach that risks limiting retirement investors' access to much needed advice.

As the IAA suggested in its 2015 comments to the Department's proposed rule,[10] the Department should categorically exempt pre-contractual communications from the definition of "recommendation" in all cases *where an SEC registered, fee-based adviser, acting as such, will be a fiduciary after entering into a contractual arrangement with the client.* Such treatment would permit Americans to have ready access to trusted and reliable retirement information and advice and would also be consistent with the current understanding between advisers and prospective clients that communications made prior to a contractual relationship are mere sales efforts, and do not signify the existence of any relationship of impartiality.[11]

## II. The Department Should Provide Broad, Practical Exceptions from Fiduciary Status for Pre-Contract and Sales Discussions.

To the extent that the Department does not amend the definition of "recommendation" as requested above, the Department should: (1) adopt a broader, more workable, "hire me" exception to the fiduciary definition; (2) broaden and clarify the "independent fiduciary exception"; and (3) clarify that intra-company conversations do not trigger fiduciary status. We discuss these specific suggestions below.

### A. The Fiduciary Rule Should Broaden the "Hire Me" Exception to Promote Access to Information to Enable Sound Fiduciary Selection Decisions.

The preamble to the final Fiduciary Rule explains that "a person or firm can tout the quality of his, her, or its own advisory or investment management services or those of any other person known by the investor to be, or fairly identified by the adviser as, an affiliate, without triggering fiduciary obligations" (commonly known as the "Hire Me" exception).[12] However, if the communication involves a suggestion "that the investor pull money out of a plan or invest in

[10] *See Letter from Kathy D. Ireland, Associate General Counsel, IAA, to the Department of Labor (July 21, 2015),* which we incorporate by reference herein.

[11] We note that registered investment advisers are already subject to SEC requirements and guidance to ensure that marketing communications are clear, presented fairly, and not misleading, which appropriately protect prospective clients in the context of sales discussions. And investment advisers' fee arrangements are straightforward and fully disclosed.

[12] 81 Fed. Reg. at 20,968.

a particular fund, that advice is given in a fiduciary capacity even if part of a presentation in which the adviser is also recommending that the person enter into an advisory relationship."[13]

The IAA strongly agrees with the underlying rationale of the "Hire Me" exception; pre-relationship sales and marketing efforts with respect to one's own services and products should not be considered fiduciary in nature. However, in its current form, the "Hire Me" exception offers almost no real-world value. Specifically, in view of the expansive definition of "recommendation," from a practical perspective, most communications intended to fall under "Hire Me" could involve an investment recommendation, thus precluding the use of the exception.[14] This limited interpretation of "Hire Me" impedes an investor's access to information to enable sound fiduciary selection decisions. As noted above, an adviser's explanation of its services and strategies and responses to questions are important tools that a client uses in deciding whether to engage an adviser for financial advice or investment management.

The IAA suggests that the Department expand the "Hire Me" exception to cover all sales conversations – even those containing a "suggestion" for action – other than those specifically directed to individual plan participants or IRA holders acting as such that involve recommending a rollover from a qualified plan to an IRA or a transfer from an IRA to another IRA. This approach strikes the appropriate balance between promoting normal business and marketing activities and the Department's consumer protection concerns with respect to individual rollover decisions.

### B. The Department Should Broaden and Clarify the "Independent Fiduciary Exemption" to Avoid Inhibiting Interactions Between Advisers and other Professional Fiduciaries.

In creating the Fiduciary Rule, the Department was primarily concerned with the millions of *individual* Americans – many of whom lack financial expertise – who are responsible for directing their own investments within a plan or an IRA. The final Rule, however, over-broadly applies to all communications with all clients and prospective clients – including *institutional* clients – and all communications with entities that may be representing clients that may be plans or plan participants. The Department appropriately acknowledged that "ordinary business activities among financial institutions and licensed financial professionals" should not trigger fiduciary status "merely because the institution or professional was acting on behalf of an ERISA plan or IRA."[15]

---

[13] *Id.*

[14] While this may not be the Department's intention, advisers may take a conservative approach given potential liability and the subjective nature of the assessment of sales conversations.

[15] 81 Fed. Reg. at 20,982.

The Independent Fiduciary Exception in the Rule is intended to address this concern and to permit advisers to engage in arm's length transactions with qualified counterparties. However, this exception, while helpful, contains restrictions and conditions that make its use overly complicated and too narrow for its intended purpose. For example, to comply with the exception advisers will often have to engage in a burdensome process involving: identifying clients by type and size; creating and reviewing legal representations; communicating to clients the need for the exchange of representations; creating a system to identify changes in client status and to track notices from clients of such changes; evaluating clients' capabilities and level of understanding with respect to representations and responsibilities; and addressing situations where clients are unwilling to provide necessary information. Moreover, in some cases, even after engaging in this protracted process, advisers may not even be able to engage in direct conversations with plan fiduciaries without fear of losing the exception. The process is cumbersome and unnecessary, particularly given the retail-facing goals of the Rule.[16]

**1. The Department Should Streamline and Broaden the Independent Fiduciary Exception.**

To streamline this process, the IAA recommends that the Department modify the Independent Fiduciary Exception to take a disclosure-based approach. The Exception should allow advisers to provide appropriate notice to prospective clients that the sales process is separate and distinct from the fiduciary relationship that is about to be entered into by the parties and that the adviser is not intending to provide impartial investment advice before entering into a services arrangement with the plan or IRA. This approach is consistent with the "seller's carve out" concept for which the Department has previously expressed support.

In addition, this revised Exception should be available for all interactions with a person representing or acting on behalf of an ERISA plan or an IRA, other than a plan participant or IRA holder acting as such. We also suggest that the Department consider permitting an IRA holder who meets the requirements of a "qualified purchaser" under section 2(a)(51) of the Investment Company Act of 1940 to act as a representative fiduciary with respect to its own IRA. This revised Exception would better target the rule to avoid much of the marketplace disruption identified as a concern in the Presidential Memorandum, and still serve the Department's goals of protecting retirement assets and promoting access to investment advice.

[16] The IAA notes that under the Rule as it is set to become applicable on June 9, 2017, the institutional investment adviser community (entities that are already fiduciaries) must engage in this substantial logistical effort in preparation for the June 9 applicability date, while other securities professionals who take the position that any services they provide are non-fiduciary, and who routinely deal with retail investors are permitted to wait until January 2018 to comply with their most challenging aspects of the Rule and ultimately may never be required to comply.

### 2. The Department Should Confirm that the Exception Applies to Model Portfolios.

One important point of clarification that the Department should include with respect to the Independent Fiduciary Exception is that the Exception applies to both static and dynamic model portfolios that are often provided by an adviser to a person acting on behalf of a plan or IRA ("sponsor").[17] Such sponsors – typically acting as fiduciaries themselves – often receive models from other financial institutions and use them in a variety of ways, typically without any further input from the model provider, who generally is not part of and has no visibility into the ultimate client relationship. The Department should confirm that the model provider is not regarded as a fiduciary where its client is the sponsor, it has no privity with the sponsor's end client, it does not knowingly design the model for a specifically identified end client, and it has no control over whether its model is applied to a specific sponsor's client, which may include an ERISA plan, plan fiduciary, plan participant or beneficiary, IRA or IRA owner.

## C. The Fiduciary Rule Should Clearly Except Intra-Company Communications.

The Department should also ensure that the Fiduciary Rule clearly excepts communications between persons acting on behalf of a single company or a group of affiliates. As currently drafted, the Fiduciary Rule unintentionally captures these situations if one of the parties to the communication is a fiduciary – even where that person may not be acting as a fiduciary for a specific client at the time of the communication. The Department partially addressed this issue in its FAQs regarding the Rule issued on January 13, 2017.[18] However, the guidance does not specifically address communications between employees of affiliated companies (as distinct from employees of the same company). These internal communications should not give rise to fiduciary status. Financial firms are often structured to include separate but affiliated business organizations for regulatory and business reasons. There is no policy purpose to be served by differential treatment of internal communications based on a financial firm's organizational structure.

## III. The Streamlined Best Interest Contract Exemption Should Be Broadened.

If – despite our comments above – the Department determines that the amended definition of fiduciary advice applies to pre-contract or sales conversations, the Department should make broadly available a streamlined exemption for such conversations for all investment advisers that will be fiduciaries once the client hires them. Virtually all investment advisers

---

[17] The IAA has requested the Department provide FAQ guidance on this point; it has not done so to date.

[18] *See* Conflict of Interest FAQs (Part II – Rule), FAQs 2 and 3 (January 2017), available at https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-2.pdf.

engaging in discretionary investment advice relationships with clients charge asset-based fees or fees that are not otherwise based on particular transactions.[19]

The BIC Exemption clearly contemplates a retail broker-dealer business model and is intended to address serial transactional relationships, and not the traditional advisory or discretionary relationship between an adviser and its clients. The BIC's focus on addressing potential conflicts in the sale of products through contractual warranties, policies and procedures aimed at transaction-related compensation and transaction-based disclosure requirements, among other requirements, make this clear. As a result, the BIC is ill-fitted to an on-going fiduciary relationship between an adviser and its client.

Instead, fiduciary investment advisers must be able to use the Streamlined BIC for their pre-contract discussions. The Streamlined BIC, however, is currently drafted and interpreted too narrowly to be workable for advisers that act as fiduciaries under arrangements that the Department itself has recognized are meaningfully protective of investors and has endorsed for decades.[20] For example, as currently drafted, the Streamlined BIC does not clearly apply to arrangements where the adviser may be relying on exemptions other than the full BIC Exemption once the adviser is hired (*e.g.*, PTE 77-4 or ERISA section 408(b)(8)) or where the adviser otherwise employs a conflict mitigation strategy that involves fee waivers, offsets, or rebates as approved by the Department in DOL Advisory Opinion 97-15A (May 22, 1997) or consistent with ERISA Technical Release No. 86-1 (May 22, 1986) (permitting soft dollar arrangements under Section 28(e) of the Securities Exchange Act of 1934). There is no rational policy reason for the Department to permit these conflict mitigation strategies as consistent with fiduciary duty *during* the adviser-client relationship but not recognize their validity for the purpose of pre-contract conversations *prior* to that relationship – particularly where the only "compensation" at issue is the compensation the adviser will receive *after* it is hired by the client.

The IAA recommends that the Department adopt a formulation of Streamlined BIC applicability that permits investment advisers and their affiliates to comply with commonly utilized strategies to mitigate fiduciary conflicts, such as fee offsets or waivers, rebates to clients, or exemption strategies that the Department has recognized as effectively supporting fiduciary relationships. Indeed, Streamlined BIC simply should be available to all SEC registered, fee

---

[19] *See* 2016 Evolution Revolution, A Profile of the Investment Adviser Profession, available at https://www.investmentadviser.org/eweb/Dynamicpage.aspx?webcode=evrev, which finds that 91.4% of total assets managed by SEC-registered investment advisers are managed on a discretionary basis and that 95.2% of investment advisers charge asset-based fees. Only 4.5% charge commissions and those firms generally are dually registered as broker-dealers.

[20] The Streamlined BIC is available if "the only fee or compensation received by the Financial Institution, Adviser and any Affiliate in connection with the advisory or investment management services is a 'Level Fee.'" Best Interest Contract Exemption, 81 Fed. Reg. at 21,011. "Level Fee" is defined as "a fee or compensation that is provided on the basis of a fixed percentage of the value of the assets or a set fee that does not vary with the particular investment recommended, rather than a commission or other transaction-based fee." *Id.* at 21,084.

based investment advisers, acting as such, who will establish an on-going fiduciary relationship once the client hires them.

We ask that in considering changes to the full BIC Exemption, including perhaps eliminating or restructuring the contract requirement, the Department take care to avoid unintentionally harming investment advisers who intend to operate in compliance with the Streamlined BIC Exemption. Specifically, the IAA would strongly object if a unified BIC Exemption resulted in *additional* conditions being placed on those firms that intend to use the Streamlined BIC. Any revisions to the BIC Exemption must *improve* Streamlined BIC, not make it more like the full BIC Exemption, which is inapt for investment advisers.

**Conclusion**

We appreciate the opportunity to provide our views, and would appreciate the opportunity to meet with the Department to discuss our comments. In the meantime, please do not hesitate to contact me if we may provide additional information or clarification regarding these matters.

Respectfully submitted,

-s- Karen L. Barr

Karen L. Barr
President and Chief Executive Officer

cc: Timothy Hauser, Deputy Assistant Secretary for Program Operations, EBSA
Joe Canary, Director, Office of Regulations and Interpretations, EBSA