



VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS  
AND INDEPENDENT FINANCIAL ADVISORS

**VIA ELECTRONIC MAIL (e-ORI@dol.gov, e-OED@dol.gov)**

July 21, 2015

Employee Benefits Security Administration  
Office of Regulations and Interpretations  
Office of Exemption Determinations  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, DC 20210

**Re:** Regulatory Definition of the Term “Fiduciary” as it Relates to Investment Advice; Conflict of Interest Proposal (RIN 1210-AB32); Proposed Best Interest Contract Exemption; Proposed Class Exemption for Principal Transactions in Certain Debt Securities Between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs; Proposed Amendment to Prohibited Transaction Exemption (PTE) 75-1, Part V, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks; Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 86-128 for Securities Transactions Involving Employee Benefit Plans and Broker-Dealers; Proposed Amendment to and Proposed Partial Revocation of PTE 75-1, Exemptions From Prohibitions Respecting Certain Classes of Transactions Involving Employee Benefit Plans and Certain Broker-Dealers, Reporting Dealers and Banks; Proposed Amendments to Class Exemptions 75-1, 77-4, 80-83 and 83-1; Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters (RIN 1210-ZA25)

To Whom It May Concern:

On April 20, 2015, the Department of Labor (Department) published its notice of proposed rulemaking regarding the definition of the term “fiduciary” of an employee benefit plan<sup>1</sup> and related proposed prohibited transaction exemptions<sup>2</sup> (Proposal). The Department proposes to revise the definition of “fiduciary” investment advice provided to a plan subject to the Employee Retirement Income Security Act of 1974 (ERISA) or its participants or beneficiaries.

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<sup>1</sup> Definition of the Term “Fiduciary,” 80 Fed. Reg. 21,928 (Apr. 20, 2015).

<sup>2</sup> Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21,960 (Apr. 20, 2015); Proposed Class Exemption for Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs, 80 Fed. Reg. 21,989 (Apr. 20, 2015); Proposed Amendment to Prohibited Transaction Exemption (PTE) 75-1, Part V, 80 Fed. Reg. 22,004 (Apr. 20, 2015); Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24, 80 Fed. Reg. 22,010 (Apr. 20, 2015); Proposed Amendments to and Proposed Partial Revocation of PTEs 86-128 and 75-1, 80 Fed. Reg. 22,021 (Apr. 20, 2015); Proposed Amendments to Class Exemptions 75-1, 77-4, 80-83 and 83-1, 80 Fed. Reg. 22,035 (Apr. 20, 2015).

The Proposal also applies to the definition of a “fiduciary” of a plan or Individual Retirement Account (IRA) under section 4975 of the Internal Revenue Code of 1986 (Code).

Under the Proposal, an individual who provides investment advice or recommendations to an employee benefit plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner would be treated as a fiduciary in a wider array of advice relationships than under current requirements. This expansive definition will mean that more independent financial advisors will be subject to ERISA fiduciary standards and liabilities.

The Financial Services Institute<sup>3</sup> (FSI) appreciates the opportunity to comment on this important proposal. We support a carefully-crafted, uniform fiduciary standard of care that would be applicable to all professionals providing personalized investment advice to retail clients. However, the current Proposal is based on flawed assumptions and creates a new regulatory regime that is too complex, too cumbersome, and far too costly to manage. We are concerned that the Proposal will make it significantly harder for consumers to receive high-quality, personalized retirement advice. We are especially concerned that advice for clients with small account balances will become cost-prohibitive if the proposal goes forward as written, thus decreasing investor access to retirement advice from a trusted advisor.

While we cannot support the Proposal as currently written, our goal is to constructively engage with the Department, and help ensure that the Proposal does not detrimentally impact access to retirement advice. We are committed to developing an alternate approach that reflects the investor protection goals that guide the Department in this effort, and guides our industry and the various federal and state regulatory entities that supervise our industry, as a result, our comments address various concerns with the Proposal, and offer alternatives that will serve to further protect investors by expanding upon the already robust broker-dealer regulatory regime.

#### Background on FSI Members

The independent financial services community has been an important and active part of the lives of American investors for more than 40 years. In the U.S., there are approximately 167,000 independent financial advisors, which account for approximately 64.5% percent of all producing registered representatives. These financial advisors are self-employed independent contractors, rather than employees of Independent Broker-Dealers.

FSI member firms provide business support to financial advisors in addition to supervising their business practices and arranging for the execution and clearing of customer transactions. Independent financial advisors are small-business owners who typically have strong ties to their communities and know their clients personally. These financial advisors provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations and retirement plans with financial education, planning, implementation, and investment monitoring. Due to their unique business model, FSI member firms and their affiliated financial advisors are especially well positioned to provide middle-class

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<sup>3</sup> The Financial Services Institute (FSI) is an advocacy association comprised of members from the independent financial services industry, and is the only organization advocating solely on behalf of independent financial advisors and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has been working to create a healthier regulatory environment for these members so they can provide affordable, objective financial advice to hard-working Main Street Americans.

Americans with the financial advice, products, and services necessary to achieve their investment goals.

## I. Executive Summary of FSI's Comments

FSI stands ready and willing to work with the Department and others toward achieving the goal of enhancing investor protection while ensuring access by all to affordable retirement advice, products, and services. FSI offers the following executive summary of the comments and issues raised in this comment letter:

- Public Policy Context and Adverse Impacts of Department's Proposal
  - *FSI Supports a Uniform Fiduciary Standard:* Since 2009, FSI has supported a uniform fiduciary standard of care applicable to all professionals providing personalized investment advice to retail clients. Consistent with the Department's intent, this standard of care would require financial advisors to act in the best interest of their clients.
  - *Barrier to Uniform Fiduciary Standard:* The Proposal would be a barrier to a uniform fiduciary standard of care that could apply to all investment advice professionals for all retail accounts.
  - *Adds Regulatory Complexity:* The Proposal will add complexity to an already complicated regulatory environment for broker-dealers, investment advisers, financial advisors, and investors. It overlays the existing regime with an intricate regulatory framework that will raise new barriers to the availability of professional investment services for millions of Americans.
  - *Exponential Increase in Number of Standards:* The Proposal would require investors to transition from understanding two standards of care to understanding six different standards of care.
  - *Reduces Access:* The Proposal would reduce access to retirement advice and services for low and middle-income investors by favoring passive investment "robo-advice" over professional and personalized investment guidance. The Proposal would also establish road blocks that prevent or deter financial advisors from offering their services to small businesses seeking to create retirement accounts for their employees.
  - *U.K. RDR:* The United Kingdom's experience with Retail Distribution Review foreshadows the negative impact that the Proposal will have on small accounts in the U.S.
- Carve-Outs from the Definition of Fiduciary Investment Advice Need Expansion
  - *Counterparty Carve-Out:* The Counterparty Carve-out should be expanded to cover advice paid for through plan assets, and should cover plans of any size. All plan fiduciaries are required to have or obtain the type of financial expertise that the Department uses to justify the "large-plan" carve out.

- *Education Carve-Out:* The Education Carve-out must preserve investor access to meaningful investment education. The Proposal's changes precluding identification of specific investment alternatives will deny investors access to helpful information that greatly benefits their investing experience.
- *Platform Carve-Outs:* The Platform Provider/Selection and Monitoring Assistance Carve-outs should be expanded to cover IRA platforms. IRA owners are fully capable of understanding that a provider's standardized IRA platform is not individualized to the needs of the IRA owner.
- The Department's Regulatory Impact Analysis is Incomplete
  - *Speculative Data:* The Department's Regulatory Impact Analysis contains data that is speculative, difficult to measure and far afield of solid empirical data gathered by independent experts.
  - *Unaccounted Costs:* The analysis fails to take into account the costs to retirement savers who would not be in the system without access to financial advice and are well served by advisors who work with them on a commission basis.
  - *Underestimates Compliance Costs:* The compliance costs outlined in the analysis are significantly understated. Based on FSI research, the costs will be several multiples higher than the Department's estimates.
- Best Interest Contract Exemption (BICE) Requires Significant Changes to Ensure Investors Have Access to Personalized Retirement Advice
  - *Written Contract Requirement:* The BICE written contract requirement is inconsistent with customary practices in the financial services industry and reasonable investor expectations. FSI encourages the Department to reconsider the BICE pre-advice, pre-transaction contract requirement.
  - *Private Right of Action:* The creation of a new private right of action appears to be beyond the scope of the Department's delegated authority. The BICE private right of action displaces SEC and FINRA authority over industry enforcement and investor disputes.
  - *Definition of Asset:* The BICE definition of "Asset" hinders best interest advice by impeding diversification in retirement accounts and exposing investors to greater risk. FSI proposes a broader definition of "Asset" to ensure financial advisors can recommend the best investments for a client's specific needs.
  - *IRA Rollovers:* The unclear application of the many BICE requirements to IRA rollover advice creates uncertainty that will jeopardize retirement savings. FSI urges the Department to clearly state that rollover advice is eligible for protection under BICE, requiring advisors to meet a best interest standard.

- *Levelized Compensation*: The BICE restrictions on compensation are duplicative and do not serve investor interests. Levelized fee arrangements would make access to financial advice cost-prohibitive for small investors.
- *Compliance Costs*: The BICE exposes financial institutions to a myriad of compliance costs and added liability risks that render the exemption unusable in its current form.
- *Operational Difficulties*: The BICE disclosure requirements will require access to third-party information and massive overhauls of administrative systems thereby increasing costs substantially.
- *Grandfathering Provision*: The BICE grandfathering provision is ineffective and should be expanded to account for customary client maintenance procedures.
- The Proposal's Prohibited Transaction Class Exemption for Debt Securities Transactions Effected on a Principal Basis is Inadequate
  - *Riskless Principal Trades*: Riskless principal trades are the functional equivalent of agency transactions and should be excluded from the PTE.
  - *Operational Difficulties*: The separate contract requirements, confirmation mark-up disclosure requirements and pricing requirements are all costly and very challenging to implement.
  - *Investor Confusion*: The multiple disclosures will not provide sufficient context and education to be useful for investors.
- The Proposal's Prohibited Transaction Class Exemption 84-24 Will Reduce Access
  - *Restricts Access*: The amendments to PTE 84-24 will require many firms to discontinue relationships that have traditionally relied on the protections of PTE 84-24, thereby reducing access to professional advice.
  - *Lack of Clarity*: Uncertainty regarding the definition of "insurance commission" clouds the compliance landscape and exposes the industry to liability risks many financial advisors will be unwilling or unable to assume.
- Proposal Requires Longer Implementation Period
  - *Applicability Date*: Our members will need, at minimum, 36 months to put the Proposal into place, assuming that the Department eliminates many of the BICE disclosures, adopts a conventional grandfathering rule, and that many of the existing prohibited transaction class exemptions are preserved in current form. If the Department does not make these changes to BICE, our members require additional time to achieve compliance.

- FSI Proposes a Workable Alternative Standard
  - *Uniform Fiduciary Standard:* We support a fiduciary standard of care that can be adopted uniformly across all types of investment accounts and can apply to all investment professionals.
  - *Compensation Governance:* We support requiring policies and procedures reasonably designed to manage material conflicts of interest.
  - *Robust Disclosures:* We suggest a comprehensive two-tiered disclosure regime, supplemented by a point-of-sale disclosure and an annual disclosure.
  - *Interagency Coordination:* The alternative should be produced through coordination between the Department, SEC, FINRA and state securities regulators.

We look forward to working collaboratively with the Department during this regulatory process to refine the Proposal's conditions and requirements and ensure access to retirement advice, products, and services for all investors. Now more than ever, individual investors need to have confidence in the reliability of the investment advice they receive.

## **II. History of FSI Support of a Uniform Fiduciary Standard**

Since 2009, FSI has publicly supported a carefully-crafted, uniform fiduciary standard of care applicable to all professionals providing personalized investment advice to retail clients.<sup>4</sup> This standard of care would require financial advisors to act in the best interest of their clients, consistent with the Department's intent. While broker-dealers are already subject to a robust regulatory and enforcement regime designed to protect investors, we recognize that the differing standards of care between broker-dealers and registered investment advisers may lead to unnecessary client confusion. As such, FSI supports the creation of a uniform fiduciary standard of care that would be applicable to all financial advisors and all asset classes. FSI is uniquely situated to provide input on such a standard because our members are dually-registered firms that provide both brokerage and advisory services to middle class Americans.

Part XI of this comment letter outlines the specific contours of our suggested uniform fiduciary standard for professionals providing personalized investment advice to retail clients. The standard of care we support is designed to address the same investor protection goals motivating the Department, but goes a step further by making this the standard for advice for all financial advisors regarding all investment products, not just tax deferred retirement savings. Therefore, we encourage the Department to work with the Securities and Exchange Commission (SEC) and the Financial Industry Regulatory Authority (FINRA) on developing this standard jointly and in a unified manner.

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<sup>4</sup> See, e.g., Letter from David T. Bellaire, Executive Vice President & General Counsel, Financial Services Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (Jul. 5, 2013) (commenting on Duties of Brokers, Dealers, and Investment Advisors, Release No. 34-69013; IA-3558; File No. 4-606), available at <https://www.sec.gov/comments/4-606/4606-3138.pdf>.

Furthermore, our suggested approach is designed to reflect the Congressional intent expressed in section 913 of the Dodd-Frank Act.<sup>5</sup> Section 913 granted the SEC the authority to evaluate the effectiveness of existing standards of care and promulgate a uniform standard of care for broker-dealers and investment advisers.<sup>6</sup> The SEC was specifically charged with evaluating how the current standards of care affect the ability of financial advisors to provide personalized investment advice about securities to retail customers, and identify any places for improvement in these standards.<sup>7</sup> Congress expressly stated that any such uniform standard should be reflective of the varied business models and regulatory regimes imposed on each of these entities.<sup>8</sup> Our members strongly believe that any rulemaking by the Department prior to SEC rulemaking would contradict Congressional intent and lead to inconsistent standards, creating unnecessary compliance burdens for advisors and increasing costs for investors.

### III. Understanding the Public Policy Context of the Department's Proposal

- A. Regulation under ERISA has always recognized the role of broker-dealers and sought to fit them into the regulatory structure.

Independent broker-dealers and independent financial advisors have offered comprehensive financial planning services and objective, affordable investment advice to millions of individuals, families and businesses large and small for decades.

As explained in detail in our February 3, 2011 letter to the Department on the October 2010 proposal to amend the rule defining a fiduciary under ERISA,<sup>9</sup> since 1974, the Department has made a consistent and considered effort to fit the activities of independent broker-dealers into the regulatory structure of ERISA. For retirement plans, these activities primarily relate to: (i) sales of packaged products such as mutual funds and variable annuities, and (ii) the provision of investment advisory or management services, either as Registered Investment Advisers (RIAs) or as solicitors.<sup>10</sup> Broker-dealers may also assist ERISA plans and IRAs with transactions in individual securities, and with their selection of retirement platforms and other investment-related services. Furthermore, they often provide a number of services ancillary to these principal activities – for example cash management sweep services, or settlement accommodations in the event purchase and sale transactions do not clear on the same schedule. However, because independent broker-dealers are most fundamentally commission-based securities firms compensated on a commission basis, regulatory solutions have been necessary for broker-dealers to continue to provide their essential services to ERISA plans and IRAs. The regulatory structure carefully constructed by the Department over the last 41 years makes provision for the many instances in which financial services firms limit their activities to non-fiduciary services (e.g., the exemptions in PTE 75-1 for

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<sup>5</sup> Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), Pub. L. 111-203, 124 Stat. 1376 (2010).

<sup>6</sup> See Dodd-Frank Act § 913(b), (g).

<sup>7</sup> See Dodd-Frank Act § 913(c).

<sup>8</sup> See Dodd-Frank Act § 913(f) (requiring consideration in rulemaking of findings, conclusions, and recommendations of the study required by Dodd-Frank Act § 913(b)); see also Letter from Congressman Barney Frank, U.S. House of Representatives, to Mary L. Shapiro, Chairman, U.S. Securities and Exchange Commission (May 31, 2011), available at <http://www.thinkadvisor.com/advisorone/files/ckeditor/Barney%20Frank%20Letter.pdf>.

<sup>9</sup> Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 88 Stat. 829, as amended.

<sup>10</sup> See Letter from Dale E. Brown, President and Chief Executive Officer, Financial Services Institute, to Employee Benefits Security Administration at 8-9 (Feb. 3, 2011) (commenting on the Department's 2010 proposed definition of the term "fiduciary"), available at <http://www.dol.gov/ebsa/pdf/1210-AB32-172.pdf>.

principal and agency transactions) and the more limited instances in which financial services firms take on the function of investment advice fiduciary (e.g., PTE 84-24 and PTE 86-128).

The Department has devoted significant resources to building a regulatory structure that makes it possible for broker-dealers to continue to provide their services to plans and their participants. The investment services provided by broker-dealers are in many cases exclusively provided by these entities, as a matter of federal and state law, and integral to the purposes of ERISA plans. The requirements of this regulatory structure turn in many instances on whether the broker-dealer is acting as an investment advice fiduciary for the plan. As such, a distinction between non-fiduciary and fiduciary activity has been, and still is sensible both in the marketplace and at law.<sup>11</sup> Whatever its perceived faults, the current five-part test for investment advice fiduciaries<sup>12</sup> provides a means for plans and broker-dealers to arrange their relationship, as fiduciary or non-fiduciary, with substantial confidence.

The Proposal would sweep aside four decades of carefully developed regulation that, by the Department's own assessment, has worked well. As the Department observes at several points in the Proposal, retail retirement investors generally have been well served by retirement advisors.<sup>13</sup> Our members work hard on behalf of their clients to see that is so. In instances where retail retirement investors have been aggrieved, they have effective recourse under existing law that is not limited to litigation under ERISA. For example, our research shows that during the five-year period of 2010 to 2014, there were at least 51 FINRA arbitrations relating to IRAs (and another 18 dealing with qualified plans)—attesting to both the high level of success of the existing regulatory structure and the availability of remedies in the limited cases when “bad actors” fail to properly serve retirement investors.<sup>14</sup> The problem the Department intends to solve through the Proposal thus remains unclear.

- B. The Proposal will add complexity to an already complicated regulatory environment for broker-dealers, investment advisers, financial advisors, and investors.

Independent broker-dealers and independent financial advisors are subject to comprehensive regulation and legal obligations under federal and state securities laws, rules, and regulations. The SEC regulates broker-dealers through its antifraud authority in the Securities Act of 1933 (Securities Act) and the Securities Exchange Act of 1934 (Exchange Act), and certain Exchange Act rules.<sup>15</sup> Under these rules, broker-dealers are required to deal fairly with their customers. Although broker-dealers are generally not subject to a fiduciary duty under the

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<sup>11</sup> See, e.g., *Farm King Supply, Inc. Integrated Profit Sharing Plan and Trust v. Edward D. Jones & Co.*, 884 F.2d 288, 291–94 (7th Cir. 1989); *Olson v. E.F. Hutton & Co.*, 957 F.2d 622, 626 (8th Cir. 1992); *Ellis v. Rycenga Homes, Inc.*, 484 F. Supp. 2d 694, 703–06 (W.D. Mich. 2007); *Blevins Screw Prods., Inc. v. Prudential Bach Sec., Inc.*, 835 F. Supp. 984, 985–87 (W.D. Mich. 1993).

<sup>12</sup> 29 C.F.R. § 2510.3-21(c).

<sup>13</sup> See, e.g., See Definition of the Term "Fiduciary," 80 Fed. Reg. 21,928, 21,935 (Apr. 20, 2015); DEPARTMENT OF LABOR, FIDUCIARY INVESTMENT ADVICE: REGULATORY IMPACT ANALYSIS at 4 (Apr. 14, 2015), available at <http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf>.

<sup>14</sup> See FINANCIAL SERVICES INSTITUTE & BRIGGS AND MORGAN, PA, THE EFFICACY OF SECURITIES ARBITRATION AND PROPOSALS FOR CHANGE, (April 2010), available at [https://www.financialservices.org/uploadedFiles/FSI\\_Content/Advocacy\\_Action\\_Center/Resources\\_and\\_Referece/White\\_Papers/fsi\\_white\\_paper\\_april2010\\_final.pdf](https://www.financialservices.org/uploadedFiles/FSI_Content/Advocacy_Action_Center/Resources_and_Referece/White_Papers/fsi_white_paper_april2010_final.pdf).

<sup>15</sup> U.S. SECURITIES AND EXCHANGE COMMISSION, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS at iii (Jan. 2011), available at <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>.



federal securities laws, courts have found broker-dealers to have a fiduciary duty in certain circumstances.<sup>16</sup>

As independent broker-dealers and financial advisors, our members are also subject to self-regulatory organization (SRO) rules, oversight, and frequent examinations.<sup>17</sup> A broker-dealer may transact business only after it satisfies the membership requirements of an SRO, which is typically the Financial Industry Regulatory Authority, Inc. (FINRA) for registered broker-dealers interacting with the public.<sup>18</sup> SRO rules require broker-dealers to commit to observe just and equitable principles of trade and high standards of commercial honor.<sup>19</sup> Contrary to the Department's assertions in the Proposal,<sup>20</sup> a broker-dealer's obligation to meet minimum business conduct requirements under SRO rules cannot be satisfied through disclosure, and cannot be waived by a customer.<sup>21</sup> In addition, broker-dealers are obligated to disclose certain material conflicts of interest to their customers, and federal securities laws and FINRA rules strictly prohibit broker-dealers from participating in certain transactions that may present acute potential conflicts of interest.<sup>22</sup> Both the SEC and FINRA diligently pursue compliance through timely examination and vigorous enforcements.<sup>23</sup>

The Department now seeks to overlay this regime with a complex regulatory framework that will raise new regulatory barriers to the availability of professional investment services for millions of Americans. The Proposal would require investors to transition from understanding two standards of care to understanding six iterations, some of which will apply only to assets invested through qualified retirement plans and IRAs. Even prior to the Department's Proposal, a 2008 RAND study found that the roles of broker-dealers and investment advisers are confusing to most investors due to this regulatory system.<sup>24</sup> The chart below contrasts the distinct regulatory regime currently applicable to broker-dealers with the complexity of the regulatory scheme proposed by the Department:

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<sup>16</sup> See, e.g., *Lowen v. Tower Asset Mgmt., Inc.*, 829 F.2d 1209 (2d Cir. 1987) (holding broker-dealer was fiduciary due to role as plan investment manager).

<sup>17</sup> See U.S. SECURITIES AND EXCHANGE COMMISSION, GUIDE TO BROKER-DEALER REGISTRATION (Apr. 2008) <http://www.sec.gov/divisions/marketreg/bdguide.htm>; U.S. Securities and Exchange Commission, Study on Investment Advisers and Broker-Dealers (Jan. 2011), available at <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

<sup>18</sup> U.S. SECURITIES AND EXCHANGE COMMISSION, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS 14 (Jan. 2011), available at <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

<sup>19</sup> See U.S. SECURITIES AND EXCHANGE COMMISSION, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS at iii (Jan. 2011), available at <https://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

<sup>20</sup> See Definition of the Term "Fiduciary," 80 Fed. Reg. 21,928, 21,941 (Apr. 20, 2015).

<sup>21</sup> See Securities Exchange Act of 1934 [Exchange Act] § 29.

<sup>22</sup> See, e.g. FINRA Rule 5121(a), (f)(5).

<sup>23</sup> In fiscal year 2014, the SEC reported a record 755 enforcement actions (up from 686 in 2013), with orders totaling \$4.16 billion in disgorgement and penalties. U.S. Securities and Exchange Commission, *SEC's FY 2014 Enforcement Actions Span Securities Industry and Include First-Ever Cases* (Oct. 16, 2014), <http://www.sec.gov/News/PressRelease/Detail/PressRelease/1370543184660>.

<sup>24</sup> See ANGELA A. HUNG ET AL., RAND INSTITUTE FOR SOCIAL JUSTICE, INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS 112-13, 117-18 (2008).

<b>Before the Department's Reproposal</b>			
	RIA	Broker/Dealer	
Retirement and Non-Retirement Assets: Duty of Care	'40 Act <sup>25</sup> fiduciary (avoidance/ disclosure of potential conflicts) <sup>26</sup>	Just and Equitable (J&E) Principles/ Suitability	<b>2 Iterations of Standard of Care</b>
<b>After the Department's Reproposal</b>			
	RIA	Broker/Dealer	
Non-Retirement Assets: Duty of Care  Retirement Assets: Duty of Care (Financial Advisor is "conflicted")	'40 Act fiduciary (avoidance/ disclosure of potential conflicts)  '40 Act fiduciary (avoidance/ disclosure of potential conflicts) +	J & E/Suitability  J & E/Suitability + ERISA fiduciary (prudence, care loyalty – for ERISA plans) +	<b>6 Iterations of Standard of Care</b>
<b>After the Department's Reproposal</b>			
	RIA	Broker/Dealer	
	ERISA fiduciary (prudence, care, loyalty – for ERISA plans) + BICE Requirements (Best Interest standard – for small ERISA plans and IRAs)	BICE Requirements  (Best Interest standard – for small ERISA plans and IRAs)	
Retirement Assets: Duty of Care (Financial Advisor is "unconflicted")	'40 Act fiduciary + ERISA fiduciary (prudence, care, loyalty - for ERISA plans)	J & E/Suitability + ERISA fiduciary (prudence, care, loyalty - for ERISA plans)	

In addition to adding to the complexity of the current regulatory environment, the Proposal is further troubling due to its ambiguity. The new Best Interest standard in the BICE is one such example. The exemption first introduces the Best Interest standard with the following language in the BICE section II(c)(1):

When providing investment advice to the Retirement Investor regarding the Asset, the Adviser and Financial Institution will provide investment advice that is in the Best Interest of the Retirement Investor (i.e., advice that reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based

<sup>25</sup> Investment Company Act of 1940 (1940 Act).

<sup>26</sup> While the current RIA compliance regime mandates the avoidance and disclosure of conflicts, FSI members understand that disclosure alone may be insufficient for addressing potential conflicts of interest. Furthermore, ERISA's fiduciary duty provisions apply to discretionary retirement plan accounts or when an RIA serves as an ERISA investment advice fiduciary pursuant to an agreement.

on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, *without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party*).<sup>27</sup>

This formulation, which appears to have been drafted specifically for the Proposal, has caused considerable confusion, to which the preambles for the revised definition and the exemptions have contributed. For example, the BICE preamble variously states:

- “The best interest standard set forth in this exemption is based on longstanding concepts derived from ERISA and the law of trusts.”<sup>28</sup>
- “The best interest standard is defined to effectively mirror the ERISA section 404 duties of prudence and loyalty, as applied in the context of fiduciary investment advice.”<sup>29</sup>
- “Under this standard, the Adviser and Financial Institution must *put the interests of the Retirement Investor ahead of the financial interests of the Adviser, Financial Institution or their Affiliates, Related Entities or any other party*.”<sup>30</sup>

It is thus unclear whether the Best Interest standard is identical to section 404(a)(1)(A) and (B) of ERISA, or instead is “based on” but varies from the statutory standard in some unspecified respect. It is also unclear whether the Best Interest standard permits the retirement advisor to have a conflicted interest so long as it is subordinated to the retirement investor’s interest, which section 404(a) and the preamble language would permit, or disallows any such interest.

C. The Proposal is a barrier to a uniform fiduciary standard of care.

The creation of a competing and distinctly different fiduciary duty for retirement and non-retirement accounts will serve only to exacerbate the existing lack of consistency in our regulatory system. Instead of increasing investor protection, the Proposal will foster investor confusion about professional standards. As recently noted by FINRA’s Chairman and Chief Executive Officer, an effective regulatory environment would apply a consistent best interest standard across, at least, all securities investments, and have the examination and enforcement mechanisms to oversee compliance with the standard.<sup>31</sup>

As previously stated, FSI has long supported a uniform standard of care applicable to all professionals providing personalized investment advice to retail clients. Uniformity is an important goal, as it will remove ambiguity by ensuring that investors receive the same protections no matter whom they choose as their financial advisor. In pursuit of that standard, FSI has provided comments to the SEC in response to the study mandated under the Dodd-Frank Act and a request for information regarding the standard of care of broker-dealers and investment advisers.<sup>32</sup>

<sup>27</sup> Proposed Best Interest Contract Exception, 80 Fed. Reg. 21,960, 21,984 (Apr. 20, 2015) (emphasis added).

<sup>28</sup> Proposed Best Interest Contract Exception, 80 Fed. Reg. 21,960, 21,970 (Apr. 20, 2015).

<sup>29</sup> Proposed Best Interest Contract Exception, 80 Fed. Reg. 21,960, 21,970 (Apr. 20, 2015).

<sup>30</sup> Proposed Best Interest Contract Exception, 80 Fed. Reg. 21,960, 21,970 (Apr. 20, 2015) (emphasis added).

<sup>31</sup> Remarks by Richard G. Ketchum, Chairman and Chief Executive Officer, FINRA, May 27, 2015, Washington, D.C.

<sup>32</sup> See Letter from Dale E. Brown, President and Chief Executive Officer, Financial Services Institute, to Elizabeth M. Murphy, Secretary, U.S. Securities and Exchange Commission (Aug. 30, 2010), available at <http://www.sec.gov/comments/4-606/4606-2687.pdf>.

FSI's alternative approach to a uniform fiduciary standard represents a more feasible option for achieving the Department's goals. Given the concerns addressed above, as well as our more detailed concerns expressed throughout this comment letter, our members believe the Department should forgo the current Proposal and collaborate with the SEC and FINRA in a joint effort to craft a uniform fiduciary standard for all accounts that maintains the necessary flexibility. As part of this comment letter, FSI proposes an alternative uniform standard of care, complete with reasonable policies and procedures designed to manage material conflicts, a comprehensive two-tiered disclosure regime designed to inform investor decision making, point-of-sale and annual disclosure requirements, and a workable grandfathering provision.

The standard of care suggested by FSI in Part XI of this letter is designed to address the investor protection goals that have motivated the Department to release the Proposal. There are two key differences between this uniform fiduciary standard of care and the Department's proposal: (i) this uniform fiduciary standard of care would not create the same disruption to the current retirement savings marketplace, and (ii) it would give financial advisors and firms the necessary flexibility to offer clients choices regarding which investments and payment models are in their best interest.

- D. The Proposal will reduce access to retirement advice and services for low and middle-income investors.

The Department's Proposal fails to acknowledge the impact it will have on low and middle-income investors' access to financial advice. The Department relies on selective academic research and anecdotes to support its Proposal, despite the large body of quantitative research and evidence that demonstrate the essential and constructive role played by independent broker-dealer firms in this market.

While the Department places its faith in, and gives preference to, "passive management solutions" such as "robo-advisers,"<sup>33</sup> this approach ignores the importance of a holistic investment approach to saving for retirement and other important needs,<sup>34</sup> particularly for low-income savers. Financial advisors help clients with their total financial picture. Retirement is just one aspect of that picture. Although technology firms can create tools and services to automate asset allocation or portfolio rebalancing at a modest price point, they cannot provide individualized advice with respect to the life events of their clients and tailored financial planning services designed to bring employers and participants into the retirement system and keep them there. For example:

- Our Financial advisors emphasize the importance of commencing and retaining retirement savings, encouraging employers to adopt plans and individuals to participate in those plans and/or IRAs. For example, independent broker dealers, their affiliated investment

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<sup>33</sup> See, e.g., Ben Steverman & Margaret Collins, *The Robots are Coming. To Put You in an Index Fund*, BLOOMBERGBUSINESS.COM (Jun. 25, 2015), <http://bloom.bg/1NfanGM>; Mark Schoeff, Jr., *DOL Secretary Perez Touts Wealthfront as Paragon of Low-Cost Fiduciary Advice*, INVESTMENTNEWS.COM (Jun. 19, 2015), <http://www.investmentnews.com/article/20150619/FREE/150619892/dol-secretary-perez-touts-wealthfront-as-paragon-of-low-cost>.

<sup>34</sup> These needs include organizing personal finances, setting financial goals, life and disability contingent planning, and estate planning.

adviser firms and their financial advisors have been instrumental in promoting retirement savings to segments of our population underrepresented in the retirement system.

- Financial advisors help clients weather market volatility, where inexperienced retail investors often make impulsive and ill-informed decisions like buying securities at market highs and selling at market lows.
- Financial advisors offer their skill and expertise to help clients navigate major financial pressures imposed by medical concerns, bankruptcy, deaths in the family, and caring for aging family members.
- Financial advisors assist clients in providing for other types of financial needs, such as life insurance, to provide security to clients' family members as well as lifetime income and longevity protection in retirement.
- Financial advisors protect investors from cashing out their retirement accounts for short-term needs and help prevent retirement asset "leakage".
- Finally, investors need professional financial advisors to assist them with decisions related to estate and tax planning and making their assets last through their retirement.

The Department's Proposal would give preference to on-line, algorithm-based allocation and rebalancing tools which would encourage the displacement of one-on-one, holistic investment advice delivered by a trusted professional. In practice, this would deny investors choices regarding who and how they want to receive and pay for financial advice and detrimentally impacting the amount saved in retirement plan solution.<sup>35</sup>

This is particularly problematic because research from a variety of sources has shown that investors who work with financial advisors save more and are better prepared for their retirement. The following is a small sampling of that research:

- According to a 2012 study by the Investment Funds Institute of Canada and a 2010 survey by the ING Retirement Research Institute, individuals who spent at least some time working with a financial advisor had saved, on average, more than twice the amount for retirement than those that had not worked with an advisor.<sup>36</sup>
- An April 2014 study by Quantria Strategies found that retirement savings balances are 33% higher for individuals who have access to financial advice; employees are less likely to take cash withdrawals out of their retirement savings if they discuss their distribution options with a financial advisor; and limiting access to this assistance could increase annual

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<sup>35</sup> We also note that retirement investors who chose to work with investment professionals tend to have larger retirement savings than those who do not. See, e.g., ING RETIREMENT RESEARCH INSTITUTE, WORKING WITH AN ADVISOR: IMPROVED RETIREMENT SAVINGS, FINANCIAL KNOWLEDGE AND RETIREMENT CONFIDENCE! 6 (2010), available at [http://voyacdn.com/file\\_repository/5151/help\\_wanted\\_wp.pdf](http://voyacdn.com/file_repository/5151/help_wanted_wp.pdf).

<sup>36</sup> JON COCKERLINE, THE INVESTMENT FUNDS INSTITUTE OF CANADA, NEW EVIDENCE ON THE VALUE OF FINANCIAL ADVICE (2012), available at <https://www.ific.ca/wp-content/uploads/2013/08/New-Evidence-on-the-Value-of-Financial-Advice-November-2012.pdf/1653/>; ING RETIREMENT RESEARCH INSTITUTE, WORKING WITH AN ADVISOR: IMPROVED RETIREMENT SAVINGS, FINANCIAL KNOWLEDGE AND RETIREMENT CONFIDENCE! 6 (2010), available at [http://voyacdn.com/file\\_repository/5151/help\\_wanted\\_wp.pdf](http://voyacdn.com/file_repository/5151/help_wanted_wp.pdf).

cash outs of retirement savings for employees leaving a job by \$20-32 billion, thus reducing the accumulated retirement savings of affected employees by 20-40%.<sup>37</sup>

- A study released earlier this month by Oliver Wyman found that investors working with a financial advisor had a minimum of 25% more assets than non-advised individuals, irrespective of age and income levels. The data was particularly notable with regards to a key demographic of retirement savers (individuals aged 35-54 with \$100,000 or less in annual income); the study found that those in that demographic who worked with a financial advisor had 38% more assets than those who did not work with a financial advisor.<sup>38</sup>
- A 2012 survey conducted by LIMRA found that investors working with a financial advisor are more likely to be saving for retirement at higher rates (defined as contributing more than 7% of their salary to a retirement plan) with 61% of investors who worked with an advisor saving at the higher rates compared to 36% of investors that were not working with a financial advisor.<sup>39</sup>
- A 2014 study by Prudential found that African-Americans with a financial advisor were significantly more likely to participate in employer sponsored retirement plans, have a savings account, life insurance, long-term care insurance, annuities, and mutual funds. That same study also found that African Americans who worked with a financial advisor were more financially confident than those who did not.<sup>40</sup>
- A 2013 Morningstar study found that by working with a financial advisor, a retiree can be expected to generate 22.6% more certainty-equivalent income.<sup>41</sup> This has the same impact on expected utility as an annual return increase of 1.59%, which represents a significant improvement in portfolio efficiency for a retiree.<sup>42</sup>

Moreover, by promoting on-line automated advice, the Proposal also presumes that all investors have equal access to online investment resources. Research shows that this is not the case. A 2013 Pew Research Center study shows that while 70% of Americans 18 and older have access to broadband at home, that number drops to only 64% among African-Americans and 53% among Latinos.<sup>43</sup> Similarly, urban and rural households have lower rates of internet access than

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<sup>37</sup> QUANTRIA STRATEGIES, ACCESS TO CALL CENTERS AND BROKER DEALERS AND THEIR EFFECTS ON RETIREMENT SAVINGS (Apr. 2014), available at [http://quantria.com/DistributionStudy\\_Quantria\\_4-1-14\\_final\\_pm.pdf](http://quantria.com/DistributionStudy_Quantria_4-1-14_final_pm.pdf).

<sup>38</sup> OLIVER WYMAN, THE ROLE OF FINANCIAL ADVISORS IN THE US RETIREMENT MARKET 6, 16 (Jul. 2015), available at <http://fsroundtable.org/wp-content/uploads/2015/07/The-role-of-financial-advisors-in-the-US-retirement-market-Oliver-Wyman.pdf>.

<sup>39</sup> See LIMRA, *Advisors Positively Influence Consumers' Behavior and Sentiment Toward Preparing for Retirement* (Jul. 11, 2012), [http://www.limra.com/Posts/PR/News\\_Releases/LIMRA\\_\\_Advisors\\_Positively\\_Influence\\_Consumers\\_\\_Behavior\\_and\\_Sentiment\\_Toward\\_Preparing\\_for\\_Retirement.aspx](http://www.limra.com/Posts/PR/News_Releases/LIMRA__Advisors_Positively_Influence_Consumers__Behavior_and_Sentiment_Toward_Preparing_for_Retirement.aspx).

<sup>40</sup> THE PRUDENTIAL INSURANCE COMPANY OF NORTH AMERICA, THE AFRICAN AMERICAN FINANCIAL EXPERIENCE (2014), available at <http://www.prudential.com/media/managed/aa/AAStudy.pdf>.

<sup>41</sup> Certainty-equivalent is defined as a guaranteed return that an investor would accept, rather than taking a chance on a higher, but uncertain, return.

<sup>42</sup> DAVID BLANCHETT & PAUL KAPLAN, MORNINGSTAR INVESTMENT MANAGEMENT, ALPHA, BETA, AND NOW . . . GAMMA 16 (Aug. 28, 2013), available at <http://corporate.morningstar.com/ib/documents/PublishedResearch/AlphaBetaandNowGamma.pdf>.

<sup>43</sup> Kathryn Zickur & Aaron Smith, *Home Broadband 2013*, PEW RESEARCH CENTER (Aug. 26, 2013), <http://www.pewinternet.org/2013/08/26/home-broadband-2013/>.

suburban households, and households earning \$50,000 or less are far less likely to have home broadband service than households earning more than \$75,000.<sup>44</sup> While we dispute the wisdom of turning smaller investors' retirement futures over to computer algorithms, it is clear that until broadband access is universally available in urban and rural areas, the Department cannot assume robo-advisers will appropriately serve these markets.<sup>45</sup> We recommend that the Department revisit its assumption that robo-advice is an optimal solution for the challenges investors face when planning for retirement, and not offer preferential treatment to their business model.

- E. The United Kingdom's experience with Retail Distribution Review foreshadows the negative impact that the Proposal will have on small advisors and accounts in the U.S.

The United Kingdom's (UK) Retail Distribution Review (RDR) proposal, issued in 2006, was structured in a manner similar to the Department's Proposal. Like the Department's Proposal, the RDR widened the category of investment products that were subject to a new, heightened standard of conduct, banned customary forms of commission sales, and implemented onerous new data collection, reporting, and notification standards.<sup>46</sup> According to the UK's Financial Conduct Authority (FCA), the RDR aimed to provide greater transparency in the retail investment market in order to help investors learn what kind of advice they are getting, how much it will cost and how it will be paid for, and have confidence that their advisor is well-qualified and acting in their best interests.<sup>47</sup> Unfortunately, the law's good intentions were quickly eclipsed by the detrimental impact it had on small independent financial advisors and investors with small account balances.

A study conducted by the Cass Business School at the City University of London just six months after the RDR's January 2013 effective date noted a 25% drop in the number of independent financial advisors (IFAs) in the UK during the run-up to the RDR's implementation.<sup>48</sup> In order to remain in business, financial advisors were forced to focus more on higher net-worth clients, thus leading smaller net-worth clients to receive lower-tiered services.<sup>49</sup> The study also found that small independent financial advisors were more likely to be negatively impacted by the reforms, and were increasingly likely to sell their practices to larger market participants.<sup>50</sup>

The reforms were equally damaging for investors with small account balances. As smaller firms and financial advisors found it increasingly difficult to serve clients with smaller portfolios, larger firms began to service those lower net-worth clients. However, those larger firms only offered access to a select number of investment advisors and offered little to no advice from a human independent financial advisor. The negative effect that RDR had on smaller investors could also be seen in the erosion of investment advice provided to smaller investors by the UK's four

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<sup>44</sup> *Id.*

<sup>45</sup> We understand that the Department's longstanding reluctance to endorse electronic communications from plan sponsors and administrators to participants is based on similar concerns. See Department of Labor Technical Release 2011-03, September 13, 2011.

<sup>46</sup> See Financial Conduct Authority, *Retail Distribution Review FAQs*, <http://www.fca.org.uk/firms/being-regulated/retail-investments/faqs> (last visited Jul. 17, 2015).

<sup>47</sup> See *id.*

<sup>48</sup> ANDREW CLARE ET. AL., CASS CONSULTING, *THE IMPACT OF THE RDR ON THE UK'S MARKET FOR FINANCIAL ADVICE* (City University of London 2013), available at [http://www.cass.city.ac.uk/\\_\\_data/assets/pdf\\_file/0016/202336/The-impact-of-RDR-Cass-version.pdf](http://www.cass.city.ac.uk/__data/assets/pdf_file/0016/202336/The-impact-of-RDR-Cass-version.pdf).

<sup>49</sup> *Id.*

<sup>50</sup> See *id.* at 7–11.

largest banks. These banks had large outreach efforts dedicated to investors of modest means. However, after the RDR process began, large banks found it too costly and burdensome to serve these smaller investors and largely stopped providing advice to smaller investors.<sup>51</sup> In essence, small financial advisors were effectively pushed out of the market, and low and moderate net-worth investors saw lower quality advising options as a result of the change to the law. Our members fear that the Department's Proposal will have similar effects if issued in its current form.

As part of its Regulatory Impact Analysis for the Proposal, the Department asserts that, unlike the UK's RDR, the Proposal does not ban payment of commissions, and therefore the potential for unintended negative consequences is far lower.<sup>52</sup> However, with the BICE's complexities (e.g., disclosure requirements), ambiguities (e.g., definition of reasonable compensation) and likely burdens (e.g., litigation risk), our members believe that offering retirement services via a commission-based broker-dealer business model will become practically impossible to maintain. These complexities will be more fully addressed in Section VI, below.

#### **IV. Definitional Carve-Outs**

##### **A. Introduction.**

Our members appreciate that the Department recognizes that, in many circumstances, plan fiduciaries may provide recommendations that may meet the definition of "fiduciary advice", but should not be treated as such due to the context in which the recommendation is provided.<sup>53</sup> According to the preamble for the proposed definition, the Proposal's carve-outs cover communications that the Department believes Congress did not intend to be considered fiduciary "investment advice," and that the parties would not ordinarily view as communications characterized by a relationship of trust or impartiality.<sup>54</sup>

However, the language of the proposed carve-outs excludes investment activities that should not be considered fiduciary in nature. As a result, we believe the Department has limited the usefulness of each of the carve-outs, and has done so to the detriment of retirement investors. We discuss these concerns more fully below.

##### **B. The Counterparty Carve-Out should be expanded to cover all advice, and should cover plans of any size.**

The Department states that the purpose of the Counterparty Carve-out is to "avoid imposing ERISA fiduciary obligations on sales pitches that are part of arm's length transactions where neither side assumes that the counterparty to the plan is acting as an impartial trusted adviser, but the seller is making representations about the value and benefits of proposed deals."<sup>55</sup> To some extent, the Department acknowledges that certain sales activities will include investment recommendations regarding products and services offered by a broker-dealer, and that financial advisors should not be viewed as fiduciaries under ERISA or Code section 4975(e)(3)(B) when they are clearly acting in a sales capacity.

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<sup>51</sup> See *id.* at 12–16.

<sup>52</sup> See DEPARTMENT OF LABOR, FIDUCIARY INVESTMENT ADVICE: REGULATORY IMPACT ANALYSIS at 37, 40–41, 47 (Apr. 14, 2015).

<sup>53</sup> See Definition of the Term "Fiduciary," 80 Fed. Reg. 21,928, 21,941 (Apr. 20, 2015).

<sup>54</sup> See *id.*

<sup>55</sup> *Id.*



However, our members were concerned to find that the Counterparty Carve-out under the Proposal is far more restrictive, and less useful, than the Department's 2010 "seller's exception." For example, the Department's decision to deny the carve-out to an advisor if the plan directly pays a fee for investment advice is both unjustified and unhelpful. This distinction, which did not appear in the 2010 proposal, suggests that the fiduciary nature of the recommendation changes depending on the source of the compensation. Many small employers with new plans often offset the cost of obtaining sound investment advice by spreading the initial costs of the advice among plan accounts. If the advice provided is not "fiduciary in nature", the nature of the advice should not change (and access to advice should not be denied) simply because the employer is not in a position to pay for the advice out-of-pocket. This distinction does a disservice to small plans and, to a similar extent, individual investors who choose to pay for professional advice with IRA assets. Distinguishing between advice that is purchased with plan or IRA assets and advice that is purchased otherwise does little to protect investors. The seller's carve-out should therefore apply to any advice, irrespective of the source of the compensation paid to the advisor.

Furthermore, unlike the 2010 seller's exception, the Counterparty Carve-out draws an unwarranted distinction between large and small plan fiduciaries. The carve-out is not applicable to advice provided to fiduciaries for plans with fewer than 100 participants and fiduciaries managing less than \$100 million in plan assets.<sup>56</sup> The preamble states that small plans are "much more similar to individual retail investors than to large financially sophisticated institutional investors."<sup>57</sup> The exclusion of small plans from the carve-out thus presumes that "large" plan fiduciaries exclusively possess the requisite competence and skill to understand when an advisor is acting in a selling capacity. There is no legitimate basis for this distinction. ERISA demands competence and prudence from plan fiduciaries, irrespective of plan size. The Proposal should not waiver on this requirement. Therefore, FSI strongly encourages the Department to consider extending the Counterparty Carve-out to plans with fewer than 100 participants.

Because all plan fiduciaries are already required to have or obtain the type of financial expertise that the Department uses to justify the large-plan carve-out,<sup>58</sup> it stands to reason that all plan fiduciaries, including those serving plans with less than 100 participants, should be covered. Therefore, FSI strongly encourages the Department to consider extending the Counterparty Carve-out to plans with fewer than 100 participants.

The Department has specifically requested public comment on whether existing and proposed prohibited transaction exemptions eliminate or mitigate the need for any Counterparty Carve-out.<sup>59</sup> Our members do not believe that this is the case. The proposed exemptions narrow, rather than broaden, the protections provided to customary marketing practices. They also significantly increase exposure to potential fiduciary liability for activities in which the seller may be simply discussing the value of an investment service or option, rather than offering investment advice. Because of the increased exposure to "inadvertent fiduciary" liability and the uncertainties inherent in many of the Department's proposed exemptions, an expanded seller's carve-out is absolutely necessary.

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<sup>56</sup> See *id.*

<sup>57</sup> See *id.* at 21,942 n.20.

<sup>58</sup> In addition, courts have held that ERISA requires plan fiduciaries to understand when they lack the expertise to satisfy ERISA's prudent expert standard, and to hire independent experts. See *Kastsaros v. Cody*, 744 F. 2d 270, 279 (2d Cir. 1984).

<sup>59</sup> Definition of the Term "Fiduciary," 80 Fed. Reg. 21,928, 21,942 (Apr. 20, 2015).

C. The Education Carve-Out must preserve investor access to meaningful investment education.

Investment education is at the very core of the services provided by our members. In order for investors to make educated decisions regarding their financial futures, it has always been imperative that they receive professional guidance. However, as defined-contribution plans have replaced traditional pensions and investors bear greater responsibility for funding their retirements, investor education has become even more important. Furthermore, as Americans live longer lives, they will require more savings to benefit from a dignified retirement. Therefore, it is critical that the Department provide investors with access to the proper tools and information to make informed decisions. Our members firmly believe that any regulation in the retirement savings sphere must not erect additional barriers for individuals to receive vital education regarding their investments and retirement savings.

While the Proposal strives for this goal, in practice it will have a detrimental impact on the availability of investment education. The Department has recognized that, under Interpretive Bulletin (IB) 96-1, advisors currently find it difficult to clearly illustrate longevity risks and the effects of “decumulation” on retirement savings. We appreciate the Department’s decision to take action on this issue and broaden the Education Carve-out include education regarding decumulation. This is a significant improvement from the 2010 proposal.

Despite this improvement, the Department would serve investors well by reconsidering the current structure of the Education Carve-out. The proposed carve-out would supersede IB 96-1, replace it with a carve-out in the revised fiduciary definition, and substantially modify its content in several respects. One of the most potentially detrimental changes would preclude the identification of specific investment alternatives available under the plan or IRA. This change will deny investors access to the type of helpful information regarding their investment options that they have come to expect. In addition, the proposed changes to IB 96-1 regarding asset allocation models will prove to be a disservice to investors. Financial advisors use asset allocation models and similar illustrations to demonstrate how plan participants and other retirement investors can diversify their portfolios to manage risk. To a great extent, investor comprehension is contingent upon being able to identify what funds or other investment options available to them align with a certain category of investment. By removing the financial advisors’ ability to provide the proper context in these educational materials, the Department will curtail the effectiveness of these important educational resources. Unfortunately, this will lead to confusion among investors and a decrease in the overall financial knowledge of individuals when making important decisions regarding their retirement investments.

Given the importance of allowing broker-dealers and investment advisers to provide investment education to clients without exposure to potential fiduciary liability, we encourage the Department to revise the Education Carve-out to allow financial advisors to specifically identify investments and distribution options available under a plan or IRA. “Education” is clearly not “advice.” Investment education does not constitute a “call to action” in the vein of a recommendation,<sup>60</sup> and there is little risk of confusion between the two among investors. In addition, the Education Carve-out should be revised to protect recommendations that relate to

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<sup>60</sup> FINRA Suitability Rule 2111.

previous investment products, and education regarding activities that reduce plan leakage, such as rollovers to IRAs.

- D. The Platform Provider/Selection and Monitoring Assistance Carve-Outs should be expanded to cover IRA platforms.

Consistent with the other carve-outs proposed by the Department, the Platform Provider and the Selection and Monitoring assistance Carve-outs (“Platform Carve-outs”) are “designed to draw an appropriate line between fiduciary and non-fiduciary communications, consistent with the text and purpose of the statutory provisions.”<sup>61</sup> The Platform Carve-outs allow service providers who might otherwise be treated as advice fiduciaries to offer investments to a participant-directed plan, its participants, or beneficiaries through a standardized platform. Providers will also be able to assist fiduciaries in selecting and monitoring investment alternatives made available to participants without triggering fiduciary status, provided the investments are not individualized to the needs of the plan.<sup>62</sup>

FSI’s members believe that the principles that the Department applies to demonstrate the need for a Platform Carve-out for plans apply equally to IRAs, and that platforms offered to IRAs (as well as related IRA platform services) should therefore be covered under the carve-out. The platform provider exceptions are intended to “recognize circumstances where the platform provider and the plan fiduciary clearly understand that the provider has financial or other relationships with the offered investments and is not purporting to provide impartial investment advice.”<sup>63</sup> Despite the fact that the premise for the carve-out applies equally in the IRA market, the Proposal does not extend the Platform Carve-outs to IRAs, under the theory that there is typically no separate independent plan fiduciary interacting with the provider to protect the interest of the account holders.<sup>64</sup> However, IRA owners are fully capable of understanding that a provider’s standardized IRA platform is not individualized to the needs of the IRA owner, and that the providers who offer such platforms are not, therefore, offering impartial investment advice. To the extent that the Department remains concerned, an IRA platform carve-out lends itself easily to a disclosure requirement in which an advisor clearly states that the platform is standardized and not intended to be personalized investment advice. FSI therefore supports a carve-out for providers marketing platforms to IRA owners if the revised definition is adopted substantially in its current form. However, we again stress the importance of a uniform standard that does not trigger the need for complex carve-outs, and strongly recommend the alternative standard proposed in Section IX as a superior alternative.

## V. Regulatory Impact Analysis

With current assets of approximately \$19.5 trillion, the U.S. private retirement system provides substantial equity and debt capitalization for the U.S. economy.<sup>65</sup> The overextension of ERISA fiduciary status has the potential to create significant disruption in the U.S. capital markets. Accordingly, the Department should seek to balance the strict requirements ERISA imposes on fiduciaries with the structure of national policies served by the U.S. financial markets as governed by their primary regulators. Regrettably, the Proposal does not take this approach. Instead, the

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<sup>61</sup> Definition of the Term “Fiduciary,” 80 Fed. Reg. 21,928, 21,929 (Apr. 20, 2015).

<sup>62</sup> *Id.* at 21,943.

<sup>63</sup> *Id.*

<sup>64</sup> *Id.* at 21,944.

<sup>65</sup> Investment Company Institute Fact book available at <https://www.ici.org/research/stats/factbook>.

Department simply relies on unsubstantiated academic and anecdotal evidence to conclude that the investment advice market for retirement plans is fundamentally flawed.

In an effort to better understand the potential impacts of the proposal on the independent financial services channel, we partnered with Oxford Economics<sup>66</sup> to assess the economic impact of complying with the Department's Proposal. Oxford Economics has conducted approximately a dozen interviews with FSI member firms and related parties, and has made use of survey results from 54 member firms in order to evaluate the Department's economic impact assessment. During the post-hearings comment period, we will be releasing a detailed report, but we will be sharing some early impressions of the study's findings in this section.

A. The Department's Regulatory Impact Analysis is dubious.

The flaws in the Department's Regulatory Impact Analysis are particularly alarming given the gravity of the Proposal and the inevitable impact it will have on the retirement system specifically, and financial markets generally.

The fee data cited in the academic studies that serve as the foundation for the Department's analysis are speculative, difficult to measure, and far afield of solid empirical data gathered by independent industry experts. This data was recently called into question by economists during a hearing regarding the Proposal before the United States House of Representatives Committee on Education and the Workforce.<sup>67</sup> The oral and written testimony of these economists effectively contradicts the studies on which the Department's Regulatory Impact Analysis relies, including the Department's assertions regarding the current harm caused to investors by potentially conflicted advice, and the need to take regulatory action in the absence of coordination with the SEC.<sup>68</sup> While the Department has clearly invested considerable time and resources into defending the need to revamp the fiduciary standard, the significance of the Proposal warrants a deeper, more nuanced perspective on investor costs and returns than the points cited in the Department's advocacy.

First, the Department's analysis fails to take into account the interests of retirement savers that would not be in the system without, or that are in the system and well served by, financial advisors who work on a commission basis. In 2015, the retirement plan market is largely one where plans are sold, not bought. As a result the Proposal should not establish road blocks that prevent or deter financial advisors from offering their services to small businesses. Unfortunately, the Department's effort to impose a new fiduciary duty standard on the act of selling a plan may actually retard the adoption of new employer-sponsored plans, and thus the opportunity for individual savings.

Second, the compliance costs outlined in the regulatory impact analysis are significantly understated. According to a recent survey we commissioned regarding the Proposal conducted by Oxford Economics, we believe that the costs for both large and small firms will be several multiples higher than what the Department estimated. While our full economic analysis of the costs related to complying with the Proposal is still being finalized, it is clear that the Department has

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<sup>66</sup> <http://www.oxfordeconomics.com/>.

<sup>67</sup> See, e.g., Oral Testimony of Brian Reid, Chief Economist, Investment Company Institute, Subcommittee on Health, Employment, Labor and Pensions, Committee on Education and the Workforce, United States House of Representatives, June 17, 2015, available at [http://edworkforce.house.gov/uploadedfiles/testimony\\_reid.pdf](http://edworkforce.house.gov/uploadedfiles/testimony_reid.pdf).

<sup>68</sup> *Id.*

overlooked certain complexities such as the need to create an enterprise-wide reporting and disclosure system, enhance data security requirements, increase compliance logistics, and the associated costs to third-party service providers. Many firms predict that only very large financial institutions will have the resources to bear these costs which will result in the demise of smaller firms, who will be acquired, merged with larger entities, or simply disappear.

The Oxford Economics study that will be submitted to the Department during the post-hearing supplemental period will cover the following concerns that the Department appears to not have adequately considered in its economic impact assessment:

- Increased pass-through costs for investors;<sup>69</sup>
- Elimination of choice for investors as firms reduce their catalog of investment options;
- Homogenization of investing strategies that will create greater risk for investors;
- The push into “robo-investing,” which will be particularly detrimental for inexperienced investors, who need greater hand holding from human investment advisors;
- Information overloads that will be faced by investors and inhibit their ability to properly comprehend their investment choices;
- Loss of access to commission based accounts and products that are more appropriate for some investors than fee-based accounts and products.

B. The compliance costs outlined in the analysis are significantly understated.

Through the analysis conducted by Oxford Economics, we are able to project that the costs related to the proposal’s implementation will be several multiples larger than the Department stated in its economic impact assessment. This is true for both broker-dealer and investment advisory firms. While the Department appears to believe that costs will be minimal for non-broker dealer investment advisory firms, the interviews conducted for this study do not bear out that conclusion. In part, this is because most of these firms expect that they too will have to fully implement the BICE requirements in order to be in compliance with the proposal.

Furthermore, the Department’s description of the adjustments necessary to firms’ current business practices is incomplete. The four categories of adjustments identified by the Department are: firm costs;<sup>70</sup> switching/training costs for broker-dealers transitioning to investment adviser status; errors & omissions insurance; and PTE/Exception Costs (Best Interest Contract Exemption).<sup>71</sup> However, they do not cover all of the direct implementation costs that firms will bear. Moreover, because the costs of distinct requirements of the new rules on firms are not broken out by the specific burdens faced by firms, this makes it impossible to perform cost-benefit analysis on specific elements of the regulation. Through their interviews, Oxford Economics found that substantial costs were apparently either excluded or underestimated by the Department. These include:

- Disclosure requirements (including the public-facing website requirement contained in the BICE);

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<sup>69</sup> 76% of respondents to FSI’s member firm survey indicated customer costs would increase.

<sup>70</sup> Firm costs are described as including the costs of “developing and maintaining a disclosure form and customer relationship guide,” and the cost “to develop and implement a new, comprehensive compliance and supervisory system and procedures and related training programs to adapt to the new uniform fiduciary standard.”

<sup>71</sup> Department of Labor, Fiduciary Investment Advice, Regulatory Impact Analysis, April 14, 2015, pg. 178.

- Record keeping costs (including the six-year retention requirement contained in the BICE);
- Implementation costs of Best Interest Contracts for both new and existing clients;
- Supervisory, compliance and legal oversight costs;
- System interface development costs related to the need to accept new data feeds required by the proposal;
- Training and licensing costs;
- Litigation costs (including potential class action lawsuits stemming from the BICE).<sup>72</sup>

C. The Proposal will have substantial deleterious effects on independent broker-dealer firms as small businesses.

In addition to the likely cost increases on retirement products and advice that retail investors will see, the research conducted by Oxford Economics also will show that the higher cost estimates discussed above will result in the regulatory burden falling disproportionately on smaller firms who cannot take advantage of scale. Small firms will also bear the proportionally higher pass-on costs from their clearing brokers.<sup>73</sup> Additionally, the Oxford Economics research will also show that the Department appears to have failed to account for various other unintended consequences to small businesses in the industry and the investors that they serve, including:

- Impact of revealing sensitive business information to competitors;
- Dramatic changes to the retirement fund industry's structure (i.e. consolidation);
- Impact of Offering fewer product choices and diversification strategies concentrates investors into fewer asset classes creating greater systemic risk that will disproportionately hurt smaller firms; and
- Ambiguity caused by undefined terms in the Proposal change and expected conflicts with the rules of other regulatory agencies and organizations will create significant uncertainty as to how the Proposal will be implemented and enforced.

## **VI. Proposed Best Interest Contract Exemption**

### **A. Introduction.**

The Department stated that the intent of the BICE is to preserve the ability for investment advice fiduciaries to receive variable compensation and compensation from third parties.<sup>74</sup> These compensation and fee arrangements are vital to ensuring that investors of modest means have access to critical financial advice. While FSI appreciates the Department's recognition that these compensation practices facilitate the provision of investment advice to retirement savers, the BICE as currently crafted will in fact have a detrimental impact on access to investment advice. The BICE poses various operational and administrative burdens, has limited applicability, and imposes liability risks and compliance costs that may be too great for many firms to bear.

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<sup>72</sup> During the interview process conducted by Oxford Economics, many FSI members stated that the anticipated substantial litigation risks would likely cause many critical aspects of the industry to be fundamentally reshaped.

<sup>73</sup> A clearing firm is a brokerage firm that handles the confirmation, settlement, and delivery of transactions, and maintains custody of securities and other assets.

<sup>74</sup> 80 Fed. Reg. 21960,21967.

B. The BICE should be expanded to cover a wider range of eligible investors and advice services.

As currently conceived, the BICE applies to the provision of advice to (i) a participant or beneficiary of a plan who is able to direct the investments of the plan account, (ii) the beneficial owner of an IRA, or (iii) a plan sponsor of a non-participant directed plan with fewer than 100 participants. FSI believes the Proposal should be expanded at a minimum to include plan-level advice for participant-directed plans. The Department asserts that it limited the universe of eligible investors under the BICE in light of the Counterparty Carve-out. However, FSI believes that the narrow provisions of the Counterparty Carve-out do not adequately ensure access to plan-level advice. FSI believes that they should be included in any exemption designed to preserve existing brokerage industry compensation practices.

In addition, the BICE currently does not provide protection for advice provided to participants and beneficiaries of Keogh plans that do not cover common-law employees. While these plans are not subject Title I of ERISA, the Department has held that investment services provided to Keogh plans are subject to the prohibited transaction provisions of Code section 4975. Unless Section (b)(1) of the exemption is amended to cover advice provided to all plans subject to the Code's prohibited transaction provisions, financial advisors will be prohibited from providing investment advice to participants in these plans.

C. The BICE definition of "Asset" hinders Best Interest advice.

The Department has limited the products available to retirement plan and IRA investors by excluding a variety of investments from the list of assets eligible for BICE treatment (Asset or Assets). The Department asserts that it has endeavored to ensure that investors are eligible to build "basic diversified" portfolios while ensuring that eligible assets feature an appropriate degree of transparency, liquidity, and marketability.<sup>75</sup> The Department does not detail its process for selecting the Assets that deserve protection under this important exemption, or why certain other assets were excluded from the BICE. Rather, the Department states that the investments excluded from the list can be obtained through pooled investment funds covered by the BICE. However, the exclusion of specific investments from the list is confusing in light of the BICE requirement to act in the best interest of the investor. It appears as if the Department has reached the conclusion that the excluded investments would never, under any circumstances, be in the best interest of any retirement investor. As described below, we determine this is an inappropriate conclusion.

The Department's limitations regarding the definition of covered Assets impede diversification in retirement accounts, and as a result expose investors to greater risk. Furthermore, the limitation will stifle capital formation as well as innovation and evolution in the investment product development market. Many investors, particularly high-net worth and sophisticated investors, want access to products such as non-traded real estate investment trusts (REITs) and Business Development Companies (BDC) to diversify risk exposure. For purposes of long-term investment, mass affluent clients often seek out alternative investments as part of their IRA investment strategy. FINRA suitability rules, as well as other securities laws, restrict investments in certain of these assets to institutional and high-net worth clients. Very recently, the SEC approved amendments to FINRA Rule 2310 and NASD Rule 2340 to modify the requirements relating to the

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<sup>75</sup> "Proposed Best Interest Contract Exemption," 80 Fed. Reg. 21960, 21,967 (April 20, 2015).

inclusion of per share estimated values for direct participation program (DPP) and non-traded REIT securities on customer account statements. These changes significantly improve the transparency of the per share estimated values of these securities on customer account statements by ensuring that investors receive more accurate information regarding the nature and worth of their holdings of DPP and REIT securities. In addition, these products are also subject to multiple layers of rigorous due diligence. As such, there is little risk that expanding the definition of Assets would result in more middle and lower income Americans being steered toward alternative investments for their IRAs.

Furthermore, we also find the Department's narrow definition of Assets and its use of that term throughout the proposal confusing when placed in context. In the broker-dealer context, the term "asset" is generally used to refer to classes of underlying investments, such as equities, fixed income, cash equivalents, commodities or real estate. However, as defined in the BICE, "Asset" is used as a synonym for investment product, and BICE uses the term "investment option" interchangeably with "Asset." The 13 items listed in the BICE definition of "Assets" should be considered investment products, not assets. The BICE definition of the term "Assets" therefore conflicts with the general understanding of "asset" in the financial services industry. With regard to the BICE requirement to offer "a broad array of Assets", the use of this term leaves our members unsure as to whether the Department intended to require a financial institution to provide a broad array of different types of investment products, or instead intended to refer to classes of their underlying investments, such as equities, fixed income, cash equivalents, commodities or real estate. We encourage the Department to clarify its intention as part of any final rule.

Irrespective of the Department's intent in defining the term "Assets," FSI believes that financial advisors are in the best position to understand their clients' unique retirement savings needs and recommend the best investments in the context of those specific needs. But the BICE would limit a financial advisor's ability to make recommendations that reflect the goals, risks and unique circumstances of a particular investor. Advisors will not be able to confidently say that they recommended the product that is in the best interest of the investor without an ability to recommend from a full range of investment options. FSI encourages the Department to reconsider its approach to limit the universe of eligible Assets. It is unclear why this limitation is necessary in light of the best interest obligations to which a financial advisor would be contractually bound. Instead, we encourage the Department to consider our alternative uniform standard proposed in Section XI which would eliminate the need for an overly restrictive Assets definition.

The decision to only include the listed products as eligible for BICE treatment is particularly troublesome given recent research and experience applying Modern Portfolio Theory<sup>76</sup> and endowment portfolio strategies<sup>77</sup> for individual investors. Academic research has demonstrated that risk-adjusted returns of a portfolio can be improved by diversification across assets with varied correlations.<sup>78</sup> Large college endowments, like those at Yale and Harvard, have distinguished themselves by generating above market-rate returns and lower volatility through diversified portfolio strategies that include illiquid direct investments in alternative investments

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<sup>76</sup> See, e.g., Harry Markowitz, *Portfolio Selection*, 7 J. Fin., Mar., 1952, at 77-91.

<sup>77</sup> See David F. Swenson, *Pioneering Portfolio Management* (Free Press, 1st ed. 2000).

<sup>78</sup> See, e.g., Franco Modigliani & Leah Modigliani, *Risk-Adjusted Performance*, 23 J. Portfolio Mgmt., Winter 1997, at 45-54.



including real estate, timber, oil and gas leases partnerships, and others.<sup>79</sup> Over the last 10 years, Yale had an average annual return of 11 percent net of fees, while domestic equities had an average annual return of 8.4 percent and domestic bonds an average of 4.9 percent.<sup>80</sup> The Department's assumption, that "limiting the exemption to those investments that are relatively transparent and liquid" will "ensure[] that the investments needed to build a basic diversified portfolio are available to plans"<sup>81</sup> is demonstrably false, and will deny investors many of the same strategies that large college endowments have successfully utilized.

Endowment portfolio models for individual investors seek to replicate similar asset allocation strategies as large university endowments. Although operating on a shorter time horizon, current retirees and investors nearing retirement must meet on-going cash needs while managing overall portfolio risk to overcome extreme and unpredictable market events. Wide diversification and disciplined utilization of alternative investments is an important characteristic of large university endowment success, and an important strategic element for individual investors utilizing endowment portfolio strategies. Alternative investments, such as non-traded REITs, and other publicly-registered securities that allow investors to access markets that provide steady inflation-adjusted income that is non-correlated to disruptions in the equity markets. Long-term investors seeking the benefits of inflation-adjusted income streams during volatile market events are in fact well-served by the relative illiquidity of these products. Alternative investments allow investors to enjoy the benefits of inflation hedging and protection from volatility in the broader equity markets. In addition, many of these investments allow investors to capture the additional return paid to compensate them for the illiquidity risk of these long-term assets, often referred to as the "illiquidity premium."<sup>82</sup> Many direct illiquid alternative investments allow investors to make long-term commitments that will generate higher-yielding income compared to other liquid investment options. Retirees especially benefit by securing higher earnings to cover the loss of income when they are no longer working.

Financial advisors have successfully assisted clients in utilizing endowment portfolio models for their IRAs. Like endowments, retirement accounts seek to generate income to cover immediate and ongoing liabilities while managing overall risk. Of significant importance is diversifying retirement portfolios to overcome extreme volatility and so-called "Black Swan" events. Recent scholarly work has raised serious concerns increasing correlation of domestic equity and domestic bonds. This work points to a variety of causes for this trend, including aggressive central bank policies.<sup>83</sup> Restricting the list of available investment options under the BICE would lead to a homogenization of investment strategies and a loss of portfolio diversification, increasing the risk to which retirement investors would be subject to. The BICE would forbid financial advisors from

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<sup>79</sup> See, e.g., Yale Endowment Annual Report 12–13 (2014); Harvard Management Company Annual Endowment Report 5-6 (2014).

<sup>80</sup> Yale Endowment Annual Report 20 (2014).

<sup>81</sup> Proposed Best Interest Contract Exemption, 80 Fed. Reg. at 21,967.

<sup>82</sup> See Renato Staub, *Modeling Illiquidity Premiums for Alternative Investments*, CFA Institute, June 2010, at 40, available at <http://www.cfapubs.org/doi/pdf/10.2469/cp.v27.n2.3> ("Alternative investments generally require investors to commit funds for a specified lockup period. Illiquidity premiums provide compensation for the associated loss of investment flexibility. A modified version of the Sharpe ratio along with the length of the lockup period and the riskiness of the asset help in determining the amount of the premium.").

<sup>83</sup> See PIMCO Quantitative Research Report, *The Stock-Bond Correlation 8* (Nov. 2013) available at [https://media.pimco.com/Documents/PIMCO\\_Quantitative\\_Research\\_Stock\\_Bond\\_Correlation\\_Oct2013.pdf](https://media.pimco.com/Documents/PIMCO_Quantitative_Research_Stock_Bond_Correlation_Oct2013.pdf) ("Over the last 15 years, many investors have been able to ignore inflation risk and have taken for granted the very negative correlation between stocks and Treasuries. In the next decade, particularly in light of aggressive and expansive central bank monetary policy, the importance of the inflation risk factor may indeed resurface. If so, many of the correlation dynamics that investors have become accustomed to may be less relevant.").

working with their clients to build portfolios that allocate to liquid and illiquid alternatives that can meet the intermediate and long-term inflation-adjusted spending needs of retirement.

While the BICE does allow investors to access alternative investments through Investment Company shares, these offerings alone are insufficient for investors implementing endowment style model portfolios. Investors cannot capture the illiquidity premium, as publicly traded securities convert quickly into cash without any price discount. Non-traded products also address the vulnerabilities and correlation problems of publicly traded securities, and are less subject to the emotions that drive public markets and individual investors. By forbidding these investment options under the BICE, the proposal will negatively affect retirement investors who would otherwise be able to enlist the help of a financial advisor to build an endowment model portfolio.

FSI suggest that the DOL alter the definition of “Assets” under the BICE to include securities that are registered with the SEC. The SEC registration process allows investors and financial professionals to receive and analyze financial and other significant information on these investments. The registration process protects investors by allowing the SEC’s Division of Corporate Finance to examine registration statements to determine whether the investment has adequately complied with disclosure requirements. The SEC enforces its rules by bringing enforcement actions against investments or companies that have made misrepresentations or committed fraud. The registration process also provides investors with important recovery rights if they can prove that there were incomplete or inaccurate disclosures of important information.

D. BICE uncertainty regarding IRA rollover advice jeopardizes retirement savings.

The Proposal treats recommendations regarding IRA rollovers and distributions as fiduciary advice. However, the BICE does not clearly afford protection for such recommendations, because the BICE, as currently drafted, is limited to the purchase, sale or holding of an investment. As such, it is unclear whether firms will be able to continue to provide this fundamental service. IRA rollovers have recently received additional focus from FINRA in Regulatory Notice 13-45.<sup>84</sup> This additional focus reflects the significance of a recommendation to undertake a rollover into an IRA. Following the publication of Regulatory Notice 13-45, broker-dealers have undertaken the task of ensuring that firms’ policies and procedures regarding rollovers are in line with FINRA’s expectations.

FSI urges the Department to clearly state that rollovers are eligible for protection under the BICE and describe how this protection interacts with Regulatory Notice 13-45. Specifically, the final BICE should state that exemptive relief is available for the receipt of compensation received in connection with rollover advice, provided that financial advisors (i) act in their clients’ best interest, and (ii) ensure that conflicts of interest do not impair their judgment. Absent such an explicit statement, regarding the treatment of rollovers under the BICE, retirement savers will lack access to important advice when deciding whether to rollover plan assets. To the extent that the Department does not include such language in the final BICE, we encourage the Department to give serious consideration to the alternative uniform standard proposed by FSI in Section XI, which would cover rollover advice.

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<sup>84</sup> Rollovers to Individual Retirement Accounts, FINRA Regulatory Notice 13-45 (December 30, 2013), available at <https://www.finra.org/sites/default/files/NoticeDocument/p418695.pdf>.

- E. The BICE written contract requirements are inconsistent with customary practices in the broker-dealer industry and investor expectations.

To the extent that a broker-dealer chooses to enter into a written contract with a client, FINRA rules only require the inclusion of “pre-dispute” arbitration clauses,<sup>85</sup> otherwise, the content and timing of the contract is left to the discretion of the broker-dealer. It is customary for broker-dealers to request that clients execute a written agreement only at such time as they effect a transaction.

As proposed, the BICE would require that a client execute a contract with a broker-dealer and financial advisor prior to the provision of any investment advice. Due to the Proposal’s expansion of the definition of investment advice, the contract would be presented to a potential client at the very beginning of the engagement process, potentially during introductory greetings. This is inconsistent with customary practices in the broker-dealer industry. Basic notions of diligence dictate that an investor will not, and should not, sign a contract with a financial advisor he or she does not know. Financial Advisors spend time with potential clients to ensure that the investor understands the variety of investing options. An investor develops an appropriate level of comfort with the financial advisor and then has time to digest all of the information prior to making a hiring determination. A contract between that financial advisor and the investor should only be operative in the event that the customer actually effects a transaction. FSI therefore encourages the Department to reconsider the BICE requirement and develop an exemption that reflects the personal nature of these relationships better than a rigid contract executed prior to execution of any transaction.

Consider, for example, the operational challenges of requiring a contract in the call center setting. The investor typically has no individual relationship with a particular call center representative; most often, calls from investors are randomly assigned to the next available representative. It makes no sense that (i) each time she calls, the investor must enter into a new contract that includes the call center representative taking that call, and (ii) the call center must operate a reliable mechanism for execution and delivery of that contract while the call is pending, but prior to any substantive discussion between the investor and the representative. To take another example, there is a growing practice of multiple financial advisors operating as an “ensemble” practice, with each advisor providing focused expertise in a particular type of investment or aspect of investment or financial planning. Investors are finding these practices very beneficial, both for the specialized expertise provided in investments and for the continuity of service and succession planning among the financial advisors. It is a needless complication, operationally, to require that each financial advisor must execute the contract, or that the contract must be re-executed each time an advisor joins or leaves the ensemble practice.

To the extent that the written contract requirement is made part of the final exemption, the exemption should allow for negative consent to the BICE contract. In the absence of a negative consent provision, it will be extremely difficult for broker-dealers and investment advisers to obtain new signatures for all of their long-standing and existing clients, exposing firms to considerable liability risk, particularly given Department’s anticipated eight-month timeline for implementing the final rule. Furthermore, a negative consent provision is necessary in special circumstances, for example with clients who decline to respond to a request to enter into a new contract even after a firm employs its best efforts. Finally, we propose an alternative approach

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<sup>85</sup> See FINRA Rule 12200.

that would address the Department's concerns regarding the advisor-client relationship without the necessity of a pre-transaction contract.

F. BICE restrictions on compensation are duplicative, and do not serve investor interests.

The preamble to the BICE suggests that the exemption is intended to be a business-model neutral approach to differential compensation that seeks to preserve existing compensation practices.<sup>86</sup> However, despite these statements, the Department appears to be expressing a preference for a level-fee structure, free of any potential conflicts created by bonuses or other incentive compensation.<sup>87</sup> The Department's apparent preference for this structure ignores the fact that level-fee structures and anti-conflict compensation requirements already apply to many broker-dealers, and that including these structures under the BICE will do little to protect investors or increase savings.

The BICE requires broker-dealers and investment advisers to warrant that their policies and procedures do not authorize compensation or incentive systems that would "tend to encourage individual advisors to make recommendations that are not in the Best Interest of Retirement Investors."<sup>88</sup> In the preamble, the Department states that a "level-fee" structure in which compensation for financial advisors would not vary based on the particular investment product recommended would comply with this requirement.<sup>89</sup> In addition, the contractual warranties also prohibit the use of quotas, appraisals, bonuses, awards, differential compensation or incentives.<sup>90</sup>

The SEC began encouraging, but not requiring, broker-dealers to use compensation schedules that levelize compensation between proprietary and non-proprietary products more than 20 years ago. These SEC rules do not suggest that all fees should be levelized to the extent required by the BICE.<sup>91</sup> While we agree that levelized fee structures may be appropriate for some accounts, they are certainly not appropriate as a standard practice for all accounts. Studies have shown that level-fee accounts generally result in higher fees over time than commission-based accounts, particularly for investors who do not engage in frequent transactions.<sup>92</sup> Furthermore, the Department's preference for level fees is based on the flawed assumption that levelized compensation at the broker-dealer level will result in a lower amount of investment-related costs to investors. In fact, broker-dealer compensation is typically paid by or negotiated with the issuer of the investment product, not the investor.

The Department's bias in favor of levelized fee arrangements would adversely impact investors' ability to obtain retirement security. With an increasing number of individuals dependent upon making their savings last throughout their retirement years, the importance of

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<sup>86</sup> Proposed Best Interest Contract Exemption, 80 Fed. Reg. at 21,971.

<sup>87</sup> *Id.* ("one way for a Financial Institution to comply [with the Best Interest standard] is to adopt a 'level-fee' structure")

<sup>88</sup> *Id.*

<sup>89</sup> *Id.*

<sup>90</sup> *Id.* at 21,984.

<sup>91</sup> See Report of the Committee on Compensation Practices (1995), available at <https://www.sec.gov/news/studies/bkrcomp.txt> (the "Tully Report").

<sup>92</sup> See Bullard, Friesen, and Sapp, *Investor Timing and Fund Distribution Channels*, 2008, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1070545](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1070545).

lifetime income protection and guarantees through annuities and similar products should not be overlooked, and it is important that the Department's proposal not reduce their availability. Unfortunately, rather than encouraging the use of such protections and guarantees, the BICE would constrict their availability by substantially constraining the ability of a financial advisor to receive commissions for the offering of such solutions inside ERISA plans and IRAs.

With regard to non-cash compensation, the BICE compensation standards overlap with certain standards already applicable to broker-dealers, and conflict with others. The requirements do little to offer increased investor protections, but add significant confusion to the current regulatory landscape. Existing broker-dealer rules generally do not impose standards on compensation for brokers except for certain public securities offerings which impose restrictions on brokers' receipt of non-cash compensation.<sup>93</sup> These restrictions generally require any non-cash incentive arrangements to use total production and equal weighting concepts, which are intended to limit the impact of non-cash sales incentives at the point-of-sale. Furthermore, while existing FINRA rules do not prohibit cash incentives or bonuses, FINRA has identified this practice as a potential conflict of interest.<sup>94</sup>

As noted in recent comments by Richard Ketchum, FINRA Chairman and Chief Financial Officer, the Proposal bears no relation to existing broker-dealer in models in this regard. These overlapping standards will foster confusion in the marketplace, but may also encourage firms to exclude transactions in Retirement Investor accounts from incentive or bonus programs offered to its brokers in order to comply with the warranty. Doing so, however, could run afoul of total production requirements imposed by FINRA rules for non-cash incentive compensation, creating yet another unforeseen conflict between FINRA regulation and the Department's Proposal. We noted for the Department's consideration that adopting the alternative standard proposed in Section XI would eliminate the potential for regulatory conflict.

G. The BICE exposes broker-dealers to a myriad of liability risks and compliance costs that render the exemption unusable in its current form.

1. The BICE should not be premised on broad-based acknowledgement of fiduciary status.

As financial intermediaries, broker-dealers are not generally fiduciaries. The functional nature of the ERISA fiduciary definition means that a broker-dealer should not be a fiduciary at all times and in all respects simply by virtue of seeking the protection of the BICE for the receipt of compensation. An evergreen acknowledgement of fiduciary status should not, therefore, be a requirement for the exemption.

In addition, the BICE may have implications under the Investment Adviser's Act of 1940 ("40 Act") for investment advisers that enter into BICE agreements acknowledging fiduciary status. In accordance with the '40 Act, anyone in the business of providing investment advice for compensation is treated as a fiduciary, and is required to register as an investment adviser.<sup>95</sup> However, the '40 Act specifically excludes brokers from its registration requirement, to the extent that the broker provides advice that is solely incidental to the sale of securities, and receives no

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<sup>93</sup> See FINRA Rule 2320(g) and NASD Rule 2830(l).

<sup>94</sup> See, e.g., FINRA Report on Conflicts of Interest, October 2013 available at <https://www.finra.org/file/conflict-interest-report>.

<sup>95</sup> See, e.g. Form ADV Part 2, available at <https://www.sec.gov/about/forms/formadv-part2.pdf>.

special compensation.<sup>96</sup> As the exemption is currently drafted, the BICE would require even advisors who provide incidental advice to declare fiduciary status, which will therefore trigger fiduciary status and a registration obligation, under the '40 Act. This would be true even in instances where the investor did not seek, and does not desire to pay for, ongoing fiduciary investment advice.

## 2. BICE principles should clearly define “reasonable compensation.”

The impartial conduct standards under the BICE require that broker-dealers agree that they will not recommend an Asset if the total amount of compensation anticipated to be received in connection with the purchase, sale, or holding of the Asset will exceed reasonable compensation in relation to the total services the broker provides to the investor.<sup>97</sup> The ambiguity surrounding this “reasonable compensation” requirement triggers significant liability exposure for broker-dealers. In the absence of clear guidance regarding permissible compensation structures, broker-dealers will be subject to allowing state courts to decide, in hindsight, whether their fees were indeed ‘reasonable’. This exposure alone renders the BICE effectively unworkable in its current form.

The Proposal does not offer any factors that brokers might use to determine reasonable or excessive compensation, and it does not elaborate on the meaning of “total services” in this context. Moreover, we know of no source for obtaining reliable, objective information regarding standard broker fees or compensation. This places broker-dealers in the untenable position of being subject to a standard that is impossible to meet accurately and consistently. In addition, the text of the BICE compensation standard offers no true recognition of individual circumstances, and does not account for the many factors that may cause fees to vary from broker-dealer to broker-dealer and from financial advisor to financial advisor.

Compensation deemed to be unreasonable for purposes of the BICE standards could be considered reasonable and appropriate under existing broker-dealer regulations. Federal securities laws, FINRA rules, and certain state securities rules impose “fair and reasonable” standards or explicit limits on broker-dealer compensation.<sup>98</sup> Although the Department seeks comments on standards for determining reasonable compensation in the context of existing law, the BICE exemption does not guarantee any harmonization of those rules with the Department’s final standard.

For these reasons, the BICE reasonable compensation requirement should be clearly defined or eliminated in its entirety until the Department can offer an objective, consistent standard by which broker-dealers, investors, and ultimately, courts can evaluate a financial advisor’s compensation.

In addition, we request the Department confirm its intention to apply a consistent definition of “reasonable compensation” under the Proposal. At various instances throughout the Proposal, the Department appears to apply dissimilar or inconsistent definitions of this term. For instance:

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<sup>96</sup> See 17 C.F.R. § 275.202(a)(11)-1.

<sup>97</sup> Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21,960, 21,984.

<sup>98</sup> Investment Adviser’s Act §211(g)(11).

- With regard to the Impartial Conduct Standards, the preamble to the BICE states: “The obligation to pay no more than reasonable compensation to service providers is long recognized under ERISA. See ERISA section 408(b)(2), 29 CFR 2550.408b-2(a)(3), and 29 CFR 255.408c-2. The reasonableness of the fees depends on the particular facts and circumstances.”
- With regard to the conditions for offering a limited range of investment products under the BICE, the preamble states: “...the proposal provides that the payments received in connection with these limited menus be reasonable in relation to the value of specific services....This is more specific than the reasonable compensation requirement set forth under [the BICE Impartial Conduct Standards]...”
- In connection with the annuity exemption, the preamble states: “...the combined total of all fees and compensation received by the insurance company is not in excess of reasonable compensation under the circumstances...”. No further guidance is provided.
- With regard to the general conditions under PTE 84-24, the exemption states: “The combined total of all fees, Insurance Commissions, Mutual Fund Commissions, and other consideration received by the insurance agent or broker...is not in excess of ‘reasonable compensation’ within the contemplation of ERISA section 408(b)(2) and [Internal Revenue] Code section 4975(d)(2) and 4975(d)(10).”

Based on discussions during the notice and comment period, we understand that the Department intends to apply existing guidance regarding the interpretation of “reasonable compensation” for all purposes under the Proposal. We request that the Department confirm this approach in writing as part of any final guidance. However, to the extent that the Department intends to apply a higher standard to the definition of “reasonable compensation” for purposes of the requirement to offer a range of investment options, we request that the Department clearly identify a process for meeting this standard.

3. The BICE “broad range of investments” requirement is unclear and inconsistent with existing broker-dealer practices and rules.

The BICE currently requires a financial institution to offer a range of investment options that is broad enough to enable the financial advisor to make recommendations from all of the asset classes reasonably necessary to serve the investor’s Best Interest. This requirement is inconsistent with broker-dealer practices and potentially conflicts with FINRA rules.

A broker-dealer’s decisions regarding which investments to offer on its platform are driven by many factors and should not be subject to second-guessing or scrutiny by the Department simply because the investments may be offered to retirement plans or IRAs.

The BICE investment range requirement would place platform requirements on brokers that even SEC and FINRA have not seen necessary to implement. Under FINRA guidance, broker-dealers are permitted, but not required, to maintain a menu of investment options.<sup>99</sup> If a broker-dealer opts to provide a platform, neither SEC nor FINRA guidance set standards regarding composition of the platform. The broker may choose to limit product offerings to just one or two

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<sup>99</sup> See, e.g. FINRA Rule 2111.

available investments, or may choose to offer an array of products. In some instances, a broker-dealer's membership agreement with FINRA may limit the firm's ability to engage in transactions in certain types of securities. Brokers may also choose to voluntarily limit lines of business for reasons wholly independent of their client relationships, such as internal support, risk management or relationship with a product manufacturer. In addition, FINRA rules impose a due diligence obligation on broker-dealers with respect to all securities that they offer to customers. The review and analysis necessary to satisfy this obligation can be considerable, and as a result, many firms choose to limit their products offerings to those which they possess the relevant expertise. In many circumstances, the business model or client base of a given firm may be such that the firm does not see significant demand for a given product or service, and chose not offer it. In its current form, the BICE would appear to require firms to expand their product offerings without any real benefit to customers.

The "broad investment range" requirement has no real bearing on an investor's ability or a firm's willingness to offer appropriate investments that are in the Best Interest of the investor. As financial advisor who offers a broad range of investments may not offer investments that would align with a particular client's best interest; by contrast, a financial advisor with a deep understanding of her potential client base may offer only a few investment options that are keenly targeted to meet her clients' needs. An advisor's ability to seek relief under the BICE should not be denied simply because a financial advisor chooses to offer a limited range of investments.

Finally, we request that any final guidance address current ambiguities regarding pre-selected IRAs in light of BICE Section IV. The BICE requirement to offer a "broad range of investment products" is inconsistent with the nature of IRA products that are not "self-directed", i.e., those that offer a preselected core group of investments or a specific investment. Furthermore, the supplemental requirements for products that offer a limited range of investment options do not contemplate the structure and business model applied to a pre-selected IRA product. In order for sales of these products to continue, we request that the Department provide additional guidance regarding the intended application of Section IV to these important products.

- H. The BICE Disclosure Requirements will require access to third-party information and massive overhauls of administrative systems.

FSI believes investors can make better choices when they are properly informed of considerations and factors relative to the advice and services being offered. In order to provide investors with the information they need, investors should receive concise, consolidated disclosure documents written in plain English. However, the Proposal creates a complex set of new disclosure requirements that may have the perverse effect of limiting the availability of affordable investment advice. The disclosures mandated by the BICE are voluminous, costly, and in certain respects in conflict with federal securities rules. Furthermore, it is unclear whether the proposed disclosures could be delivered in a manner and format that will allow investors to make better-informed decisions.

1. The Point-of-Sale and Annual Disclosure requirements are duplicative, and, in the format requested, may conflict with existing regulations.



The BICE requires that, before executing a new asset purchase, advisors must provide investors with an individualized disclosure estimating the total cost of the investment.<sup>100</sup> The Proposal also mandates an annual disclosure to each investor that lists: (i) each asset that the investor purchased or sold during the prior year and the corresponding transaction price; (ii) the total dollar amount of all fees and expenses paid with respect to each asset that the investor purchased, held, or sold during the year; and (iii) the total amount of all direct and indirect compensation that the advisor and firm received in relation to the purchase, retention, or sale of the investor's assets.<sup>101</sup>

These requirements duplicate disclosures that advisors already provide to investors, and they will increase financial advisors' ongoing compliance burdens significantly. To ensure that they capture all of the information required by the Department in the disclosures, financial advisors will be forced to retain accounting, financial, and programming experts to redesign their sales, transaction, accounting, reporting, and information technology systems. It will also require significant legal and consulting resources to ensure that the content, format, timing, and delivery of the disclosures comply with the BICE.

The point of sale disclosure, in particular, raises additional concerns. The BICE would require an advisor to furnish a chart to a Retirement Investor that shows, for each Asset recommended, the total projected cost for 1-, 5- and 10-year periods, expressed as a dollar amount, assuming an investment of the dollar amount recommended by the financial advisor and applying "reasonable assumptions" regarding investment performance.<sup>102</sup> While this information superficially resembles the information provided in the fee table included in prospectuses for mutual funds and variable annuities, the BICE disclosure differs in certain material respects:

- The BICE requires the information to be expressed in terms of the amount proposed to be invested, rather than the \$10,000 required by SEC requirements for mutual fund and variable annuity prospectuses.<sup>103</sup>
- Although SEC requirements mandate that costs be calculated based on a 5% return assumption, the BICE instead requires that the return assumption be "reasonable" and further provides no comfort that the 5% rate of return used as a proxy or safe harbor for a rate that would be considered to represent a "reasonable" assumption of investment performance.
- The BICE requires the advisor to make an assumption of "reasonable performance" in order to calculate the cost information, but making an assumption of future performance would violate SEC and FINRA rules prohibiting broker-dealers from using communications projecting future performance of an investment.<sup>104</sup>

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<sup>100</sup> Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960, 21985.

<sup>101</sup> 80 Fed Reg. 21960, 21985.

<sup>102</sup> *Id.* at 21,985.

<sup>103</sup> See Item 3 of Registration Statement Form N-1A (for mutual funds) and Item 3 of Registration Statement Form N-4 (for variable annuities), adopted by the SEC.

<sup>104</sup> The SEC does not permit future performance projections. See, e.g., 17 C.F.R. §§ 230.156, 230.482 (Rules 156 and 482). Disclosure of future fees (by projecting future performance) effectively conflicts with such rules. See also FINRA Rule 2210(d)(1)(F), which prohibits member firms from using communications that project performance of an investment.

- Even if SEC and FINRA rules did not prohibit such projections, broker-dealers and investment advisers do not have access to the tools and data necessary to create the cost projections. To the extent such projections exist, financial institutions would need to purchase this information from third-party services. In this regard, FSI members are uncertain whether there are any third party services currently available that could reliably provide the tools and data necessary. Moreover, firms may end up providing different cost disclosures on the same exact investment given different disclosure requirements thereby confusing investors.
- Since the “fee table” information is not required for most Assets available under the BICE, the existing SEC requirement is not transferable to the BICE requirement.

Thus, while the BICE appears to draw on an existing SEC disclosure requirement in the content of the point of sale disclosure, its efforts are ineffective in application. Even if broker-dealers and investment advisers had access to the tools necessary to project future costs, doing so based on proposed investment amounts would be enormously time-consuming and cost-prohibitive.

For the reasons cited above, FSI recommends that the Department reconsider the scope of the initial and annual disclosure requirements. If it does not eliminate these requirements, the Department should at a minimum reconsider the scope of the disclosures and ensure that they provide investors with useful information that is concise and that does not conflict with existing regulatory requirements. In Section XI of this letter, FSI offers for the Department’s consideration an alternative disclosure regime that our members believe strikes the appropriate balance between investor protection and the Department’s disclosure goals.

2. The scope, breadth, and complexity of the BICE web page disclosure requirement render it unmanageable.

The BICE requires massive and overly-burdensome internet disclosures. The exemption requires that each financial institution maintain a machine-readable public website that reports: (i) the direct and indirect compensation to the firm, each individual financial advisor, and each firm affiliate that was provided in connection with each asset that was purchased, held, or sold through or by the financial institution within the prior 365 days; (ii) the source of all of the compensation; and (iii) how the compensation varied within and among the classes of assets that were available to be purchased, held, or sold through or by the firm.

In the independent financial advisor model, advisors have access to a vast array of investment products that they offer to their clients. Each product has unique pricing structures, and several versions of each product are typically offered. For example, when one factors in the various share classes available, a single mutual fund family might offer more than 500 versions of their funds. In addition, multiple broker-dealer representatives may receive compensation for the sale of a particular product as a result of a team-based sales approach employed by the firm, or ensemble practices that require financial advisors to split compensation for the sale of a particular product or group of products. Therefore, compiling, presenting, and maintaining the required internet disclosure for each financial advisor affiliated with a financial institution—some of whom are affiliated with thousands of financial advisors—will be a monumental undertaking that will impose significant costs on advisors and firms. In addition, the scope, breadth, and complexity of such an undertaking will lead to inadvertent errors that could confuse investors or expose financial advisors and financial institutions to an unreasonable risk of litigation.

Moreover, it is questionable how useful this information would be to investors, especially given the enormous expense and effort that would be required to produce it. The Department should, therefore, eliminate this requirement from the BICE.

The Department's efforts to provide massive amounts of data to investors will likely oversaturate investors rather than induce greater transparency. Investors already receive more information than they can consume in any reasonable amount of time. However, very little of this information allows investors to make true, meaningful comparisons between investment products. We believe that investors would benefit from more simplified, standardized disclosures that allow them to make direct comparisons between investment products not only concerning price and fees, but on quality and features as well. The summary prospectus provided for mutual fund investments is an example of simplified disclosures that can be useful and can lead to greater transparency for investors. The Department's approach will only increase "information overload" by providing information that will be so complex, and so detailed, that even sophisticated investors will find it daunting rather than enlightening.

In addition, the website disclosures may be cost-prohibitive for small firms that would be required to develop a BICE compliant disclosure system. Large broker-dealer firms often have a significant level of control over the information sources needed to gather and process the information required by the web disclosure. By contrast, our members' experiences with the section 408(b)(2) disclosure have demonstrated that firms that clear on a fully disclosed basis will find it much more difficult to obtain all of the information necessary to comply with these disclosures. For purposes of section 408(b)(2) compliance, many independent broker-dealers have been forced to hire outside service providers to collect the necessary data, at costs of up to \$100 per account. Even assuming half that cost for a much more complex disclosure regime under BICE, small firms will once again spend millions of dollars attempting to locate and retain providers to assist with data collection. These website costs alone will be significant enough to cause certain small independent broker-dealers and investment advisers to exit the retirement plan market.

Moreover, the website disclosure raises significant concerns regarding potential advisor recruiting and may have the unintentional consequence of driving inflation in certain segments of the investment market, resulting in higher investment costs. We fear that as a result many smaller firms will likely decide that the benefits of servicing retirement assets simply do not outweigh the costs – real or potential.

Our members negotiate commission terms with each individual financial advisor. Collecting information on the terms of each individual financial advisor's compensation with regard to each asset that an investor could possibly purchase, hold or sell, and formulating that information into a webpage will result in a massive disclosure, and massive costs.

- I. FSI questions the Department's authority to create a new private right of action.

The BICE would create a private right of action against a financial advisor for breaching the terms of the contract at the core of the exemption. The creation of this new right of action raises concerns amongst our members for several reasons. First, there appears to be no statutory authority under ERISA that would permit the Department to make a failure to comply with the terms of a regulation (or, in this case, an exemption) subject to a private right of action under state law. Second, the Department's attempt to transfer broker-dealer enforcement to a contract law regime impinges upon the ability of both the SEC and FINRA to apply their own enforcement

authority in this area. Finally, by creating a private right of action under the BICE, the Department attempts to replace the will of Congress with its own desire to enforce ERISA's fiduciary duties in the context of IRAs by leveraging state court contract enforcement authority.

The creation of a new private right of action appears to be beyond the scope of the powers delegated to the Department pursuant to ERISA. Congress authorized certain private rights of action under ERISA section 502. ERISA section 502(a)(3) authorizes a private action "to enjoin any act or practice which violates [ERISA]" or "to obtain other appropriate equitable relief." Private ERISA actions are based on the terms of the plan or program under which benefits are sought, and state law, such as contract law, is effectively preempted. In drafting the statute, Congress carefully defined the circumstances in which a private right of action would be appropriate in the context of an ERISA plan benefit<sup>105</sup>, and years of jurisprudence have served to further develop principles that provide for private rights of action by participants and beneficiaries.<sup>106</sup> The BICE would unilaterally upend these principles based solely on whether a financial advisor would receive differential compensation associated with the provision of investment advice. It would allow plaintiffs to seek damages that extend far beyond the benefits lost and associated investment gains, and would allow the plaintiffs' bar to plead for vague and often unquantifiable "benefit of the bargain" damages, including expectation damages, consequential damages, and even punitive damages in some cases. There is no indication that Congress intended to endow the Department with the authority to create such an expansive right of action against any fiduciary. Neither the preambles in the Proposal, nor the Department's lengthy regulatory analysis, identify the source of any Congressional authority that directs or authorizes the Department to create a new private right of action under state contract law with regard to plans and IRAs. Furthermore, there is certainly no indication that Congress would authorize the Department to craft such a right to apply only to financial advisors, and no other fiduciaries in any context.

In addition, the BICE private right of action displaces SEC and FINRA authority over brokerage industry enforcement, and resolution of investor disputes. In particular, FINRA rules provide for both a dispute resolution process and an investor complaint process.<sup>107</sup> These processes allow investors to seek redress for many of the activities that would be at issue in a BICE contract dispute, such as a failure to disclose a material conflict or a broker's receipt of excessive commissions. However, the new state law contract right of action will prompt the plaintiffs' bar to encourage investors to forgo FINRA's complaint processes in favor of proceeding directly to court and the potential for lucrative damage awards. FINRA, in many cases, may not have an opportunity to investigate and enforce its own regulatory regime before BICE disputes appear in court. The BICE private right of action will therefore undermine the certainty associated with current agency dispute and enforcement practices in the broker-dealer industry, and will create new risk exposures that will result in increased advice costs and cause certain investment firms to exit the market.

By relying on state contract and tort remedies, rather than uniform federal law, to enforce the fiduciary standards it would impose on retirement advisors, the BICE would be highly disruptive. It is one of the great successes of ERISA that uniform law generally applies nationally to the retirement system and the enforcement of the legal standards under ERISA. To our knowledge, the Proposal represents the first instance in which the Department has purposefully

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<sup>105</sup> No such cause of action currently exists for purposes of an IRA.

<sup>106</sup> See, e.g., *Alexander v. Sandoval*, 532 U.S. 275 (2001).

<sup>107</sup> See, e.g. FINRA Rule 12200.

abandoned that essential principle and remitted the enforcement of ERISA standards to the vagaries of state law. Similar precepts apply under the securities law, because of the national interest in the applicability of uniform law in that area as well. For example, Congress enacted (i) the Private Securities Litigation Reform Act of 1995 (PSLRA) to provide uniform national law on certain aspects of securities litigation; (ii) the National Securities Markets Improvement Act of 1996 (NSMIA) to define the boundaries of state regulatory authority over securities offerings in the context of a national securities market, making the SEC the exclusive regulator of offerings in many circumstances; and (iii) the Securities Litigation Uniform Standards Act of 1998 (SLUSA) to preempt certain class actions that alleged fraud under state law "in connection with the purchase or sale" of securities. This lack of uniformity under the BICE will complicate the availability and delivery of services to plans, participants and IRA owners in entirely unanticipated ways.

Furthermore, the BICE includes a provision which would require financial advisors to warrant that they are in compliance with all applicable laws. Broker-dealers are subject to a myriad of laws and regulations from many jurisdictions, including the SEC, FINRA, and all 50 states. Investment advisers are subject to a well-defined system of regulation under state or federal law supported by SEC regulations. Dual registrant firms, like the vast majority of FSI members, are subject to both regulatory regimes. The BICE would create a situation in which even an inadvertent breach of a law or rule that has nothing to do with the individual investor's situation could create a right of action for rescission or damages under the terms of the agreement between the firm and the customer. This would create potentially unlimited liability exposure for broker-dealers and investment advisers, and may prompt many firms to consider leaving the market for advice to retirement plans.

Finally, we are concerned that the enforcement of fiduciary principles through a private right of action impinges on Congress's exclusive right to legislate at the federal level. The Department clearly has the authority to issue "regulations, rulings, opinions, and exemptions" pursuant to section 4975 of the Code, including those that relate to IRA plans. However, we find no provision under ERISA or the Code that would allow the Department to enforce ERISA's fiduciary principles with regard to IRAs, and certainly no ability to direct state courts to use contract or tort principles as a surrogate for such enforcement authority. To the extent that the Department asserts that ERISA's fiduciary duties should apply ERISA section 404 principles to IRAs in the same manner as they apply to plans, the Department has the ability to work with Congress in the legislative process. And we note that responsibility for the tax provisions that are the analogues to ERISA section 404(a) – the "exclusive benefit" requirement of Code section 401(a) and related provisions -- were *not* transferred to the Department in Reorganization Plan No. 4. Instead, the Department uses the BICE private right of action to place IRAs on par with employer-sponsored ERISA plans from a fiduciary perspective, substituting state court power for Departmental regulatory authority in an area where Congress has affirmatively declined to legislate. We urge the Department to review and elaborate on its statutory authority as part of this public rulemaking process or eliminate the contract requirement from the BICE.

J. The BICE grandfathering provision should be expanded.

While the Department appears to have recognized a need for relief with regard to IRA accounts established prior to the effective date of the BICE for advisors who did not consider themselves to be fiduciaries,<sup>108</sup> in order to rely on the relief, the financial advisor is prohibited

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<sup>108</sup> Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21960, 21977.

from providing any further advice to the IRA account owner regarding the purchase, sale, or holding of the Asset after the applicability date of the BICE.<sup>109</sup> Therefore, a broker-dealer or investment adviser relying on this ‘grandfather’ provision would need to implement controls to ensure compliance with this “stand still” provision. Therefore, the provision would require a massive re-papering of existing accounts in order to move forward with any subsequent advice – a process that, for the reasons described in Sections VI.G. and VI.H. above, would be prohibitively costly for broker-dealers and investment advisers in many respects, and inadvertently expose them to liability for a prohibited transaction in others.

The structure of the current grandfathering provision is impractical given customary client maintenance procedures for most broker-dealer and investment adviser firms. Many firms offer quarterly or annual reviews of investment accounts on an individual basis. The grandfather provision would preclude this practice, and would therefore present an immense repapering challenge involving tens of millions of accounts.

Moreover, it is unclear whether the grandfather provision would allow financial advisors to provide ongoing services under certain existing IRA arrangements. To the extent that a financial advisor services an existing IRA arrangement that requires the advisor to rebalance the investment portfolio after the effective date of the BICE, it is uncertain whether such action would be considered the provision of “advice,” and would destroy grandfather protection. Similarly, because the grandfather provision provides no protection for existing IRA arrangements that contain investments that are not Assets under the BICE, it is unclear how advisors will be expected to handle these assets as of the exemption’s effective date. Adding to this complexity is the fact that several of these assets will be illiquid and may also have dividend reinvestment provisions. The final exemption should address these matters and provide a clear path to compliance for advisors.

In addition, the current grandfather provision could have certain incongruous consequences for Retirement Investors. Currently, the grandfather provision requires a financial advisor and a firm to discontinue the receipt of certain types of compensation, such as revenue sharing, if the advisor provides investment advice to the account holder after the BICE effective date. However, if the financial advisor simply provides no additional advice regarding an existing arrangement, the advisor would not need to avail himself of the protection of the BICE, and the advisor and the firm would be permitted to continue to receive payments otherwise permitted under the current rule. The financial advisor would also avoid the disclosure and liability costs associated with the exemption in its current form. As a result, financial advisors would have a perverse incentive to not provide further advice, which surely is not what the Department intends, and stands contrary to our interest in protecting the best interests of investors.

While we appreciate the Department’s attempt to provide an exemption for pre-existing accounts, the relief proposed is extremely narrow and not likely to be meaningful in practice given the rule’s conditions. Instead, we support replacing the proposed pre-existing transaction rule with a conventional grandfather rule that offers existing protections for transactions (products, platforms, and underlying investments, where applicable) and relationship agreements executed prior to the effective date of the final rule. The grandfathering provision would apply to a product or platform (and underlying investments) without regard to whether the product or underlying investment is eligible for protection under the BICE.

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<sup>109</sup> *Id.* at 21,987.

- K. The BICE recordkeeping and data request requirements are costly and administratively cumbersome.

The BICE requirement that financial institutions retain all records relating to their compliance with the BICE for six years, and that they provide unconditional access to those records during business hours to the Department, the Internal Revenue Service, retirement plan participants, retirement plan fiduciaries, and IRA owners (and their representatives) will create a significant administrative and financial burden on financial services firms. Upon request by the Department, firms would also be required to produce massive amounts of information about each asset that their customers purchase, hold, or sell, and that information would be required to be reported within six months of the Department's request. These data requests could include detailed information about investors' accounts and the assets managed by the firm, including information about the aggregate shares or units purchased, the aggregate purchase price and the investor cost of those purchases, the revenue the firm and its affiliates received related to the assets (including the identity of each revenue source), and comparable information related to all asset sales and holdings.

Firms would also be required to disclose detailed information about each investor, including the identity of the investor's financial advisor, quarterly return information for the investor's portfolio, and external cash flows into and out of the investor's portfolio (including the date of the transfers). Most troubling of all, perhaps, is that the Department would have the power to publicly disclose any and all of the information it obtains pursuant to Section IX(d), so long as it removes individually-identifiable financial information of the investor. As the Department would maintain the right to disclose the identity of the financial advisor servicing the particular investor we request that the Department clarify the circumstances in which information collected pursuant to BICE Section IX(e) would be publicly disclosed.

Retaining and producing this data will be a massive undertaking that will require the expenditure of logistical, technical, legal, and financial resources to ensure compliance with the BICE requirements. This huge undertaking will come with astronomical costs that ultimately will be passed on to investors. Moreover, these data retention and disclosure requirements may duplicate or overlap with existing regulations, and the massive data pools that financial institutions will be required to compile are certain to attract criminals and others who wish to use identification techniques to appropriate investors' personal financial information for their own uses. In order for the BICE to be a workable exemption, these data retention and disclosure requirements must be greatly scaled back so that the costs of compliance are reasonable. The Department must also clarify whether the BICE requires the maintenance of records and recordkeeping standards that are beyond those required under other regulations (e.g., SEC Rules 17a-3 and 17a-4). Lastly the Department must take steps to ensure that it can guarantee the safety and security of the individually-identifiable financial information that it will receive. FSI notes that FINRA, which proposed a comprehensive customer data collection project last year, has indicated that it is reconsidering the proposal in light of, among other things, security concerns associated with collecting and maintaining sensitive customer information.<sup>110</sup>

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<sup>110</sup> See, e.g., SIFMA Letter to Marcia E. Asquith, Office of the Corporate Secretary, FINRA, Re: Regulatory Notice 14-37 available at <http://www.sifma.org/issues/item.aspx?id=8589952228> See also, FINRA's statement regarding changes to CARDS proposal, available at <https://www.finra.org/file/regulatory-notice-13-42-update>.

- L. The BICE should not be limited to nondiscretionary advisory arrangements.

Finally, while the BICE was developed and proposed in connection with the expansion of the investment advice fiduciary definition, we suggest that it provides sufficient safeguards (with the refinements suggested in this letter and by other commentators) that it can also be appropriately available to fiduciaries with discretion over the investment of plan and IRA assets. The core principles of the BICE – an obligation to act in the best interest of the retirement investor, supported by useful and effective transparency – are equally applicable to both discretionary arrangements and nondiscretionary arrangements. It may be that required disclosures would differ in these two circumstances, but otherwise we see no reason why the Department could not make the required findings under ERISA section 408(a) for both types of arrangements. And this is an opportunity to introduce a small measure of efficiency into the Proposal; the availability of the same exemptive relief for both types of arrangements would permit the construction of a single ERISA compliance procedure, rather than separate compliance procedures for discretionary and nondiscretionary arrangements that are otherwise administered on the same basis (which is often the case in the industry). We encourage the Department to act on this opportunity.

## **VII. Proposed Class Exemption for Debt Securities Transactions Effected on Principal Basis**

In addition to the BICE class exemption, the Department has proposed to create a separate class exemption for certain transactions in debt securities effected on a principal basis, titled “Principal Transactions in Certain Debt Securities between Investment Advice Fiduciaries and Employee Benefit Plans and IRAs” (Principal Transactions PTE). The Department stated that the exemption would permit principal transactions in certain debt securities by a financial advisor and his or her financial institution under conditions that would safeguard the interests of Retirement Investors. FSI is supportive of a class exemption for principal transactions in debt securities as it is customary for purchases and sales of debt securities to be effected on a principal basis in the fixed income markets, and broker-dealers who are deemed to be “fiduciaries” under the Proposal would be foreclosed from providing advice to Retirement Investors with regard to debt securities if class exemption relief were not provided. However, FSI has concerns with various requirements of the Principal Transactions PTE that it believes will be unworkable or contrary to the best interests of Retirement Investors.

- A. The Department should confirm that riskless principal transactions are not subject to the Principal Transactions PTE.

It appears from the text of the Principal Transactions PTE that the Department intended to limit the PTE to transactions in which the debt security purchased from or sold to a Retirement Investor is for or from the financial institution’s inventory. More particularly, in several contexts, the Principal Transactions PTE describes the principal transactions covered by the PTE as transactions in which a financial institution purchases or sells “out of inventory.” The Principal Transactions PTE does not in any way mention or reference transactions effected on a riskless principal basis.<sup>111</sup> The clear implication is that the Principal Transactions PTE is limited to principal transactions from inventory, and does not cover “riskless principal” transactions. Transactions effected on a riskless principal basis do not present the same degree of conflicts as those presented by principal

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<sup>111</sup> A riskless principal transaction refers to a situation in which a broker-dealer after receiving a customer order purchases a security for resale to a customer to fill the customer’s order.



transactions out of inventory. Riskless principal trades are the functional equivalent of agency trades; the fact that they are effected as a principal basis is simply reflective of the fixed income market structure. Moreover, riskless principal transactions ordinarily reflect better pricing than principal transactions from inventory, as the broker-dealer, in effecting the trade, needs only to account for costs associated with settlement risk and order filling, and does not have to account for inventory costs. To avoid any ambiguity, FSI urges the Department, if it proceeds with the Principal Transactions PTE, to confirm that the PTE does not cover riskless principal transactions, and that if effected by a fiduciary, these transactions would be subject to the BICE.

- B. Separate contract requirements for principal transactions are problematic and costly.

The Principal Transactions PTE would require a financial institution and advisor to enter into a contract with a Retirement Investor pursuant to which they would acknowledge their fiduciary status, commit to adhere to “impartial conduct standards,” make warranties regarding compliance with law and material conflicts of interests, and provide specified disclosures regarding principal transactions and consent. This contract requirement is virtually identical to that for the BICE, except with regard to the required disclosures which are specific to principal transactions. As several of the asset classes covered by the BICE include debt securities, and transactions in debt securities are, as noted above, commonly effected on a principal basis, FSI members readily foresee situations in which they would need to enter into two very similar agreements with the same Retirement Investor covering the same transactions, creating ambiguity over which agreement – and which set of rules – governs. The Principal Transactions PTE suggests that the contract could “be part of a master agreement” with the Retirement Investor, but does not indicate that a Principal Transactions PTE contract could be combined with or integrated into a BICE contract. Thus, it appears that a broker-dealer effecting transactions in debt securities on a principal basis for a Retirement Investor account may very well need to enter into two agreements covering substantially the same subject matter with the Retirement Investor.

Moreover, the two agreements would pertain to the same transactions effected for the same customer account. Multiple agreements for one account will confuse Retirement Investors and will create the necessity for additional disclosures to assist Retirement Investors in understanding the paperwork and additional training of financial advisors to understand their obligations. Additionally, FSI members believe that the operational and supervisory costs associated with maintaining separate forms of agreements, disclosures, and related policies and procedures will be excessively – and unnecessarily – costly. In light of these concerns, FSI urges the Department to eliminate the requirement for an agreement under the Principal Transactions PTE if the Retirement Investor has entered into a BICE contract with the financial institution and advisor.

- C. Confirmation mark-up disclosure requirements will be operationally challenging.

The Principal Transactions PTE would require a financial institution to provide a written confirmation of the principal transaction in accordance with Rule 10b-10 under the Securities Exchange Act of 1934 that also includes disclosure of the mark-up, mark-down or other payment to the advisor, financial institution, or affiliate in connection with the principal transaction. FSI members note that confirmation rules currently applicable to broker-dealers, including Rule 10b-10, do not require disclosure of mark-up information for transactions in debt securities. Adding the mark-up information to confirmations would be a substantial operational challenge for broker-dealers. Not only would they have to develop the systems and processes to add the mark-up

information to confirmations, but they would also deal with the complexity and challenges of maintaining two different types of confirmations, one with the markup information for Retirement Investors, and one without for customers who are not Retirement Investors.<sup>112</sup>

FSI members want to underscore that the mark-up information mandated by the Principal Transactions PTE will require substantial modifications and upgrades to current trading and back-office systems, including those of third-party providers on which FSI members rely. Many FSI member firms are introducing brokers maintaining fully-disclosed clearing relationships, in which the clearing broker executes customer transactions on behalf of the introducing broker. Alternatively, FSI members may execute their customers' transactions while relying on a clearing firm for clearing and custodial services, including sending confirmations. In either case, all of these firms will be required to work with their clearing firms and other third-party providers to modify their interfaces to ensure that not only the customer trade but also the appropriate mark-up information is captured and transmitted to the third party. Additionally, FSI member firms will be required to work with these providers to create oversight mechanisms to ensure that the correct information is included on the confirmations. In the event a mistake is printed and sent to a customer, FSI members will be required to work with these providers to amend and resend the confirmation.

These enhancements would necessitate the establishment of additional processes that will be both automated and manual in nature. Particularly for smaller firms without the requisite resources to build and maintain fully automated systems, the Principal Transactions PTE would require the creation of multiple additional manual processes. The manual nature of these additions presents a high level of operational risk such that these smaller firms may no longer be able to offer debt securities to their Retirement Investor customers. These additional processes create multiple opportunities for errors that will result in increased costs for firms to correct inaccurate information provided to customers and increased customer confusion following their receipt of multiple confirmations for a particular transaction. Firms will be required to hire additional personnel to track and log the additional mark-up information, input and transmit the markup information to the clearing firm for inclusion on the confirmation, and review customer confirmations to validate the accuracy of the information provided to the Retirement Investor. All of this will add to the cost of services provided to the Retirement Investor.

FSI members are also concerned that the proposed mark-up information requirement for confirmations places a disproportionate emphasis on the amount of the mark-up to the exclusion of other factors also important in evaluating the financial institution's services in connection with effecting a principal transaction in debt securities. Mark-up information absent contextual information may be confusing, misleading, and inaccurate. FSI believes that Retirement Investors need contextual explanations to understand why they are charged for a transaction and why the services are necessary, rather than numerical information concerning the amount of the mark-up.

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<sup>112</sup> Working with the SEC, FINRA and the MSRB are both currently actively engaged in rulemaking that would require disclosure of mark-ups in certain principal transactions. See Pricing Disclosure in the Fixed Income Markets, FINRA Regulatory Notice 14-52 (Nov. 2014) ("FINRA Proposal"); Request for Comment on Draft Rule Amendments to Require Dealers to Provide Pricing Reference Information on Retail Customer Confirmations, MSRB Regulatory Notice 2014-20 (Nov. 2014) ("MSRB Proposal"). We urge the Department to allow FINRA and the MSRB to take the lead in rulemaking on this topic as their rules will apply across retirement and non-retirement accounts.

FSI also believes that the information required to be provided to Retirement Investors before execution of a principal transaction in debt securities, specifically, that the transaction will be effected on a principal basis, along with available pricing information, will fully satisfy the Department's concerns.

Accordingly, FSI urges the Department to eliminate the requirement in the Principal Transactions PTE to include mark-up information on confirmations for debt securities effected in reliance on the exemption.

- D. Multiple disclosures may be excessive and do not provide sufficient context and education regarding fixed income pricing considerations.

The Principal Transactions PTE would require a financial institution to provide multiple disclosures regarding principal transactions. First, the contract, which must be entered into before any advice is provided, must disclose that the financial advisor and financial institution may engage in principal transactions, and identify and disclose material conflicts of interest associated with those transactions. Second, prior to engaging in a principal transaction, the advisor or financial institution must disclose that the transaction will be effected on a principal basis, and provide available pricing information, including the mark-up, mark-down, or other payment, and contemporaneous price quotations from two third parties. It appears that this disclosure must be provided before each principal transaction. Third, as noted above, the financial institution must provide a confirmation for each transaction, including the mark-up, mark-down, or other payment. Fourth, the financial institution must provide an annual disclosure statement providing on a transaction-by-transaction basis the price and applicable mark-up, mark-down, or other payment. Taken together, these disclosure requirements call for multiple presentations of the same or similar information, and reflect a presumption that only the mark-up amount matters. The Principal Transactions PTE overlooks the importance of contextual explanation and education of Retirement Investors. FSI urges the Department to streamline the disclosures to eliminate repetition and to focus the disclosures on education of Retirement Investors regarding the markets for these types of transactions and the various factors impacting price and execution.

- E. The pricing requirements of the Principal Transactions PTE are impracticable.

The Principal Transactions PTE would require a financial advisor and a financial institution to make two separate determinations regarding the price of a debt security at which a principal transaction is executed: (i) that the price is at least as favorable to the Retirement Investor as the price in a transaction in the same security that is not a principal transaction; and (ii) that the price is at least as favorable to the Retirement Investor as the contemporaneous price offered by two ready and willing counterparties that are not affiliates for the same debt security or a similar security if a price is not available for the same debt security.<sup>113</sup>

FSI members have serious concerns with the practicability of the pricing requirement. The first part of the requirement – that the price be at least as favorable to the Retirement Investor as the price in a transaction that is not effected on a principal transaction – presumes that the security in question is routinely purchased and sold on an agency basis for which pricing information would be available. However, in the experience of FSI members, there simply are no transactions effected on an agency basis for a significant percentage of outstanding debt issues.

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<sup>113</sup> 80 Fed. Reg. 21989,22003.

Rather, as explained above, the common practice is for a transaction in a debt security to be executed on a principal basis if the debt security is in the financial institution's inventory or on a riskless principal basis if it is not. Given existing market operations, FSI members do not think that there will be information readily available about prices for transactions effected on a non-principal basis to support the determination required by the first part of the pricing requirement.

Similarly, with regard to the second part of the pricing requirement – that the price be at least as favorable to the Retirement Investor as the contemporaneous price offered by two ready and willing counterparties for the same or similar security – FSI members believe that it will not be practicable to obtain the two-quote information to support the determination required. First, FSI members think it highly unlikely that counterparties would readily provide them with quotes for transactions that the counterparties would effect with their own customers, as that information is proprietary to the counterparties.<sup>114</sup> Second, putting aside whether a counterparty would share proprietary quote information, FSI members do not know how to determine what security would be considered a “similar security” for purposes of the pricing requirement if quote information for the security that is the subject of the transaction were not readily available. FSI members acknowledge the Department's reference to FINRA Rule 2121 for guidance in identifying a “similar security,” but point out that there simply may not be “similar securities” for which quotes are available.

More generally, FSI members believe that the pricing requirement conflicts with the fundamental objective of the Principal Transactions PTE because compliance with the requirement will not be in the best interest of Retirement Investors. The effort required to satisfy these requirements will impede efficiency in executing transactions in debt securities and will harm market liquidity. Further, the effort will have the effect of raising transaction costs for Retirement Investors, which would be completely at odds with the objective of the Department's rulemaking. Finally, FSI members believe that compliance with these requirements will interfere with a broker-dealer's policies and procedures to comply with the fair pricing rule that currently apply to their principal transaction activities.<sup>115</sup> In light of these considerations, FSI urges the Department to remove the “pricing” requirement from the Principal Transactions PTE.

### **VIII. Proposed Amendments to Prohibited Transaction Class Exemption 84-24**

In its current form, PTE 84-24 permits brokers who are fiduciaries to recommend the purchase of insurance or annuity contracts for a plan or IRA and to receive commissions on the sales. The broker-dealer industry has historically relied on PTE 84-24 heavily, particularly in the context of commissioned sales of annuity products to IRAs. Any contraction of or amendment to the relief offered under PTE 84-24 would appear to require the Department to offer a clear path toward compliance and sufficient flexibility to allow financial advisors and investors to adjust their arrangements accordingly. Unfortunately, PTE 84-24, in its proposed form, offers neither.

The revised PTE would require brokers relying on this exemption to comply with the Best Interest standard, among other requirements. Premising PTE 84-24 on compliance with this standard will require many broker-dealers to discontinue relationships that have traditionally

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<sup>114</sup> Counterparties may provide quotes for transactions to be effected between broker-dealers, but they would not readily share with a competitor quotes for transactions they might effect with their customers.

<sup>115</sup> See FINRA Rule 2121. These rules already require broker-dealers to exercise diligence in assessing a market value.

relied on the protections of PTE 84-24, and will reduce access to professional advice, particularly among IRA owners.

The revised PTE 84-24 would also deny future exemptive relief for IRA transactions involving variable annuity contracts and other contracts that are securities under federal law.<sup>116</sup> Financial advisors would be required to comply with the BICE in order to receive certain types of revenue that are commonly paid in conjunction with sales of these products. As discussed above, the impartial conduct standards under the BICE as well as its ambiguous “reasonable compensation” model – are incompatible with existing broker-dealer rules. To the extent that exemptive relief for the receipt of commissions for the sale of variable annuities flows exclusively through the BICE, these products will disappear from the landscape of investment options currently offered to retirement investors. Moreover, while it is fashionable to disparage variable annuities, in 2015 these products routinely are available with daily transferability to high-rate fixed accounts and/or guaranteed lifetime income features that can be very useful in retirement planning.

In addition, the new iteration of PTE 84-24 would require brokers to provide information regarding commissions, expressed as a percentage of gross annual premium payments in year 1 and in succeeding years, as well as a description of any charges, fees, discounts, penalties or adjustments under the contract.<sup>117</sup> As discussed in Section VI.H. regarding the BICE disclosure requirements, independent broker-dealers do not create, compile, or maintain this information. To the extent this information is available, it must be obtained from the annuity contract issuer. However, much of the required information is not currently required to be maintained by annuity issuers and each issuer presumably maintains its data in a different manner. In light of the large number of annuity contract issuers, this requirement will entail an extensive and expensive logistical effort by broker-dealers. We fear these costs will make servicing retirement investors cost-prohibitive for many firms.

Finally, the proposed PTE 84-24 would provide new definitions for “insurance commission” and “mutual fund commission”, explicitly prohibiting revenue sharing, administrative fees and marketing payments, or payments from parties other than the insurance company product manufacturer.<sup>118</sup> The definition of “insurance commission” lists only two forms of commission payments – renewal fees and trails - that would actually be permissible under the proposed exemption. In its current form, the amended definition forces financial advisors to speculate about the Department’s expectations regarding other types of permissible commission sales. In addition to the other characteristics that render the exemption untenable, this uncertainty clouds the compliance landscape for broker-dealers under an important exemption and exposes the industry to liability risks many advisors will be unwilling or unable to assume.

While PTE 84-24 offers little actual exemptive relief in its proposed form, certain changes would make the exemption more workable for the broker-dealer industry. In keeping with the Department’s stated commitment to preserve existing business models, PTE 84-24 should be expanded to allow compensation, in all forms, for both fixed and variable annuities and proprietary and non-proprietary mutual fund sales for plans, participants and IRAs. Furthermore,

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<sup>116</sup> Proposed Amendment to and Proposed Partial Revocation of Prohibited Transaction Exemption (PTE) 84-24 for Certain Transactions Involving Insurance Agents and Brokers, Pension Consultants, Insurance Companies and Investment Company Principal Underwriters, 80 Fed. Reg. 22,010, 22,012 (Apr. 20, 2015).

<sup>117</sup> *Id.* at 22,013.

<sup>118</sup> *Id.* at 22,015.

the exemption should provide for a more certain path to compliance with respect to commissioned sales (where compensation may vary by product type and, within a product type, by product manufacturer) and proprietary products. In the alternative, FSI again draws the Department's attention to the alternative uniform standard in Section XI, which would eliminate the need for amendments to this exemption. That is, the fact that compensation may vary between annuities and mutual funds by product classes, or between specific annuities or specific mutual funds, or between proprietary and nonproprietary products, does not mean that any given investment recommendation is not in the best interest of the investor. And any lack of certainty on this point will artificially skew the recommendations investors receive. It is, therefore, incumbent upon the Department to address this point.

#### **IX. Proposed Amendments to Prohibited Transaction Class Exemption 86-128**

PTE 86-128 as currently constituted provides section 406(b) relief for securities trading commissions and certain agency cross-trade transactions. This relief is available where a securities firm either has discretion with the management of the assets being traded or just provides advice with respect to that investment activity.<sup>119</sup> The safeguards for plans and participants provided in PTE 86-128 are appropriate in either circumstance and, since firms often offer a particular investment strategy or service on either an "advisory" or "discretionary" basis, it is highly efficient to construct ERISA compliance procedures for both around the same exemptive relief.

We infer from the reference to Advisory Opinion 2011-08A in the preamble that the Department intends that PTE 86-128 will continue to be generally available for fiduciaries as defined under either subsection (i) or (ii) of ERISA section 3(21)(a), and we would appreciate explicit confirmation of that point in connection with any final amendments to this exemption. The only distinction on that point under the amendment is in the case of IRAs, where investment advice fiduciaries would be covered under the BICE rather than PTE 86-128. With the revisions to the BICE urged in this letter and by other commentators, we see no reason why relief for IRAs should not be available under either the BICE or PTE 86-128, and we recommend that section I(c) of the proposed amendment be deleted in any final amendment.

#### **X. Applicability Date**

The Department's eight month delayed applicability date is inadequate, even assuming adoption of the substantial changes necessary to make the Proposal workable. By way of example, the time between the publication of the Department's interim final guidance under ERISA section 408(b)(2) and the effective date of the final regulations was two years.<sup>120</sup> The Department recognized the need for this extended implementation period despite the fact that the substance of the section 408(b)(2) rules changed very little between the interim final draft and the final rule.

The Proposal is more complex and larger in scope than the section 408(b)(2) guidance. The disclosure requirements alone represent a substantial change for the investment advice industry. Furthermore, unlike the section 408(b)(2) guidance, the current Proposal bears only a vague resemblance to the Department's 2010 proposal. The attendant exemptions, some of which

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<sup>119</sup> Department of Labor, Advisory Opinion 2011-08A (June 21, 2011).

<sup>120</sup> See Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure, 75 Fed. Reg. 41600 (July 16, 2010); Reasonable Contract or Arrangement Under Section 408(b)(2)—Fee Disclosure; Final Rule, 77 Fed. Reg. 5,632 (Feb. 3, 2012) (with final effective date of July 1, 2012).

the broker-dealer industry will need to rely on to continue customary sales practices, are entirely foreign in application. Furthermore, broker-dealers will need time to budget for the costs associated with an entirely new compliance regime, even before the implementation process begins. The new standards for fiduciaries, the training and follow-up supervision required to ensure compliance, and the administrative and systems processes that will need to be implemented will require, at minimum, 36 months to be put into place. Even this estimation assumes that the Proposal is streamlined and revamped to eliminate many of the BICE disclosures, that a conventional grandfather rule is adopted, and that many of the existing exemptions are preserved largely in current form. If these recommendations are not adopted by the Department, firms will require a much longer transition period.

## **XI. Alternatives Proposed by FSI**

In an effort to work constructively with the Department to protect investor interests and preserve existing broker-dealer and investment adviser business models that have served retirement investors well for decades, we offer the following alternatives to the Proposal. We suggest the Department in conjunction with the SEC and FINRA work on adopting the following requirements for firms and financial advisors providing investment advice to retail investors. We believe these suggestions represent initiatives that will satisfy the intent behind the Proposal, while avoiding many of the challenges posed by the Proposal that we have outlined in this letter.

Specifically, we suggest an alternative standard of care that would unequivocally require financial advisors to act in the best interest of their clients while preserving the investor protections provided by the existing broker-dealer and investment adviser regulatory framework. Additionally, we suggest text for required policies and procedures to manage material conflicts of interest. Lastly, we offer a suggested disclosure regime that includes full and fair disclosure of all fees and expenses as well as material conflicts of interest related to potential investments.

### **A. Uniform Standard of Care.**

1. The Department should coordinate with the SEC, FINRA, and state securities regulators to offer a simplified standard of care that can be adopted uniformly across all types of investment accounts, and can apply to all investment professionals.

FSI believes that a uniform fiduciary standard of care is critical to the protection of retirement plan assets and the stability of the financial markets. Such a definition should explicitly require Financial Institutions and financial advisors to:

- Act in the best interest of their clients;
- Provide advice with skill, care, and diligence based upon information that is known, about the customer's investment objectives, risk tolerance, financial situation, and other needs;<sup>121</sup> and

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<sup>121</sup> FSI believes that a financial advisor should use reasonable diligence to obtain the necessary information to provide advice.

- Disclose and manage material conflicts of interest, avoid them when possible, and obtain informed customer consent to act when such conflicts cannot be reasonably avoided.<sup>122</sup>

FSI believes that imposing this standard of care on financial advisors in conjunction with the robust existing broker-dealer and investment advisor regulatory regime will ensure that customers are protected to the degree desired by the Department. Aside from the suitability obligations imposed by FINRA rules, broker-dealers are also subject to licensing and registration requirements; “know your customer” standards; just and equitable principles of trade; strict guidelines regarding communications with the public; best execution standards; an active supervisory system; demanding examination requirements; and binding customer arbitration rules for the settlement of disputes. Investment advisers are likewise subject to a comprehensive regulatory regime, while dual registrants are obligated to comply with these combined regulatory requirements. The sum total of this regulatory framework creates an incredibly robust investor protection structure that would be jeopardized, not strengthened, by the Proposal. Our suggested standard of care is therefore an appropriate and balanced approach for maintaining current investor protections while still achieving the Department’s goals. Specifically, this standard builds on existing requirements and preserves their ability to protect investors while also mandating the necessary disclosure and conflict management requirements.

While this suggested standard of care would require a financial advisor to provide advice that is in the best interest of the customer, it would not necessarily require recommending the lowest cost investment option. We recognize that cost is an important factor in assessing the appropriateness of an investment recommendation. Nevertheless, research has shown that a consideration of cost alone does not necessarily result in better returns for investors.<sup>123</sup> Assessing the appropriateness of an investment has been accurately described as a “subtle exercise that does not lend itself to gross generalizations.”<sup>124</sup> Our suggested standard of care allows financial advisors to consider the full spectrum of material information in recommending an investment that is in the best interest of the investor. Factors such as risk tolerance, investment time horizon, past performance, diversification, age, other investments, and liquidity needs make up essential components of investment advice. A recommendation that considers the totality of these factors may in fact be the lowest cost option, however, that may not always be the case. While a financial advisor must determine that all related fees and costs are within the customer’s best interest, we believe that best interest should not be contingent on recommending the least costly option.

## 2. Reasonable Policies and Procedures Designed to Manage Material Conflicts of Interest.

FSI supports the notion that Financial Institutions and financial advisors have an obligation to mitigate the impact of material conflicts of interest on the provision of investment advice to retail customers. We believe that in accordance with a requirement to act in the best interest of their customers, financial advisors must be subject to policies and procedures reasonably designed to mitigate conflicts concerning the provision of investment advice to retail investors. Financial

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<sup>122</sup> Should customer consent be necessary it may be provided at account opening.

<sup>123</sup> Morningstar Inc., *Mutual Fund Share Class Limits and Share Class Suitability* (May 15, 2006), available at <http://corporate.morningstar.com/us/documents/MethodologyDocuments/MethodologyPapers/ShareClassLimitsandSuitability.pdf>.

<sup>124</sup> *Id.* at 18.



advisors have long noted that conflict mitigation is essential to maintaining the trust and confidence between advisors and investors. The open product architecture, in which Financial Institutions offer investment products from a wide variety of issuers, has long been the hallmark of the independent financial services industry, and was designed specifically to enable financial advisors to exercise their independent judgment in determining which products to recommend to investors. The independent channel has flourished, in part, based upon the reduced conflicts associated with the model.

The Department proposes to require the adoption of written policies and procedures reasonably designed to mitigate the impact of material conflicts of interest. The text of the BICE does not expand on this requirement and does not include any guidance or safe harbors. The Department stated that it did not mandate specific policies and procedures in order to provide flexibility for a firm to adopt policies and procedures that are tailored to the firm's particular business model. While we appreciate the Department endeavoring to provide flexibility to Financial Institutions, an absence of specificity yields great uncertainty which results in higher compliance costs that are passed on to investors.

The Department also states that it does not intend to mandate level-fees, although it notes that level-fees would be a satisfactory way for firms to comply with the BICE requirement. The endorsement of a level-fee structure, without any binding statement about potential variable compensation models bearing some similarity to those currently employed by broker-dealers and investment advisers has led to increased support for the belief that BICE will inevitably lead to level-fees. We do not believe that a level-fee system is in the best interest of investors as it will likely result in retirement advice becoming cost prohibitive for many savers of modest means. Additionally, we are further concerned that an endorsement of level-fees suggests a predilection for fee-based accounts. In addition to recommendations for investment products, financial advisors also assess the suitability of particular account types. The SEC and FINRA have expressed their view that in many circumstances commission-based accounts are in fact in the best interest of investors.<sup>125</sup> As such, it is all the more important to ensure that the BICE reflects a workable framework that will protect retirement investors while ensuring that broker-dealers do not run afoul of the federal securities laws.

Therefore, FSI believes that any class-exemption designed to preserve commission-based brokerage business should include more specific requirements regarding the adoption of policies and procedures to mitigate conflicts of interest. In its discussion regarding the adoption of such written policies and procedures the Department lists six suggested "components" that were featured in FINRA's Report on Conflicts of Interest.<sup>126</sup> The Department merely states that a broker-dealer could consider these policies and procedures in seeking to meet BICE requirements. We believe that these represent sound policies and procedures that would in fact enable a firm to adequately mitigate conflicts of interest. As such, we suggest that in addition to the adoption of our proposed standard of care, the Department adopt the following text describing the requirement to manage material conflicts of interest:

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<sup>125</sup> Wall Street Journal, "SEC Targets 'Reverse Churning' by Advisors", Feb. 24, 2014, available at <http://www.wsj.com/articles/SB10001424052702304610404579403251590760602>.

<sup>126</sup> See Proposed Best Interest Contract Exemption, 80 Fed. Reg. 21,960, 21,971-21,972 (April 20, 2015); Financial Industry Regulatory Authority, Report on Conflicts of Interest 26-27 (Oct. 2013), available at <https://www.finra.org/sites/default/files/Industry/p359971.pdf>.

A Financial Institution must adopt written policies and procedures reasonably designed to mitigate the impact of material conflicts of interest on the provision of investment advice to retirement investors. Such written policies and procedures must ensure that a Financial Institution:

- (i) Avoids creating compensation thresholds that enable an Advisor to increase his or her compensation disproportionately through an incremental increase in sales;
- (ii) Maintains a supervisory program that employs specialized surveillance of an Advisor that is approaching a threshold that would:
  - a. Result in a higher payout percentage in a Financial Institution's compensation grid,
  - b. Qualify an Advisor to receive a back-end bonus, or
  - c. Qualify an Advisor to participate in a recognition club;
- (iii) Maintains a neutral compensation grid that does not include higher payout percentages for particular products;
- (iv) Refrains from providing higher compensation to an Advisor for the sale of proprietary products or products for which the firm has entered into revenue sharing arrangements;
- (v) Monitors recommendations around key liquidity events in an investor's lifecycle; and
- (vi) Develops red flag processes that include compensation adjustments for employees who do not properly manage conflicts of interest.

FSI believes that written policies and procedures that address each of these six items will ensure that Financial Institutions mitigate the impact of conflicts of interest on the provision of investment advice by financial advisors. However, we also understand that the Department is concerned about apparent conflicts regarding revenue sharing arrangements or the conferring of other economic benefits on a Financial Institution by a product manufacturer, even in instances where the financial advisor will not receive a benefit for selling the product. While the independent financial services industry does partake in such arrangements, the very nature of our business model goes a long way to mitigate many of these conflicts. It is incredibly difficult for a firm to impute its interests through financial or other incentives on an independent contractor without jeopardizing that classification.

Revenue sharing arrangements enable our member firms to provide affordable financial advice and services to investors of all means. We strongly support maintaining these revenue sources. Nevertheless, we also understand the Department's legitimate concern regarding the impact of these potential material conflicts of interest. Therefore, we propose that under our best interest standard all types of revenue sharing or similar arrangements would be permitted, provided the Financial Institution satisfies two additional requirements. First the firm must disclose the arrangements in accordance with our proposed disclosure regime outlined below. Second, Financial Institutions would be required to maintain written policies and procedures reasonably designed to mitigate the impact of potential material conflicts of interest from revenue sharing arrangements.

FSI believes that our suggested compensation governance framework represents a balanced approach that meets the Department's goals while preserving access to traditional commission-based brokerage arrangements. Requiring Financial Institutions to maintain such policies and procedures will offer significant incentive to firms to maintain robust oversight

programs of their revenue sharing arrangements. Moreover, this will be an additional mechanism that can be used to further ensure that investors receive advice that is in their best interests.

B. Disclosure Alternative.

FSI believes investors can make better choices when they are properly informed of all the material facts concerning the investing process. In order to provide investors with the information they need, they should receive concise, consolidated disclosure documents written in plain English. Disclosures should be presented in the most effective manner to ensure they inform rather than intimidate investors. Unfortunately, the Department's Proposal creates a complex set of new disclosure requirements and makes compliance with all those requirements a condition of the BICE. As Financial Institutions would need to rely on third parties to provide certain aspects of the information required in the BICE disclosure (such as projected anticipated cost), the disclosure requirement would render the BICE impractical. Moreover, and perhaps more significantly, FSI is concerned that the disclosure requirements are more likely to be confusing rather than helpful to investors.

Nevertheless, we believe that the Department is correct to assert that investors should receive relevant disclosures from their financial advisors. As such, we have developed an alternate disclosure regime for the Department to consider in lieu of the BICE contract and disclosure requirements. FSI believes that the two-tiered disclosure regime outlined below will serve to inform investors of the information that is most critical to their decision-making, at the point in time when that information is most useful and in a method that is operationally efficient. We support the Department's goal of ensuring investors understand the various ways financial advisors and firms are compensated for securities transactions. In fact, many Financial Institutions currently provide this important information on their publicly-available websites. These disclosures would be supplemented by required point-of-sale disclosures that will inform customers about important information concerning the particular asset and the nature of the compensation to be paid to the advisor and the firm. Additionally, Financial Institutions will be required to provide an annual disclosure to investors of all fees paid by the investor to the firm in the previous year.

Moreover, the first tier disclosure will serve the additional purpose of binding the financial advisor and Financial Institution to act in accordance with the applicable standard of care owed to the customer. Therefore, the purpose of these disclosures is not simply to inform, but also to ensure that customers receive an up-front, enforceable commitment on the part of both the firm and the financial advisor to act in a customer's best interest consistent with the Department's intent.

The two-tiered disclosures would include:

- First Tier: A short-form disclosure document, provided as part of the account opening process<sup>127</sup> that would focus on the issues that are of greatest importance to investors. The short-form disclosure would also represent an up-front, enforceable commitment on the part of the financial advisor and the Financial Institution to act in the best interest of the client.<sup>128</sup> The information detailed on the short-form disclosure would include:

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<sup>127</sup> The disclosure could be provided in paper or electronic format.

<sup>128</sup> The client would be able to enforce the best interest standard of care pursuant to existing venues and processes for filing securities law claims against financial advisors and Financial Institutions.

- A statement of the best interest standard of care owed by the Financial Institution to the client;
- The nature and scope of the business relationship between the parties, the services to be provided, and the duration of the engagement;
- A general description of the nature and scope of compensation to be received by the Financial Institution and financial advisor;
- A general description of any material conflicts of interest that may exist between the Financial Institution, financial advisor and investor;
- An explanation of the investor's obligation to provide the Financial Institution with information regarding the investor's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other relevant information the customer may choose to disclose, as well as an explanation of the investor's obligation to inform the Financial Institution of any material changes in this information;
- A statement explaining that customers may research the Financial Institution and its financial advisors through FINRA's BrokerCheck database or the IARD;
- A phone number and/or e-mail address the investor can use to contact the Financial Institution regarding any concerns about the advice or service they have received; and
- A description of the means by which a customer can obtain more detailed information regarding these issues, free of charge, including a link to the section of the Financial Institution's website featuring the second tier disclosures.

Financial Institutions would be able to include additional information on the short-form disclosure should they choose to do so. However, any additional information must ensure that it does not detrimentally impact the ability of the investor to understand the material, nor does it oversaturate the investor with information. Lastly, Financial Institutions and financial advisors would be prohibited from including any language on the short-form disclosure that disclaims or otherwise limits the liability of the financial advisor or Financial Institution to act in accordance with the stated fiduciary standard of care.

- Second Tier -The second tier disclosure would provide investors with access to detailed compensation and material conflicts information via the Financial Institution's website or brochures to be provided free of cost. These disclosures would be in lieu of the website disclosure requirements of BICE Section III(c). Utilizing hyperlinks and other internet functionality, investors will be able to receive detailed information concerning available investments, considerations for making investment decisions, and information explaining how a financial advisor and a Financial Institution receive compensation for a particular type of product. The disclosures are designed to allow investors to better understand both the existence of payments to be made to the Financial Institution and the purposes of such payments. The expanded disclosures featured on Financial Institution's website would include:

- A detailed schedule of typical account fees and service charges;
- A page containing information for each type of packaged product (e.g., mutual funds, variable annuities, unit investment trusts, etc.) that includes:
  - Educational information describing the product,
  - Considerations for selecting a particular share class or ways to reduce sales charges (if applicable), and
  - Narrative descriptions of the types of arrangements in which the Financial Institution receives an economic benefit from a product manufacturer,
    - The narrative descriptions should include a statement on whether these arrangements impact financial advisor compensation; and,
- A list of all product manufacturers with whom the Financial Institution maintains arrangements that provide economic benefits to either the financial advisor or the Financial Institution.
  - To the extent the Financial Institution maintains tiers representing different levels of arrangements with product manufacturers, the Financial Institution must group the product manufacturers by tier and provide a narrative description of the benefits that different tiers offer product manufacturers.

i. Point of Sale Disclosures.

In addition to the above disclosures, we also propose that financial advisors be required to provide point of sale disclosures to customers, prior to the execution of any purchase transaction. We appreciate the Department's concern that investors understand the costs associated with a particular investment. However, we believe it is important to note that this information is already available to investors in digestible formats through various other required disclosures. As such, we believe that financial advisors be able to utilize these already existing documents and educate investors on how to use these materials. Therefore, we propose that financial advisors be required to deliver no more than either a prospectus or a summary prospectus to investors at the point of sale. All the relevant cost information that would be useful to an investor is currently disclosed in a prospectus. Allowing financial advisors to rely on already existing disclosures will contribute to significantly lower implementation and operational costs, without detrimentally impacting investor protection.

Moreover, should a product feature a summary prospectus or similar summary document, delivery of the summary prospectus would satisfy the point of sale disclosure requirement. The Department previously stated that the provision of a summary prospectus would satisfy the prospectus delivery requirements under ERISA Section 404(c).<sup>129</sup> We believe the same reasoning supported by the Department in Field Assistance Bulletin 2009-03 should apply in this context.

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<sup>129</sup> In authorizing the delivery of a summary prospectus the Department noted that "[t]he Summary Prospectus is a short-form document, written in plain English in a clear and concise format, and its required contents provide a summary of key information about a mutual fund that is useful to participants and beneficiaries in evaluating and comparing their plan investment options. Moreover, if a participant or beneficiary wishes additional information,

ii. Annual Disclosures.

In the BICE Section III(b), the Department proposes that an annual written disclosure be provided to customers by either a financial advisor or a Financial Institution. The Department specifically requested comment on whether this annual written disclosure would be helpful to investors in light of other disclosures mandated by the BICE. We believe that an annual disclosure of all direct fees imposed by the Financial Institution on the investor would be helpful to allow investors to have an understanding of the cost of their investing activity over a twelve-month period. We suggest that Financial Institutions be able to add a section to the customer account statement that states the total amount of fees charged to the investor by the Financial Institution over the previous twelve months.

We believe that between the suggested website and point-of-sale disclosures and requirements for customer confirmations of SEC Rule 10b-10 there is not a need to develop any additional disclosure that details the total compensation received by the financial advisor and the Financial Institution. Requiring an annual disclosure with this information will only serve to further confuse investors. Additionally, we do not believe the annual disclosure should require a list of all assets purchased or sold as this transaction information is already available for customers to view at all times through online account access which has become ubiquitous or is otherwise easily obtained.

iii. Grandfathering of Existing Accounts.

FSI suggests that for existing account holders, the first tier disclosures should be provided at the first time that a transaction is effected subsequent to the implementation date. However, Financial Institutions would not be prohibited from including first tier disclosures in an already scheduled mailing that occurs prior to the first provision of advice should the Financial Institution choose to do so. Delivery of the first-tier disclosure document to an existing customer will represent an up-front, enforceable commitment on the part of the financial advisor and the Financial Institution to act in accordance with our suggested best interest standard of care.

C. Coordination between the Department, the SEC, FINRA, and state securities regulators is critical to the success of the Proposal.

Any undertaking to implement our proposed alternative should be a coordinated and joint effort between the Department, the SEC, FINRA and state securities regulators. In the absence of proper coordination, the true meaning of terms such as “best interest” will be determined by the judicial system, not the appropriate regulatory agencies. This is a risk that independent financial services firms – and, by extension, their clients – cannot afford to take. The Department must work with the SEC to ensure that the Best Interest Standard reflected in the Proposal is consistent with the parameters for fiduciary rulemaking granted to the SEC under Section 913 of Dodd-Frank. The Department should also ensure that the Best Interest Standard is consistent with FINRA’s know-your-customer rules and related guidance. The Department must also ensure that the Best Interest

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the Summary Prospectus provides an Internet address that leads directly to the statutory prospectus as well as a toll free (or collect) telephone number and e-mail address for obtaining free of charge in paper or by email the statutory prospectus and other information.” See Department of Labor, Field Assistance Bulletin No. 2009-03 (Sept. 8, 2009), available at <http://www.dol.gov/ebsa/regs/fab2009-3.html>.

Standard is consistent with state investment adviser requirements. If not, we again recommend that the Department delay its rulemaking efforts in this regard in order to avoid multiple, and potentially conflicting, duty of care standards for the retirement plan investment industry.

To ensure consistency and effectiveness, the SEC and DOL should issue proposals requesting comment from the public on a uniform best interest standard that reflects the framework articulated in Dodd-Frank Act Section 913. The proposals must make specific reference to, analyze, and consider the recommendations of the SEC staff in its Section 913 study relating to a uniform standard of care for broker-dealers and investment advisers. Under this approach the proposed rules, while recognizing the different governing statutes of the issuing agencies, will more effectively address the broader regulatory environment for financial services firms and professionals. The proposals should also seek to harmonize the regulatory requirements and enforcement authority with respect to violations of the standard of conduct for broker-dealers and investment advisers. Finally, the agencies must also coordinate with FINRA staff to ensure that proper guidance is issued alongside a final rule. Feedback from FINRA's Small Firm Advisory Board and various additional industry advisory committees should be solicited throughout the process. These steps will ensure that industry, government, and investor stakeholders can thoroughly engage in the rulemaking process and achieve the best result.

#### Conclusion

After giving the Proposal careful thought, our members remain concerned that, if the Proposal is implemented in its current form, the result will be less available and more expensive advice, and a decline in participation in the retirement system – both of which are counterproductive to addressing the challenges of decumulation support and participation levels among middle and lower-income Americans. However, we believe that important revisions can be made to the proposal to address these concerns and any unintended consequences.

We look forward to working collaboratively with the Department during this regulatory process to refine the Proposal's conditions and requirements and ensure access to retirement advice, products and services for all investors. Now more than ever, individual investors need to have confidence in the reliability of the investment advice they receive.

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" and a distinct "Bellaire" ending in a period.

David T. Bellaire, Esq.  
Executive Vice President & General Counsel