August 29, 2011

VIA EMAIL
Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, N.E.
Washington, D.C. 20549-1090

Re: Business Conduct Standards for Security-Based Swap Dealers and Major Security-Based Swap Participants (File No. S7-25-11)

Dear Secretary Murphy:

The American Federation of State, County and Municipal Employees (AFSCME) appreciates the opportunity to submit comments to the Securities and Exchange Commission (SEC) on the proposed business conduct standards for security-based swap (SBS) dealers and major SBS participants. AFSCME is the largest union in the AFL-CIO, representing 1.6 million state and local government workers. AFSCME strongly supported the adoption of provisions regulating the over-the-counter derivatives market during the deliberations leading to the Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). Effective rulemaking is critical to fulfilling the promise of Dodd-Frank to establish oversight and transparency to the financial markets.

The financial crisis caused in part by unregulated, unobservable OTC derivatives[1] has decimated the budgets of state and local governments and eroded both the livelihood of AFSCME members and the public services they provide to communities. Defined benefit pension plans for employees of state and local

[1] The Financial Crisis Inquiry Commission concluded, "The scale and nature of the over-the-counter (OTC) derivatives market created significant systemic risk throughout the financial system and helped fuel the panic in the fall of 2008: millions of contracts in this opaque and deregulated market created interconnections among a vast web of financial institutions through counterparty credit risk, thus exposing the system to a contagion of spreading losses and defaults. Enormous positions concentrated in the hands of systemically significant institutions that were major OTC derivatives dealers added to uncertainty in the market. The "bank runs" on these institutions included runs on their derivatives operations through novations, collateral demands, and refusals to act as counterparties." Financial Crisis Inquiry Commission Report, January 27, 2011, page 386.

governments, to which AFSCME members contribute through regular payroll deductions, are still struggling to recover from losses sustained in the crisis.

In addition to the systemic risk posed by OTC derivatives, AFSCME is particularly concerned with the protections afforded to Special Entities as defined in the new Section 15F.(h)(2)(c) of the Securities Exchange Act of 1934 as amended by Dodd-Frank. We draw your attention to the fact that this Section includes the phrase "any governmental plan" and we believe that Dodd-Frank unambiguously includes state and local government pension plans in the definition of Special Entities, even when they are not subject to ERISA.

Special Entities warrant additional protection from swaps dealers due to the complexity of derivatives operations. Warren Buffet called derivatives "very dangerous stuff," difficult for market participants, regulators, auditors, and investors to understand —indeed, he concluded, "I don't think I could manage" a complex derivatives book.[2] Furthermore, swaps dealers have not proven to take into account the best interests of their clients in swaps transactions. Journalists as diverse as Gretchen Morgenson and Matt Taibbi have detailed the billions of dollars of ill-suited swaps sold to municipal governments.[3] Last year, in the city of Philadelphia alone, Pennsylvania Auditor General Jack Wagner identified the following potential losses due to swaps:

- City of Philadelphia – 6 active swaps with a net "negative fair value" (the cost if the swaps were terminated as of the date of the financial report) of $122.6 million; swaps related to $1.25 billion in total debt;
- School District of Philadelphia – 12 active swaps with a net negative fair value of $124.7 million; swaps related to $682.6 million in debt;
- SEPTA – 3 active swaps with a net negative fair value of $52.4 million; swaps related to $345.5 million in debt;
- Philadelphia Authority for Industrial Development – 3 active swaps with a net negative fair value of $27.7 million; swaps related to $588.2 million in debt; and
- Philadelphia Intergovernmental Cooperation Authority – 4 active swaps with a net negative fair value of $45.3 million; swaps related to $253.1 million in debt.[4]

Attached for your review are AFSCME's written comments to the CFTC on proposed business conduct standards for swap dealers and major swap participants, submitted on February 22, 2011 (Attachment 1); and comments to the Department of Labor regarding the definition of "fiduciary" and the interplay between ERISA and the implementation of Dodd-Frank with respect to derivatives, submitted on April 12, 2011 (Attachment 2).

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[2] FCIC report, op cit, pg 49.
[3] Gretchen Morgenson, "Wall Street's Tax on Main Street," *The New York Times*, August 6, 2011 and "The Swaps That Swallowed Your Town," *The New York Times*, March 2010. Matt Taibbi, "Looting Main Street: How the nation's biggest banks are ripping of American cities with the same predatory deals that brought down Greece," *Rolling Stone*, March 31, 2010.
[4] Pennsylvania Department of the Auditor General, "Philadelphia Derivatives Show Danger of Failure to Rein in Wall Street," April 27, 2010. Available at

Each of these letters and their attachments provide important information regarding our views on issues raised in the SEC request for comment to which we are responding today.

AFSCME urges the SEC to revise the proposed business conduct standards to reflect the structure proposed by the CFTC, taking into account the suggestions in our CFTC comment letter. We fear that the standards proposed by the SEC, if not significantly revised, would fail to protect our financial system from the abusive practices that Dodd-Frank intended to curb. We take this opportunity to highlight some of the most critical flaws in the proposed business conduct standards with respect to the protection of Special Entities:

Advisor to Special Entities: the SEC proposes to permit an SBS dealer to escape the critical responsibilities associated with "acting as an advisor" by having Special Entities waive this right. This waiver, if not remedied, will inevitably form part of the boiler plate language that any Special Entity is forced to sign in order to enter into a swap. In addition, a customized swap *per se* involves a reliance on an assurance that the SBS dealer designed the swap based on the needs of the Special Entity. We urge the SEC to eliminate this escape clause.

Qualified Independent Representative: the SEC proposes to allow a Special Entity to state that it is not relying on the advice of an SBS dealer but instead a "qualified independent representative." However, the standards for the independence of the representative are remarkably low: not being associated with the SBS dealer for the previous year; nor earning more than ten percent of gross revenues from the SBS dealer. The representative could be a former swaps dealer taking fees from eleven SBS entities and comply with this standard of independence. The independence standard must be tightened significantly.

Reasonable Basis to Believe Qualifications of Independent Representative: the SEC proposes that SBS dealers rely on written representations by Special Entities unless the SBS dealer knows that the representation is not accurate, or has information that would cause a reasonable person to question the accuracy of the representation. We fear that this extremely low standard for reliance on written representations subverts the intent of Section 764 of Dodd-Frank to protect swaps customers from swaps dealers. Written representations must be sufficiently detailed and informative to permit reliance, and the SEC must require that SBS dealers who wish to rely on those representations without further inquiry have a reasonable basis for believing those representations to be true.

We urge the SEC to adopt an approach to business conduct standards based on the rules proposed by the CFTC. While we have suggested improvements to the CFTC proposal, the business conduct standards proposed by the CFTC are much closer to the reforms intended by Dodd-Frank.

* * *

Thank you for the reviewing our comments and our attached letters. Should you wish to discuss further our views regarding protections for Special Entities, please contact Lisa Lindsley at (202) 429-1275.

Sincerely,

GERALD W. McENTEE
International President

Attachment 1

AFSCME February 22, 2011 Comment Letter to CFTC re Business Conduct Standards for Swap Dealers and Major Swap Participants (RIN 3038-AD25)

AFSCME
We Make America Happen

February 22, 2011

David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties (RIN 3038-AD25)

Dear Mr. Stawick:

The American Federation of State, County and Municipal Employees ("AFSCME") appreciates the opportunity to comment on business conduct requirements for swap dealers and major swap participants that are fundamental to implementing the reforms promised by the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). AFSCME is the largest union in the AFL-CIO representing 1.6 million state and local government, health care and child care workers. AFSCME members participate in over 150 public pension systems whose assets total over $1 trillion. In addition, the AFSCME Employees Pension Plan is a long-term shareholder that manages $850 million in assets for its participants, who are staff members of AFSCME and its affiliates.

During consideration of Dodd-Frank, AFSCME strongly supported the inclusion of provisions establishing the strongest possible market reforms, oversight and transparency for the "shadow markets" – principally the over-the-counter market that has grown to a size that dwarfs other markets.

<u>The Importance of Strong Derivatives Regulation is Well Established</u>

Before passage of Dodd-Frank, OTC derivatives – including interest rate swaps, foreign exchange contracts, equity swaps, commodity swaps, credit default swaps, and others - were described as bilateral agreements between sophisticated parties. As such, OTC derivatives were not subject to obligations to trade on exchanges and clear through regulated clearing operations – obligations that apply to other segments of the derivatives markets. However, the need to bring OTC derivatives into these regulated markets is clear: The public record of analysis gathered in the months following the crisis confirmed this conclusion: "It is widely acknowledged that OTC derivatives contracts, and particularly CDS, played a significant role in the current financial crisis. Although OTC derivatives have been justified as vehicles for managing financial risk, they have also spread and multiplied risk throughout the economy in the current crisis, causing great financial harm."[1]

Business Conduct Standard for Swap Dealers and Major Swap Participants With Counterparties is a Vital Component of the Statute's Promise

The proposed rule outlines the obligations of swap dealers and MSPs obligations to: verify counterparties' eligibility; disclose material risks; in certain transactions, provide a more detailed scenario analysis of various exposures or notify the counterparty of its right to request such an analysis; notify the counterparty of its right to receive, upon request, the daily mark from the derivatives clearing organization ("DCO") regarding cleared swaps, or for uncleared swaps, provide the daily mark, calculated as the proposal requires; notify the counterparty of its right to select the DCO at which to clear a swap subject to mandatory clearing and its right to elect clearing and choose the DCO for swaps not subject to mandatory clearing; and communicate in a fair and balanced manner based on principles of fair dealing and good faith.

The Commission repeatedly outlines the specific sources of analogous duties that already apply in other markets. Clearly, many of the large financial firms that will likely become registered swap dealers and MSPs once Dodd-Frank is implemented are already large players through the products and services they provide in those other markets and the army of intermediaries they employ as distributors.

Special Entities must be Protected as Congress Intended

By designating pension plans, endowments, foundations – pools of "other peoples' money" managed by fiduciaries and trustees with the highest duties of prudence and loyalty – as Special Entities, Congress made clear that *caveat emptor* does not apply. Instead, these Special Entities are managed by fiduciaries who for too long have been locked into a duty to ask, explore and evaluate that far exceeds the duty of sellers to reply responsibly.

The proposed rules require that a swap dealer that "acts as an advisor to a Special Entity regarding a swap shall have a duty to act in the best interests of the Special Entity." "Acting as an advisor" is defined as including a "recommendation" but

[1] "U.S. Financial Regulatory Reform: The Investors' Perspective", Investors Working Group, an Independent Taskforce Sponsored by CFA Institute Centre for Financial Market Integrity and Council of Institutional Investors, published in July 2009, submitted to the Federal Reserve Board September 22, 2010.

excluding activity where a swap dealer provides "information to a Special Entity that is general transaction, financial, or market information" or "swap terms in response to a competitive bid request from the Special Entity." It has been asserted by commenters "representing many of the most active participants in the swap markets"[2] that this is an overly broad concept of advice and, when coupled with disclosure requirements that amount to required "advice", will prevent Special Entities from experiencing the best of the swaps marketplace.

AFSCME agrees that it is important to focus on what constitutes "advice" in this market. Special entities – and no doubt many other investors – would be better served by clearer distinctions that alert investors as to when they are, and are not, receiving something they should consider the recommendation of a trusted advisor. In transactions and strategies as complex as many of those marketed to Special Entities, where familiarity with the intricate operation of a synthetic investment product will be so heavily tilted to one-side, it is of course challenging to distinguish between "advice," "education" or "sales and marketing".

The proposed rule imposes the duty to act in the Special Entities' "best interests" when acting as an advisor, as the law requires. It would be vastly improved if greater specifics could be identified to distinguish "recommendations" from the general "market information" that might elicit – as no doubt intended – a request for a bid that might then be considered outside the disclosure and other duties that should apply when dealing with a Special Entity.

SIFMA and ISDA assert that the disclosure required of swap dealers to special entities would be tailored, individual advice. AFSCME disagrees because the disclosure obligations outline the kind of information that dealers and banks would insist upon when dealing with each other, under circumstances when they would not imagine they are offering each other "advice". More is needed in order to turn detailed and specific information about a swap into "advice" about whether to invest in what is disclosed.

What Congress understands is that a seller representing itself as a "trusted adviser" and providing advice for which it would be accountable is often assumed by investors in swaps when the investor is not also a swap dealer. Therefore, Congress holds swap dealers to a higher standard when acting as an advisor recommending a swap or trading strategy. The Commission must continue refinements so that the distinction is clear and provides the protection that comes from accountability from swap dealers when they provide recommendations and up-front notice to Special Entities about how the rules change when they do not.

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[2] February 17, 2011, Submission of the Securities Industry and Financial Markets Association ("SIFMA") and International Swaps and Derivatives Association, Inc. ("ISDA"), page 1.

SIFMA and ISDA point to activity underway at the Department of Labor to reexamine and update the meaning of "advice" and "fiduciary" responsibility in light of the tremendous changes in products, services and players in the retirement world and the ways in which past definitions might not adequately capture the more complex offerings that exist today. The trade associations question whether the newly proposed expansion of ERISA's definition of a fiduciary might sweep in swap dealers offering recommendations as defined under the CFTC's proposed regulations. Informal consultations with the Department of Labor ("DoL") during the legislative consideration of Dodd-Frank provided assurance that duties imposed under other statutes do not automatically render those parties ERISA fiduciaries, and that providers of varied services to ERISA plans operate under many other duties that present no obstacle to their service to ERISA plans or access to the ERISA marketplace. More formal guidance from counsel with extensive ERISA litigation experience confirmed that assurance.[3]

It is important to convene a very public coordination and consultation process that involves the Department of Labor. SIFMA, ISDA, and other trade associations have stated their preference that the DoL and CFTC proposals "harmonize" by embracing a provision in the DoL proposal which they read as allowing sellers to avoid any fiduciary risk or obligation for giving advice by making clear that they are not impartial, and do have an interest in the advice being given. That is not an appropriate implementation of fiduciary duty regarding giving advice under ERISA and it is not the "solution" we want to see imported here to the CFTC's proposal. Compelling comments to DoL by the Pension Rights Center, the National Employment Lawyers Association, and many others, outline the inadvisability of this course (Appendix B). Simply saying "you're on your own" is not a meaningful way to modernize ERISA rules in an increasingly complex investing world. And it is certainly not what Congress intended regarding swaps.

SIFMA and ISDA note that their efforts to scale back what can be considered advice do not apply only to ERISA and DoL but also to the scope of commercial products and services available to the municipal marketplace as well. Clearly, it will be essential to drill deeper to unbundle the definition of "advice" for all the marketplaces. What is the investor buying? A product or strategy AND advice? How much is going to which party in the chain, and for what? Who bears accountability for the product and for the advice? And how were they compensated within the structure of the transaction? How was the Special Entity compensated for the risk it is bearing?

ERISA allows the DoL to grant exemptions that allow transactions with plans which could otherwise constitute "prohibited transactions" given, e.g., different kinds of compensation embedded in the product or transaction being structured. Many of those

[3] May 13, 2010, Letter from Karen L. Handorf and Marc I. Machiz of Cohen Milstein to Americans for Financial Reform (attached as Appendix A)

exemptions have been cited by SIFMA and ISDA and many others have been put into the CFTC comment record.[4] Some involve hedge funds and other investments and will likely be revised post Dodd-Frank even without DoL's attention to the definition of when one becomes a "fiduciary". Clearly, swaps play a large role in the ERISA marketplace, and they have done so without triggering some untenable fiduciary connection to date. The interplay between new Dodd-Frank provisions and ERISA will necessitate a reexamination of many prohibited transactions and the way in which they are structured to protect plans, so the suggestions of SIFMA, ISDA and others to coordinate these provisions with DoL, too, is well-taken.

Much of the challenge facing the CFTC, DoL and other regulators about defining "advice" is that, in practice, the result is not that more investors receive "advice." The result is efforts to exclude products and services and packages from the definition of "advice" or at least finding ways to exclude them from statutory prohibitions against conflicts of interest included in the package that affects the advice. One comment submitted to DoL recently helps to illuminate this challenge. It calls DoL's attention to a very real and time-sensitive example of the way in which packaged products can skirt the line between "education" and "advice" and highlights the kind of definitional precision that will be needed in these rules, as well. [5]

<u>Use Caution when Limiting the "Plans" that are considered Special Entities</u>

SIFMA, ISDA and other commenters suggest a variety of entities that might be excluded from the category of Special Entities to whom swap dealers owe particular responsibilities. More specifically, they suggest a variety of investment vehicles and structures that might hold investments from plans and suggest that they should be provided relief from Dodd-Frank's inhibitions on swap investments since they are already protected by ERISA's fiduciary responsibility requirements. AFSCME disagrees. The goal of Congress in protecting Special Entities and the special responsibilities they bear is not served by broadly alleging that "ERISA will do" and importing broad carve-outs.

SIFMA and ISDA also recommend that the Commission retain certain governmental plans within the definition of Special Entities, while excluding a wide variety of other governmental plans such as retirement and deferred compensation plans. That was not the intent of Congress. Ample evidence exists in the legislative history and the regulatory comments to confirm that the retirement plans SIFMA and ISDA would exclude from these new protections are a large part of the population they were explicitly intended to protect. Drafting typos are offered as the bases for allowing an exclusion that would do a huge disservice to an important new provision and to millions of workers and

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[4] August 31, 2010, Submission from Rick Matta.
[5] January 27, 2011, Comment by Anonymous, attached as Appendix C.

retirees.

AFSCME notes that more thorough and prudent statutory analysis is available in the comment record[6]. The New York City Bar Association's Committee on Futures and Derivatives Regulation notes in its comment of November 29, 2010, that "[T]he intense negotiations leading up to the adoption of the Act left little time for the draftspersons to review the final wording of many provisions." Agreed. The comments of Ropes & Gray, Inc., of September 28, 2010, amply demonstrate minor irreconcilable inconsistencies. However, Congress' intent is clear. The very public involvement of varied parties during the legislative and regulatory comment period confirms the broad scope of this provision. Efforts to exclude a huge part of the intended beneficiaries of this important new provision should be flatly rejected.

<u>The Independent Representative</u>

Similar arguments have been raised about how many Special Entities will use independent representatives in swaps. We expect that independent representatives of one kind or another will play a role for all entities, but we are more troubled with the role swap dealers envision them playing. Commenters emphasize the importance of swap dealers being able to rely on representations by Special Entities and their independent representatives. As consultation takes place with other regulatory agencies and additional refinements develop, AFSCME would like to see it made clear that Special Entities and independent representatives will be provided with meaningful disclosure that allows the Special Entity to make a well-informed decision. Comments that emphasize the protection swap dealers must get from reliance on representations and warranties they are to receive rather than give seem out of touch with the goal behind this legislative provision. A well-informed Special Entity will probably make the dealer's job – whether offering advice or general market information – easier, if nothing else by helping the swap dealer know whether to fish or cut bait. The independent representative cannot become the dumping ground for disclosure from the dealer and provide the dealer with representations and warranties that amount to a waiver of compliance.

<u>Coordination with Other Regulations and Regulators is Vital to Effective Implementation</u>

AFSCME supports the strong comments submitted by the Consumer Federation of American and Americans for Financial Reform. Those comments provided a broad and painful history we all know well of the experiences with swaps from which so many special entities are still working to recover. In addition, AFSCME urges caution and consultation about any assertions that pension money is well protected by ERISA, that

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[6] See, e.g., November 29, 2010 Submission of the New York City Bar Association on behalf of the Committee on Futures and Derivatives Regulation, and September 28, 2010, Submission by Ropes & Gray, Inc.

ERISA prevents unregulated swap participants from complying with new responsibilities, and that a regulatory overlap exists which necessitates carving back on newly enacted authority. It is clear that swap participants have pushed back the reach of ERISA just as they are using ERISA to push back swaps regulation; that statutory incompatibility of the two sets of duties does not exist, and that – far from there being a regulatory overlap – there is a wide gap that it is time to close.

* * *

We appreciate the opportunity to express our views in this matter. If you have questions regarding our comments, please contact Lisa Lindsley at (202) 429-1275.

Sincerely,

Gerald W McEntee

GERALD W. McENTEE
International President

Appendix A

COHEN MILSTEIN

Karen L. Handorf
(202) 408-3628
khandorf@cohenmilstein.com

May 13, 2010

Heather Booth
Director
Americans for Financial Reform
1825 K Street, N.W.
Suite 210
Washington, D.C. 20006

Dear Ms. Booth:

This is in response to your request for our views on the impact of the Restoring American Financial Stability Act of 2010 ("the Act"), as reported by the Senate Agriculture Committee, on ERISA plans. Under the proposed Act, a swap dealer or major swap participant ("swap dealer") that engages in a swap with a pension plan has certain "fiduciary" duties. Opponents of the provisions argue that pension plans will be barred from entering into swaps if these provisions are enacted because ERISA prohibits fiduciaries from acting on both sides of a transaction. It is our view that this argument is flawed because the proposed Act does not make swap dealers fiduciaries under ERISA. Consequently, the proposed Act would not bar pension plans from entering into swaps.

ERISA's definition of a fiduciary is a functional one. A fiduciary is defined, among other things, as anyone who "exercises any authority or control respecting management or disposition of plan assets" or "renders any investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other properties of such plan." *See* 29 U.S.C. § 1002(21). Absent special circumstances, a swap dealer would not ordinarily meet this fiduciary definition. The swap dealer is not exercising authority or control respecting management or disposition of plan assets nor is it rendering investment advice for a fee; it is simply selling a product to the plan.[1]

[1]*See, e.g., Fink v. Union Cent. Life Ins. Co.*, 94 F.2d 489 (8th Cir. 1996) (to become a fiduciary, agent must be more than "merely a salesperson earning commissions'); *American Fed'n of Unions, Local 102 Health & Welfare Fund v. Equitable Life Assurance Soc.*, 841 F.2d 658, 664-65 (5th Cir. 1988) (simply urging the purchase of its product does not make an insurance company an ERISA fiduciary with respect to those products).

The proposed legislation would not change this. The legislation requires a swap dealer to verify eligibility requirements, disclose certain information, communicate in a fair and balanced manner, and verify that the plan has an independent representative that meets specified characteristics. While the legislation labels these duties as "fiduciary" duties, they are not duties that constitute fiduciary activity under ERISA because the swap dealer is not exercising any authority or control over plan assets. The authority and control over the decision to enter into the swap remains with those who have investment authority for the ERISA plan.

Nor is the swap dealer an ERISA fiduciary merely by giving advice. As noted above, ERISA's definition of fiduciary includes a person who "renders investment advice for a fee of other compensation . . ." The Department of Labor has issued regulations which define when an investment advisor is a fiduciary.[2] Neither the statute itself nor the regulations make someone a fiduciary simply by advising a plan.

ERISA plans routinely employ individuals and entities that are subject to fiduciary duties that do not arise from ERISA. Except for the rare situation where they go beyond their usual function and exercise authority or control over plan decision making or meet the requirements of the investment advice for a fee regulation, they are not ERISA fiduciaries. For example, a lawyer who advises a plan has a fiduciary duty to the plan that arises from the lawyer-client relationship, but simply providing legal advice to a plan does not make the lawyer an ERISA fiduciary.[3] Instead, the lawyer is a service provider to the plan. As one court noted, it would be inconsistent with ERISA to equate a law firm's advice in favor of a transaction with the named fiduciaries' actual decision to enter the transaction.[4]

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[2] A person shall be deemed to be rendering "investment advice" to an employee benefit plan only if: "(i) such person renders advice to the plan as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing, or selling securities or other property; and (ii) such person either directly or indirectly . . . (A) has discretionary authority or control, whether pursuant to agreement, arrangement or understanding, with respect to purchasing or selling securities or other property for the plan; or (B) renders any advice . . . on a regular basis to the plan pursuant to a mutual agreement, arrangement or understanding, written or otherwise, between such person and the plan . . . that such services will serve as a primary basis for investment decisions . . . and that such person will render individualized investment advice to the plan based on the particular needs of the plan regarding such matters as, among other things, investment policies or strategy, overall portfolio composition, or diversification of plan investments." 29 C.F.R. § 2510.3-21(c).

[3] *See, e.g. Useden v. Acker*, 947 F.2d 1563, 1577 (11th Cir. 1991) (law firm, although subject to general laws applicable to the attorney-client relationship, was not an ERISA fiduciary because it did not "depart[] from the usual functions of a law firm or otherwise effectively or realistically control [] the [ERISA] Plan"); *Custer v. Sweeney*, 89 F.3d 1156, 1162 (4th Cir. 1996) ("While an attorney's duty to his client is that of a fiduciary . . . the mere fact that an attorney represents an ERISA plan does not make the attorney an ERISA fiduciary because legal representation of ERISA plans rarely involves the discretionary authority or control required by the statute's definition of "fiduciary").

[4] *Useden*, 947 F.2d at 1577-78.

Similarly, securities brokers owe fiduciary duties to their customers.[5] Nevertheless, unless a securities broker meets the definition of an investment advisor for a fee or otherwise asserts control or influence over management or disposition of plan assets, the security broker is not a fiduciary under ERISA.[6]

Those opposing the proposed Act assert that it would be entirely inconsistent for a swap dealer to act as a fiduciary because fiduciaries have a duty to place the interests of their principal above their own. This argument, however, confuses the duties imposed upon plan fiduciaries by ERISA and the fiduciary duties imposed upon swap dealers by the proposed bill. ERISA expressly requires plan fiduciaries to act solely in the interest of plan participants and beneficiaries. The Act imposes specific duties on swap dealers, mostly requiring disclosure, to ensure that the interests of plans are protected, but it does not impose upon them a duty to act solely in the interest of plans. Accordingly, swap dealers who are not fiduciaries as defined by ERISA would not be required to consider the interests of the plans above their own under the Act.

For this reason the argument that "it is, in fact, somewhat shocking that the participant groups would want the opposing party in a transaction to be the one looking out for the plan's interest" is without any merit. Under the Act, the swap dealer is not necessarily making any decisions for the plan, nor are plan fiduciaries required to rely solely on the representations of swap dealers in making decisions for the plan. Plan fiduciaries will continue to be subject to ERISA's requirements of prudence and loyalty when they engage in swaps and, to the extent prudence dictates it, are required to consult experts before engaging in any plan investment decision, including a swap transaction. The proposed Act would simply give plan participants an added layer of protection by requiring swap dealers to deal fairly and honestly with plans, disclosing information plans need to make informed decisions about whether to engage in a swap.

The argument that exemptions from ERISA's prohibited transaction rules will not solve the problem is based on the erroneous assumption that swap dealers will necessarily be ERISA fiduciaries. Section 406(b) of ERISA, 29 U.S.C. § 1106(b), prohibits fiduciaries from acting on both sides of a transaction. As noted above, swap dealers would not, solely by virtue of being swap dealers, meet the definition of "fiduciary" under ERISA. Consequently, there would be no need for an exemption from ERISA's prohibition against fiduciaries acting on both sides of a transaction. The Department of Labor has also already issued class exemptions that, under appropriate circumstances, would allow swap dealers to engage in transactions with plans.

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[5] *See Gouger v. Bear, Stearns & Co.*, 823 F. Supp. 282 (E.D. Pa. 1993).
[6] *See Farm King Supply v. Edward Jones & Co.*, 884 F.2d 288 (7th Cir. 1989).

Finally, the argument that swap dealers will be susceptible to lawsuits under ERISA from plans alleging that the dealer did not negotiate a good enough price is baseless. ERISA authorizes lawsuits against fiduciaries and if, as explained above, the swap dealer is not an ERISA fiduciary, no such suit would lie.

Very truly yours,

Karen L. Handorf

Karen L. Handorf
Marc I. Machiz

Appendix B

PENSION RIGHTS CENTER

NELA Advocates for Employee Rights
National Employment Lawyers Association

FILED ELECTRONICALLY

e-ORI@dol.gov

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

February 3, 2011

Re: Definition of Fiduciary Proposed Rule

The Pension Rights Center (the Center) and the National Employment Lawyers Association (NELA) submit the following comments on the Department of Labor's proposed regulations on the definition of fiduciary. The Center is a nonprofit consumer organization that has been working since 1976 to protect and promote the retirement security of American workers and their families. NELA has been advancing employee rights and serving lawyers who advocate for equality and justice in the American workplace since 1985.

The proposed regulations would replace current regulations, adopted in 1975, that tightly circumscribe the circumstances under which a person or entity becomes a fiduciary when providing investment advice to a plan or participant for a fee. The regulations would also reverse a 1976 advisory opinion holding that a firm valuing employer stock for an ESOP was not a fiduciary.

The 1975 regulation and 1976 advisory opinion were not compelled by the statute and, in our view, reflected an improper narrowing of the congressional definition of fiduciary. In addition, as the Department suggests in its preamble to the proposed regulations, economic and legal developments in the fields of investments and employee benefit plans have rendered the earlier positions anachronistic and, at times, at cross-purposes with the statute. The proposed regulations are much-needed and long-overdue.

Background

When Congress passed ERISA in 1974, it included rules governing the conduct of fiduciaries. Senator Harrison Williams, Chair of the Senate Labor Committee and a key co-sponsor of ERISA in the Senate, explained the need for these rules when he presented the ERISA Conference Committee resolution reconciling the House and Senate versions of pension reform legislation: "Despite the value of full reporting and disclosure, it has become clear that such provisions are not in themselves sufficient to safeguard employee benefit plan assets from such abuses as self-dealing, imprudent investing, and misappropriation of plan funds."[1] In other words, fiduciary standards were essential for the protection of participants in employee benefit plans. Congress crafted rules applying fiduciary standards not only to plan trustees, but to a range of individuals and entities whose actions affect the security and use of plan funds and the benefits of participants. These rules of conduct applied to "fiduciaries," which Congress defined as any person who fits one of the following categories:

(1) exercises any discretionary authority or discretionary control respecting management of a plan;[2]

(2) exercises any authority or control respecting management or disposition of a plan's assets;[3]

(3) renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of a plan, or has any authority or responsibility to do so[4]; or

(4) has any discretionary authority or discretionary responsibility in the administration of a plan.[5]

The 1975 regulations addressed the third aspect of the definition – a person who renders investment advice for a fee. The regulations narrowed the statutory language (which broadly provided that a person is a fiduciary if he renders investment advice "for a fee or other compensation, direct or indirect, with respect to any moneys or other property of" a plan) to two narrow circumstances: first, if a person has discretionary authority or control with respect to purchasing or selling securities or other property for a plan;[6] and second, if a person renders investment advice to a plan on a *regular* basis, pursuant to an agreement or understanding that the advice will be a *primary* basis for the plan's investment decisions, and that the advice is *individualized* to the particular needs of the plan.[7] In the preamble to the presently proposed regulations, the Department describes this as a five-part test, with a person found to be a fiduciary only if all five parts of the test are met.

The regulations also provided, in effect, a definition of the type of advice that concerned plan investments: advice concerning the value of securities or property, or advice concerning the advisability of investing in, purchasing, or selling securities or other property.

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[1]Comments of Senator Harrison Williams, Legislative History of the Employee Retirement Income Security Act of 1974, Vol. III, at 4741(Aug 22, 1974)(comments concerning the Committee of Conference on H.R. 2).
[2]ERISA § 3(21)(A)(i).
[3]ERISA § 3(21)(A)(i)
[4]ERISA § 3(21)(A)(ii)
[5]ERISA § 3(21)(A)(iii).
[6]We note that a person who has such authority would be an investment adviser even without the "investment advice for a fee" component of the statutory definition, since the person would be exercising discretionary control of a plan asset.
[7]29 C.F.R. § 2510.3-21(c)(1)(ii)(B).

A year after the 1975 regulations were promulgated, the Department held that a consultant that provided an evaluation of employer securities for an ESOP was not a fiduciary under the regulatory definition, because the valuation would not "involve an opinion as to the relative merits of purchasing the particular employer securities in question as opposed to other securities," and would thus not serve as a "primary basis" for plan investment decisions nor "constitute advice as to the value of securities."

The newly proposed regulations would substitute a simpler and more easily understood, enforced, and administered test that bears greater fidelity to the statutory language and is appropriate to developments over the intervening 35 years in the areas of retirement plans and investments. The new test would provide that a person renders investment advice for a fee under ERISA if the person gives certain types of advice to a plan, plan fiduciary, or plan participant or beneficiary, and also falls within one of four categories of persons.

The types of advice covered by the proposed regulation are: (1) advice, appraisal, or fairness opinion concerning the value of securities or other property; (2) advice or recommendation as to the advisability of purchasing, holding, or selling securities or other property; and (3) advice or recommendations as to the management of securities or other property. The new regulations thus expand the ambit of covered investment advice from the 1975 regulations to fairness letters and appraisals of property, and eliminates the cumbersome five-part test that depends on the proof of the details of the relationship between advisor and advised and eliminates from the realm of investment advice much that any layperson would understand to be such advice.

By including advice as to the management of securities or other property in the definition of investment advice (not just advice as to valuation or the advisability of purchasing or selling securities), the Department makes explicit in the text of the regulation, its longstanding interpretation of the existing regulation, which included advice as to the selection of managers and investment options. DOL Adv. Op. 84-04A, 1984 WL 23419, *1-3 (Jan. 4, 1984). The regulations also make clear that advice as to the management of a particular asset, e.g. advice as to proxy voting or how to maximize the income incident to a piece of real property, is also fiduciary advice. In addition, they make explicit that investment advice gives rise to fiduciary status if it is furnished to a plan participant or beneficiary.

To be considered a fiduciary under the proposed regulations, a person who gives such advice meets the requirement of the regulations if the person: (1) represents or acknowledges that it is acting as a fiduciary; (2) is already a fiduciary under the other legs of the statutory definition of fiduciary; (3) is an investment adviser under the Investment Advisers Act of 1940; or (4) provides advice or makes recommendations pursuant to an agreement, arrangement, or understanding between such person and the plan, plan fiduciary, participant, or beneficiary that such advice may be considered in connection with making investment or management decisions with respect to plan assets and will be individualized. The proposed regulations' most important departure from the 1975 regulations is that under the fourth category, the advice does not have to be rendered on a regular basis and need not be provided pursuant to an agreement or understanding that it will serve as a "primary" basis for investment.

As discussed below, however, the advice must be provided pursuant to an agreement or understanding that such advice may be considered in connection with making investment management decisions and will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary. The existing regulations provide that advice be individualized to the needs of the plan. The new regulations, in what we understand is clarification of the Department's existing interpretation, make clear that the advice may be individualized to the needs of the plan, plan fiduciary, plan participant, or beneficiary, i.e. to the needs of the recipient of the advice, to distinguish such advice from the generalized buy recommendation that a broker might issue to all of its clients on a given publicly traded stock.

The regulations also include a number of limitations on the regulations' coverage. One of the limitations provides that a person offering advice or recommendations is not an investment-adviser fiduciary if such person can demonstrate that the recipient of the advice knew, or should have known, that the person is providing the advice in its capacity as a purchaser or seller (or agent for a purchaser or seller) of securities or other property, whose interest are adverse to the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice.

The regulations also do not apply to persons who provide only investment education or persons who make available to a plan a group of investment options from which a plan fiduciary will decide which options to offer. The term investment advice also does not include advice or an appraisal or fairness opinion for purposes of complying with reporting and disclosure requirements of ERISA or the Internal Revenue Code unless such report involves assets for which there is not a generally recognized market and which serves as a basis on which a plan may make distributions to plan participants and beneficiaries.

The Preamble to the Regulations also invites comments on the question of whether a person who gives advice to participants with respect to distributions is providing investment advice.

Revision of the 1975 Regulations is Warranted

Developments in Retirement Plans and Investments Since 1975

The existing regulations were promulgated in 1975, at the dawn of the ERISA era. Since then, there have been significant changes in the retirement plan and investment universe that have undermined whatever justification there might have been for the regulations' cramped scope. As the preamble to the proposed regulations notes, there has been a seismic shift in the retirement plan world from defined benefit plans – in which investment advice was generally rendered to sophisticated plan fiduciaries – to self-directed defined contribution plans – in which investment advice is issued to individual participants, many of whom have only rudimentary financial literacy. Mutual funds, and sellers and brokers for mutual funds, who played a relatively small role in retirement plans at the time ERISA was enacted, have become dominant players in the new order. The variety and complexity of investment products has also changed markedly over the last three decades.

At the time of the 1976 advisory opinion on valuations of employer stock for ESOPs, there were only 250,000 participants in 1,600 ESOPs. Today ESOPs cover more than 12 million participants in over 10,000 plans, which hold almost 1 trillion dollars in employer securities.[8] The exponential growth of ESOPs has been accompanied by numerous cases involving improper valuations of employer stock purchased or sold by ESOPs.[9] Yet, the 1976 opinion letter effectively shields these plans' valuation advisers from fiduciary liability.

There have also been significant legal developments since the time the regulations were promulgated. The Supreme Court ruled in *Mertens v. Hewitt Associates,* 508 U.S. 248 (1993), that a participant generally is entitled to legal relief under ERISA only if the defendant is a fiduciary who caused monetary loss to a plan.[10] A participant can sue a person other than a fiduciary only for equitable relief, and the Supreme Court has narrowly circumscribed the extent to which such equitable relief is available. *Great West Life & Annuity Ins. Co. v. Knudson,* 534 U.S. 204 (2002). The Labor Department, which filed *amicus curiae* briefs arguing against these positions, could not have known in 1975 that its narrowly drawn regulations and ERISA preemption would effectively create an unregulated playing field for so many actors who have a direct and substantial impact on plan investments.

Finally, in the period since 1975, the Department has determined that voting of proxies and similar issues are part of investment management and has concluded that investment advice as defined in the regulations includes advice regarding the selection of investment managers. This last point has caused controversy see *Cohrs v. Salomon Smith Barney*, 2010 WL 2104535 (D.Or., Aug. 31, 2005). and recently required the DOL to file an amicus brief to defend its interpretation of the old regulations. See DOL amicus brief in *In Re Beacon Securities Litigation*, 09-CV-077 (LBS), 2010 WL 3895582 S.D.N.Y. Although the Department's position prevailed in district court, the issue remains hotly contested and will likely be the subject of an appeal by defendants in *Beacon* if plaintiffs prevail on the merits. It is therefore appropriate for the Department to revise the regulations to address investment advice concerning such issues to eliminate any doubt in the courts that such advice should give rise to fiduciary status.

We have heard it argued that this view, that investment advice should include advice regarding the selection of fiduciaries to manage assets, will have the baneful effect of discouraging informal advice about, for example, the selection of independent fiduciaries from trusted advisors such as plan counsel. We disagree. Advice as to the selection of an independent fiduciary is not legal advice if it goes beyond evaluating whether a particular firm meets the legal requirements to act as an independent fiduciary or advising as to the nature of a prudent selection process. If lawyers choose to go beyond providing legal advice and provide advice as to whom a plan should select to manage plan assets, then there is no reason why those lawyers should receive a special dispensation from fiduciary status as compared to a consultant who habitually

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[8]The National Center for Employee Ownership, "A Statistical Profile of Employee Ownership," http://www.nceo.org/main/article.php/id/2. These figures do not include 401(k) plans with employee stock funds.
[9]*See, e.g., Keach v. U.S. Trust Co., N.A.*, 239 F. Supp. 2d 820 (C.D. Ill. 2002)(appraiser not a fiduciary); *Clark v. Ameritas Investment Cor.*, 408 F.Supp. 2d 819, (D. Neb. 2005)(appraiser not a fiduciary).
[10]ERISA §409(a). A fiduciary who breaches its responsibilities under the statute is also obligated to return to the plan any profits the fiduciary made through the use by the fiduciary of plan assets. *Id.* In *Mertens,* the Court specifically held that a non-fiduciary who knowingly participated in a breach of trust was not subject to section 409(a)

makes recommendations about asset allocations and asset manager selections, unless we adopt the too-convenient fiction that no one heeds the advice of lawyers who exceed the ambit of their professional competence. The concern that plans will be deprived of the unique perspective of lawyers who have experience working with independent fiduciaries is overblown. Lawyers can identify the independent fiduciaries with whom they have worked and describe factually their experiences with them without purporting to make a recommendation. Alternatively, they can make a recommendation and lawyers, more than anyone, understand that the implicit claim of competence in giving such advice will give rise to fiduciary responsibility.

The 1975 Regulations Improperly Narrowed the Meaning of Investment Advice

ERISA § 3(21)(A) provides straightforwardly that a person is a fiduciary if he "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so." The 1975 regulations narrowed the scope of this language by limiting it to investment advice that was "regular," rather than one-time or episodic; advice that was rendered pursuant to an agreement or understanding that it would be a "primary basis" for investment; and advice that is "individualized" to the particular needs of the plan.[11] These limitations are not consistent with the plain meaning of the term "investment advice," and at least in retrospect can be said to impede rather than advance the congressional goals of limiting self-dealing and of assuring prudent investment of plan assets.[12] As the Preamble to the Proposed Regulations notes, people providing investment advice not covered by the regulations have considerable influence on the decisions of plan fiduciaries and sometimes have conflicts of interest that result in lower returns and less retirement income for plan participants and their beneficiaries. The regulatory definition

[11]The Preambles to the proposed and final 1975 regulations include virtually no explanation for the Department's introduction of these extra-statutory conditions on the meaning of investment advice. The few comments noted in the Preamble to the 1975 final regulations asked that the definition of investment advice be narrowed (the Department responded to these comments by adding to the final regulations additional limitations on the meaning of investment advice); asked that the meaning of "fee or other compensation" be clarified (the Department responded to these comments by indicating that it was still studying this issue); asked that the applicability of the regulations to investment companies subject to the Investment Company Act of 1940 be limited (the Department responded to these comments by adding to the final regulations some conditions and limitations related to the purchase and sale of securities by investment companies); and asked for clarification of certain issues involving broker-dealers and investment advice (the Department responded to these comments with a discussion of these issues in the Preamble to the final regulations). The Preamble to the final regulations is silent as to whether it received any comments suggesting that the regulations defined investment advice too narrowly, suggesting that it did not. From conversations we have had with other groups representing interests of participants, it does not appear that such groups submitted comments on the 1975 proposed regulations (neither the Center nor NELA existed in 1975). In any event, the Department, in response to a FOIA request, has indicated that it cannot locate the comments submitted on the proposed regulations.

[12]We also note that the Supreme Court had not yet decided *Chevron U.S.A., Inc. v. Natural Resources Defense Counsel, Inc.*, 467 U.S. 837 (1984). In *Chevron*, the Court wrote that in determining what deference to give to an agency decision, the first question "always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." There is no ambiguity about the meaning of the term "investment advice" and the only limitation that Congress placed on whether a person becomes a fiduciary because it rendered investment advice is that the investment advice was rendered for a fee or other compensation. Yet the regulations substituted a unique definition of investment advice by providing that the advice had to be offered on a regular basis, had to be a primary basis for a plan's investment decisions, and had to be part of an agreement to provide individualized advice.

is also inconsistent with judicial language indicating that Congress generally intended the term fiduciary to be "broadly" construed.[13]

The problems of the regulatory definition are illustrated in judicial decisions. *In Farm King Supply, Inc. Integrated Profit Sharing Plan and Trust v. Edward D. Jones & Company*, 884 F.2d 288 (7th Cir. 1989), a plan followed a brokerage firm's conflicted investment advice and suffered a loss, but the court held that the brokerage firm was not a fiduciary because "there was no mutual understanding that Jones' advice would be a *primary basis* for Plan investments."

In a recent district court case, *Bhatia v. Dischino*, 2010 WL 1236406 (N.D. Tex. March 30, 2010), the trial court held that the actuarial consulting firm was not a fiduciary under the regulations, because the plaintiffs did not plead adequate facts to show that the firm "rendered advice on a regular basis as part of a mutual agreement that such advice serve as the primary basis of investment decisions."

The Department has explained that developing proof of the elements of the regulations, even where proof exists, has slowed and impeded enforcement of ERISA for the Department of Labor. The lack of support in the statute for the conditions in the regulation and the difficulties for enforcement are reasons enough for the regulation. But the Center and NELA would like to point out that Congress intended that ERISA would be enforceable by ordinary participants and beneficiaries who, unlike the Department of Labor, do not have subpoena power and have no ready access to the documents and testimony that would demonstrate fiduciary status under the detailed existing regulation. This has always been a severe impediment to enforcement of fiduciary responsibility by private plaintiffs, but it has been greatly exacerbated in recent years because the Supreme Court has adopted a "plausibility" standard for the evaluation of complaints on a motion to dismiss. As a consequence, complaints alleging fiduciary status may be dismissed if they fail to allege factual support for some element of the regulation, and factual support will typically be unavailable or limited without discovery. See e.g. *Glen Ridge Surgicenter, LLC v. Horizon Blue Cross Blue Shield of New Jersey, Inc.*, No. 08-6160 (JAG), 2009 WL 3233427, at *6 (D.N.J. Sept. 30, 2009) ("[P]roof of [defendant]'s fiduciary status is an element of the fiduciary duty claim, and 'a formulaic recitation [in the complaint] of the elements of a cause of action will not do.'" (quoting *Bell Atl. Corp.* v. *Twombly,* 550 U.S. 544 (2007)); see also *Braden v. Walmart Stores, Inc.,* 588 F.3d 585, 598 (8th Cir. 2009) (discussing the problem that participants are often without access to information that would allow them to plead factual support for each element of a claim).

The new regulations recognize that investment advice is no less important merely because it is rendered on a one-time basis. An individual who advises on the purchase of employer stock with all of the assets of an ESOP on a one-time basis is not less worthy of regulation than an individual who advises quarterly on asset allocation in a defined benefit plan. Moreover, the regular basis requirement finds no support in the statute or the legislative history.

Similarly, the requirement that advice be offered pursuant to an agreement or understanding that the advice will be a primary basis for making a decision is and always has been unsupported by the statute and extremely difficult to prove. As a practical matter, contracts with investment

[13]See, e.g., *LoPresti v. Terwilliger*, 126 F.3d 34, 40 (2nd Cir. 1997).

advisors are simply not written this way. An advisor agrees to provide advice of a particular sort in exchange for some form of compensation. There is no reason why the contract should specify how the advice may be used by the plan fiduciary. So while the advice may be the only real basis for an investment decision by the plan fiduciary, there will be no written agreement that the advice will be primary or even significant. Almost invariably, such an agreement or understanding will have to be inferred and will be rebutted by an integration clause in any written agreement providing for the advice. This hurdle, which the new regulations eliminate, seems to have been designed to give almost all advisors who did not specifically seek to be treated as fiduciaries a good faith argument that they are not fiduciaries. Consequently, this requirement in the old regulations is profoundly destructive of ERISA's purpose to protect participants and beneficiaries. The elimination of this requirement in the new regulations is not merely warranted, it is of critical importance.

The new regulations do not eliminate the requirement that advice be individualized, but clarify that advice should be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary. This reflects the Department's interpretation of the existing regulations but it is an important clarification. An enormous percentage of plan assets are managed in pooled vehicles holding plan assets of many plans. These may be master trusts, insurance separate accounts, fund-of-funds, and hedge funds usually organized as LLC's and operating pursuant to private placement memoranda. Advice that is "individualized" for the fiduciaries of these pooled vehicles is not individualized for a particular plan, and yet such advice is no less worthy of regulation than advice provided to one plan at a time. If anything, regulation of such advice is more critical than advice given to a single plan with the needs of that plan in mind. Similarly, many investment decisions are made by participants in 401(k) plans, and the advice given to them should not escape regulation because individual participants are uniquely vulnerable to self-interested investment pitches.

The decision in the new regulations to cover appraisals is warranted. As a practical matter, appraisers set the price of assets that are purchased or sold by plans, including and especially the closely-held employer stock that plans purchase or sell. To suggest that this advice is not investment advice defies common sense. Often an appraiser is the only outside advisor a fiduciary relies on in deciding to purchase an asset at a particular price.

In an ESOP, price is the critical concern, since diversification is excused and the courts have been skeptical of claims that employer stock may be "too risky" to be a prudent investment. We anticipate that appraisers will argue that they should not be held to fiduciary standards when their appraisals are only used for compliance and distributions. We think the proposal as it stands is appropriate. Note that the courts seem to provide a more deferential review of decisions (and by extension advice) involving only distributions. See *Armstrong v. LaSalle National Bank,* 446 F.3d 728(7th Cir. 2006) (fiduciary setting a value for ESOP distributions is entitled to deference because he must balance the interests of those taking a distribution with the interest of those who stay in the plan).

Equally important, the Department's longstanding interpretation of its regulation to exclude appraisals is difficult to defend. The opinions of appraisers are at least "a primary basis" for a typical plan's decision to buy or sell a hard-to-value asset at a particular price, and this is certainly understood by appraisers hired to value stock or other assets for a transaction. At best it might be argued that an appraiser is often hired for one transaction or one appraisal at a time, so an appraiser's opinion may well not be provided on a regular basis. Following the plain meaning of the statute, if not the old regulations, the advice given by appraisers that guides the fiduciary's decision to purchase or sell a particular asset at a particular price certainly falls within the plain meaning of "investment advice."

The Current Regulations Create Legal Uncertainty

The 1975 regulations also introduce inherently vague definitional concepts into the definition of investment advice. The regulations do not define what is meant by providing advice on a "regular basis," what is meant by advice that will be "a primary basis" for the plan's investment decisions, nor what is meant by advice that is "individualized to the plan's" needs. These must be determined on a case-by-case basis. The inherent ambiguity and subjectivity of these concepts creates uncertainty in the law and strains Departmental, judicial, and private resources in litigation of issues not related to the core concept of investment advice.

Comments on the Proposed Regulations

As we earlier indicated, we strongly support the Department's initiative to redefine the meaning of investment advice, although we offer the following comments that would strengthen the proposed regulation and more faithfully implement Congressional intent.

1. Section 2510-3-21(c)(ii)(D) makes a person who issues investment advice a fiduciary if, among other requirements, the advice "will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary." At least in cases of individual participants and beneficiaries, we are not certain why a person would be a fiduciary only if their advice was sufficiently individualized (and the regulations do not discuss when advice is sufficiently individualized to meet the proposed regulatory requirement). We have doubts that a typical participant or beneficiary will be able to discern a difference between individualized and non-individualized advice.

We are also concerned that some advisers who do not have the interests of participants at heart may be focused on selling a particular investment, rather than providing individualized advice about a variety of investments or strategies. In such instance, if the advice is directed to an individual, that advice might influence that individual's investment choices within a plan just as surely as advice that is individualized.

Finally, this aspect of the regulation might provide a perverse incentive to some providers of investment advice to not tailor the advice to the particular needs of the individual in order to avoid fiduciary status. Our concern for advice given to individual participants is heightened when the person giving the advice has been given an aura of legitimacy by virtue of having been appointed to provide advice by a plan fiduciary or who otherwise has the imprimatur of the plan, e.g., a custodian or contract administrator. At least with respect to participants, we would prefer that the regulations provide that the advice be directed to a particular participant rather than that it be "individualized."[14]

As to advice given to plans and plan fiduciaries, the regulation should be modified to eliminate the requirement that there be an agreement to provide individualized advice.

It should be sufficient that there is an agreement to provide investment advice and that the service provider performs the agreement by the providing individualized advice. Agreements generally do not specify that advice will be individualized, even when individualized advice is contemplated. For example, when a consultant is hired to recommend investment managers for a particular fund, the agreement to provide individualized advice may be unspoken or assumed by the parties - generally such a consultant will take into account the needs of the fund by providing more than a generic ranking of manager performance. Consequently, some of the very proof and investigational difficulties that inspired the new regulations will still be present unless this requirement is modified.

Moreover, the definition of "individualized" should be clarified further. The Center and NELA understand that the Department does not wish to encompass within the definition of fiduciary mere brokers or others who provide "research" on stocks, bonds, and other investments, rating them as buys, sells or holds, calculating betas or other risk measures or predicting returns. But it should be clear that when an advisor tells a fiduciary with control of plan assets (pooled or not) or a participant to buy or sell a particular investment, or that an investment without a ready market that the fiduciary is considering purchasing or selling has a particular value, then that advice is sufficiently individualized. The distinction should be between saying "you should consider buying Xerox" and "our firm rates Xerox a buy;" the first statement should be considered "individualized," regardless of the thinking or specific intent behind it. A focus on portfolio composition and diversification fails to capture this concept. Further clarification, perhaps with examples, should be undertaken in the final regulations.

2. Section 2510-3-21(c)(2)(i) provides that a person shall not be considered to be a fiduciary investment adviser if such person can demonstrate "that the recipient of the advice knows or, under the circumstances, should have known, that the person is providing the advice or making the recommendations in its capacity as a purchaser or seller of a security or other property, or as an agent of, appraiser for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice."

While we believe that this limitation may be appropriate when such advice is provided to a sophisticated plan fiduciary, it is not appropriate when the advice is given to individual participants or their beneficiaries. The Center and NELA have worked with participants for 35 and 26 years respectively, and it is our experience that most plan participants will not be able to discern when advice is impartial or conflicted. In addition, even if there is disclosure, in a one-to-one meeting, whether in person or by phone, an unsophisticated investor will often regard the

[14]Non-individualized advice on asset allocation and the like, however, will generally be characterized as investment education rather than investment advice.

adviser as acting in his interest. This is particularly true if the participant does not have access to other advisers. Indeed, an adviser's success may depend on a client's belief that the adviser is interested primarily in the customer's welfare, despite a declaration of self-interest. There is the further fact that most participants will not be knowledgeable about the types of fees and benefits that can accrue to the purchaser or seller of securities. Thus, we strongly urge the Department to revise this limitation so that it only applies to advice and recommendations given to plan fiduciaries.[15]

3. Section 2510-3-21(c)(2(iii) of the proposed regulations provides that investment advice does not include an appraisal or fairness opinion that reflects the value of an investment of a plan or participant or beneficiary, provided for purposes of reporting and compliance under ERISA or the Internal Revenue Code, unless such report involves assets for which there is not a generally recognized market and serves as a basis on which a plan may make distributions to plan participants and beneficiaries. We believe that the Department should consider revising the limitation so that it would not apply to situations when an appraisal of property for which there is not a generally recognized market would have a material effect on the funding status of a defined benefit plan.

The Center and NELA recognize that appraisers will typically include scope limitations in their appraisals. For example they will say that they are relying on management projections in preparing a discounted cash flow. In such cases, it is up to the user of the appraisal to assure himself that the projections relied upon are reasonable. The Department should be able to address the concerns of appraisers by indicating that scope limitations will be respected, and appraisers will be held responsible only for the opinions that they express (complete with limitations), subject to section 405 of ERISA, so that an appraiser who knew that he was being provided with unreliable information would have a duty to take steps to remedy the situation.

4. The Department asked for comment on whether and to what extent the final regulation should define the provision of investment advice to encompass recommendations related to taking a plan distribution. The Department has taken the position that a person providing investment advice to a participant in an individual account plan is a fiduciary, even if the person is chosen by the participant and has no other connection to the plan.[16] The Department has also held that if a plan fiduciary responds to participant questions about the advisability of taking a distribution or the investment of amounts drawn from the fund, that fiduciary must act for the sole and exclusive benefit of the participant. Moreover, a fiduciary that advises the participant to invest in an IRA managed by the fiduciary may be in violation of the prohibited transaction rules of ERISA and the Internal Revenue Code.

However, the Department has also opined that, if the person providing such advice on distributions is not connected with the plan, that person can recommend that the participant take

[15]We also note an additional concern: the proposed rule appears to undercut the prohibited transaction exemptions that apply when fiduciaries provide investment advice under certain limitations designed to protect plan participants from conflicts of interest. See ERISA § 408(g). Under the proposed regulations, an investment adviser could claim that it did not become a fiduciary under the "sale or purchaser" limitation and thus was free to give investment advice without complying with section 408(g).
[16]DOL Advisory Opinion 2005-23A.

a distribution and invest in a fund managed by that person and that does not constitute investment advice under the current regulations.[17] We see no reason for this distinction and believe that the regulations should be changed.

A recommendation to remove assets from the plan and invest them elsewhere is, in effect, a judgment about the relative merits of the plan options and the other investment(s). The person making the recommendation can have interests adverse to the plan participant and the recommendation can have a substantial effect on a participant's retirement security, both in terms of future investment performance, the loss of an economically efficient means of taking retirement income in annuity form, and tax considerations. Moreover, under the current interpretation, the person giving advice in these circumstances has no obligation under ERISA to reveal their conflict of interest. Such advice should be considered investment advice under the new regulations.

We are especially concerned about the problem of advice given by plan custodians and non-fiduciary administrators. We are aware of participants and beneficiaries who call plans to arrange for or inquire about a distribution who are then solicited to invest in products offered by the plan service provider. At a minimum the regulations should address this concern by making the entities that provide this "advice" fiduciaries. Participants and beneficiaries are inclined to believe that the persons assigned to address their inquiries regarding their rights in the plan have their interests at heart. In truth, they are unknowingly exposed to salesmen with a financial interest, whether disclosed or not. Persons using their privileged access to plan participants and beneficiaries gained through their positions (even ministerial positions) with a plan to steer participants and beneficiaries into their investment products should be held to fiduciary standards.

5. Section (c)(ii)(B) of the regulations should be clarified by adding "a plan fiduciary" after "individualized needs of the plan" and "managers" after "securities." More importantly, we are concerned that such menus that are excluded from investment advice be limited to those that give the fiduciary a broad choice to select from. At one extreme, if fiduciaries are presented with a specific or very limited lineup, it is hard to see why the individual promoting that lineup should be excused from being deemed a fiduciary, even if he discloses that he is selling a product and is not disinterested. In addition, such disclosure should specify the nature of the individual's financial interest—i.e., how is he being paid and how much he is being paid to recommend these alternatives.

6. The Preamble to the Regulations should be revised to indicate that the Department has taken litigation and administrative positions prior to the issuance of the proposed regulations interpreting the existing regulations that investment advice to a plan encompasses; a) advice to plan fiduciaries, including fiduciaries of pooled vehicles; b) advice with regard to the selection of managers; and c) advice paid for by third parties, e.g., commissions. Likewise, the Department should clarify in the Preamble that it does not view its interpretation of the existing regulations' requirement of individualized advice as precluding advice individualized to the needs of plan fiduciaries of pooled vehicles rather than a particular plan. Without such clarification,

[17] *Id.* See also *Walsh v. Principal Life Insurance Co.*, 49 EBC 1344 (S.D. Iowa 2010).

defendants will argue that the new regulations implicitly recognize that such advice would not give rise to fiduciary status under the existing regulations.

Conclusion

In sum, this is a much needed regulatory change that will better protect plans and participants and facilitate more effective enforcement when misconduct is uncovered. The Pension Rights Center and NELA applaud the Department for pursuing this initiative that will benefit both retirement plans and their participants and beneficiaries.

Respectfully submitted,

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Appendix C

Sent: Thursday, January 27, 2011 5:58 PM
To: EBSA, E-ORI - EBSA
Subject: Comment on the Proposed Fiduciary Rule

My firm respects fiduciary roles but is not in a position to challenge those who don't. So we hope you will respect our anonymity when we tell you that lots and lots of registered reps/brokers/advisers have no intention of playing by your new fiduciary advice rules. Rather, they intend to hide behind a loophole you've created.

...twice.

If you recall, the original PPA section 624 regs required QDIA allocations be either tucked inside a '40 act fund or controlled by an erisa 3(38) fiduciary. However, mega plans and mega consultants lobbied-in model portfolios as a sanctioned QDIA. This created a loophole through which small plan advisers can slip past PPA section 601 (and now the proposed Fiduciary Advice Rule) by simply calling their potentially imprudent/conflicted advice a "QDIA asset allocation model".

Here's the problem: the final QDIA reg threw the fiduciary liability of model portfolios back to the plan sponsor. Again, fine for a mega plan. However, we doubt the thousands of small plans that were subsequently sold [potentially] imprudent/conflicted models understand that (1) their adviser is exposing them to prohibited transactions, for which (2) they are personally liable, and, for which (3) the advisor has a get out of jail card courtesy of the US Department of Labor.

It is no surprise, then, that every recordkeeper (...OK, every recordkeeper that doesn't have a self-dealing proprietary lifecycle fund!) now offers a tool that turns a plan's style-box funds into model portfolios. Big custodians are making the loophole easier to use by developing tech that allows model portfolios be traded across recordkeeping platforms.

The "oops you've done it again" is on page 17 of the proposed rule. You lump models into a general exemption: "plan information, general financial and investment information, *asset allocation models*, and interactive materials – would not involve advice or recommendations within the meaning of paragraph (c)(1)(i) of the current regulation. The proposed modifications to the advice and recommendations described in paragraph (c)(1)(i) would not change this conclusion."

If your intent was to exempt generic asset class "pie charts", you need to make this clear. Specifically, the Rule should state that the exemption does not apply to models that map stock/bond/int'l asset classes to plan-specific stock/bond/int'l funds in an investable manner. To close the loophole the Rule should further state that:

- Taking discretion over model portfolio allocation & construction is a fiduciary act
- That an adviser doing so is liable under erisa
- That the plan sponsor must ensuring the allocator has no conflicts of interest.
- That the sponsor must prudently selecting & monitoring the adviser's allocation credentials, track record, processes, and insurance.

If you do not close the QDIA/Fiduciary Rule model portfolio loophole, the very intermediaries you seek to control will hide behind it, while leaving their small business owners clients liable for their losses.

Regards,

Anonymous

Attachment 2

AFSCME April 12, 2011 Comment Letter to the Department of Labor re Public Hearing on Definition of Fiduciary

April 12, 2011

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

Re: Public Hearing on Definition of Fiduciary

Dear Sir or Madam:

The American Federation of State, County and Municipal Employees ("AFSCME") is the largest union in the AFL-CIO representing 1.6 million state and local government, health care and child care workers. AFSCME members participate in over 150 public pension systems whose assets total over $1 trillion. In addition, the AFSCME Employees Pension Plan is a long-term shareholder governed by the Employee Retirement Income Security Act ("ERISA") that manages $850 million in assets for its participants, who are staff members of AFSCME and its affiliates.

AFSCME is pleased to have this opportunity to comment on the proposed definition of "fiduciary" by the Employee Benefits Security Administration ("EBSA") of the Department of Labor ("DoL"). We applaud the effort to update this 35-year old rule. We urge the DoL to adopt a definition that reflects the evolution of investment products, sales and fee structures, and retirement plans since the enactment of ERISA.

AFSCME advocates retirement security for all Americans, and there are conditions which need to be specifically addressed in this rulemaking to ensure that plan participants are protected. We encourage EBSA to coordinate with the SEC and ensure that fiduciary duty includes the moment when retirees receive distributions. The investment platforms used to narrow selections for plans and participants also need special treatment. Special caution and skepticism are warranted regarding any "sellers' exception" that attempts to differentiate the sales process from the provision of investment advice.

The adoption of an updated definition should not be delayed. However, consultation with other regulators will ensure that financial products, processes and fees do not fall outside the scope of investor protections. Financial services firms may seek to shield cross-selling practices, revenue sharing arrangements, and fee comparisons from the obligations of transparency that could accompany fiduciary duty. Business lines such as target date funds, default investment guidance, lifetime income products, sales and marketing 12b-1 fees, revenue sharing, and even derivatives involve complex relationships and regulatory structures. It is essential that EBSA coordinate with other regulators so that investors are protected.

During consideration of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"), AFSCME strongly supported the inclusion of provisions establishing the strongest possible market reforms, oversight and transparency for the "shadow markets" and other major provisions addressing corporate governance and investor protection. Investor protections important to AFSCME members include new market reforms addressing the sale of derivatives products and strategies, duties owed by those offering investment advice to investors, greater transparency for the advisors to hedge funds and private equity investments, and improved safeguards for municipal markets.

In each of these rulemaking contexts, vendors of various investment products and services have raised concerns that new obligations of disclosure or other investor protection remedies are not workable. Perhaps unsurprisingly, many Wall Street firms and their different lobbying entities argue that new investor protections under Dodd Frank may also trigger obligations under federal pension law. Banks, broker-dealers, insurers and mutual funds particularly point to the proposal by EBSA which would modernize its interpretation of the facts and circumstances that give rise to a fiduciary duty toward pension plans, the employers who sponsor plans, and the workers who contribute to plans. Financial firms call for a delay in the process of updating the definition of fiduciary duty and for "coordination" with other regulators who are implementing important investor protections pursuant to Dodd-Frank. Coordination is needed – but it must be the kind of coordination that closes gaps, not the kind that creates them.

<u>AFSCME's suggestion that DoL coordinate with other agencies is a recommendation for simultaneous development, not a suggestion to go to the back of the line.</u>

Upon review of regulatory comment letters, a pattern emerges. Firms with revenue at risk will often say, for example, "Don't do A until you do B"; then "Don't do B until you do C"; and finally, "C can't be done."

This year, in approaching the numerous new rules that real financial reform requires, many representatives of the financial services industry make the following suggestions:

> "DoL, withdraw your proposal to define fiduciary duty toward pension plans and participants, start over, and refrain from finalizing action until at least two years after SEC action is completed." SEC action has been authorized but stymied for years.
>
> "SEC, do not do anything to implement a fiduciary duty toward individual investors until you develop more proof that investors need help and more proof that small business will not be hurt."
>
> "SEC and CFTC, do not require disclosure of pricing or risks or other information from swaps dealers who are advising investors, because it may conflict with the DoL's interpretation of the kind of guidance that triggers a fiduciary duty to pension plans and participants; it may, in fact, trigger enhanced disclosure obligations regarding costs and conflicts of interest and inhibit our ability to cross-sell products and services."
>
> "SEC, do not move forward on your latest effort to protect investors by reforming the use of sales and marketing fees investors pay under Rule 12b-1. Instead, since there are so many new Dodd-Frank rules to talk about, put that 12b-1 issue on the back burner one more time."

The combined messages sound less like "coordination" and more like the same old regulatory arbitrage that has a lot to do with where the economy is today. There is a big difference between genuine consultation and coordination – the kind that avoids gaps in regulation and dangerous risk – and a call for coordination that simply pushes the goalposts further down the field, and further from each other, leaving a regulatory overlay that looks like Swiss cheese. Real coordination must take place. But just dodging and delaying – that is an old tactic that regulators and Congress must see through.

<u>DoL's interpretation of "investment advice" is an important guide – not only for the pensions directly regulated by ERISA, but also for other plans not regulated by DoL.</u>

Rendering investment advice is not the only way in which one becomes a fiduciary to an ERISA plan – but it is certainly one of the most important. When ERISA was enacted in 1974, most private sector workers who were offered a retirement plan on the job were offered a defined benefit (DB) plan in which the employer promised workers a certain benefit at retirement and the employer made investment decisions in order to accumulate assets with which to satisfy those promises. Since that time, the DB landscape has changed dramatically. Much has been made of the challenges involved in "guaranteeing" a defined benefit – less attention has been paid to the Wall Street practices that make growing plan assets so difficult. DB plans have struggled with the effects of hard-to-penetrate conflicts of interest, hidden fees, opaque derivatives recommendations, and more. And pension guidance that fits what we have seen through 2011 is needed.

Public and private sector plans, employers and employees, are now faced with deciphering new and constantly evolving investment options, risks and costs, and in need of the protection of rules that recognize the growing complexity behind the products and arrangements presented to them. Allowing misimpressions around ERISA's reach – or a dated and inappropriately limited assertion of ERISA's reach – to cast undue influence on the shape of investor protections outside ERISA would be a shameful distortion of the purposes of Dodd-Frank.

<u>DoL's current definition of advice that gives rise to fiduciary duty is outdated and far too narrow – written at a time when pensions were very different than they are today.</u>

As currently and narrowly interpreted, ERISA fiduciary responsibility for rendering investment advice does not arise unless each element in a five-part test is satisfied:

1. Advice is rendered as to the value of securities or other property, or recommendations are made as to the advisability of investing in, purchasing or selling securities or other property,
2. On a regular basis
3. Pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary, that
4. The advice will serve as a primary basis for investment decisions with respect to plan assets, and that
5. The advice will be individualized based on the particular needs of the plan.

Sponsors and trustees of DB plans often desire expert assistance in evaluating the investment scenarios that will enable them to meet the plans' long-term promises. This narrow definition means that much of the guidance they seek will be structured to fall outside a fiduciary's duty in ways that plans large and small may find hard to discern.

In its proposed rule updating this definition, EBSA appropriately concluded that plan officials and participants are poorly served by several of these conditions that limit the scope of ERISA's protections. Many plan officials and participants would be surprised by the way the current interpretation artfully limits the scope of ERISA's fiduciary definition. For example, the EBSA proposal notes that a plan's purchase of annuity contracts to meet benefit obligations when the plan is being terminated is a major transaction involving a recommendation that participants will be counting on for years. Yet even if the insurance brokerage made recommendations that were undoubtedly the primary basis for the plan's choice among annuity providers, and accepted kickbacks from insurance carriers while taking fees to advise plans regarding the selection of annuity contracts, DoL concludes it could not hold the brokers accountable as fiduciaries because the advice would not have been offered on a regular basis and would not be enough to confer fiduciary status.

DoL's 35-year old regulation was written at a time when investment advice was very different – that, too, is part of the need for an update that is coordinated with the other regulatory contexts in which the scope of covered advice is key.

While AFSCME advocates the DB plan as the most cost-effective way for employers to provide a retirement benefit, we are also concerned about the retirement security of those workers in defined contribution (DC) plans. These workers often must decide how much to contribute from their paychecks and how to allocate those contributions among the investment options available to them in the employer plan. Workers in a DC plan bear the investment risks and usually the costs of the plan and its investments.

As of 2007, 60 million active workers held roughly $ 3 trillion in assets in defined contribution plans that allowed for participant direction. To improve their access to this market, the financial industry has for years urged EBSA to issue guidance broadening the list of activities that would be considered "educational" and without fiduciary risk to the provider versus "advice" and therefore a trigger to fiduciary responsibility. Though regulatory guidance has been issued in various forms over the years, the distinction between education and advice - and between fiduciary and non-fiduciary – remains unclear and debated. Employers are under no obligation to provide either.

The ways in which "advice" is delivered have become more varied and complex, and that, too, adds to the challenge. For example, early DoL positions suggested that asset allocation services could constitute investment advice. If vendors become fiduciaries by virtue of the advice they provide, they not only face potential liability – they also face strict restrictions, known as prohibited transactions, which prohibit fiduciaries from self-dealing, and from acting on behalf of a party whose interests are adverse to the interests of the plan or its participants. Guidance from DoL in 1996 concluded that asset allocation services would not constitute advice, to the relief of financial services providers.

It is important to examine more carefully what asset allocation services could be. Asset allocation is often used as a broad description meant to sweep in generic tips on diversification among equities and bonds, or among Morningstar style boxes. However, asset allocation also refers to products that bundle together investment choices (maybe stock and bond funds), rebalancing services changing your overall allocations from time to time, and the investor's payment for that asset allocation into the dollars invested. This could include a target date fund much more complex than an illustrative pie chart on diversification, perhaps one that maps investments from one lineup to another if participants are given the chance to make a selection and do not respond.

It seems increasingly likely that advice is being provided – and paid for by workers – at the same moment in time as automatic enrollment, automatic increases of pay deferrals, and automatic changes in the investment lineup. Encouraging retirement savings is good, and automatic payroll-based savings is the most efficient way of gathering assets for investment managers. Workers need to share in that efficiency and need to be sure that Wall Street's access to automatic enrollment practices does not lower pension safeguards regarding fees, fiduciaries, and conflicts of interest.

DoL has granted a number of exemptions from the prohibited transaction rules beginning almost immediately after ERISA's passage, and mutual funds and certain other investment vehicles are accorded special status under ERISA. However, the following types of questions have nevertheless been raised:

- Can plan fiduciaries and service providers invest plan assets in mutual funds to which they provide services, without violating the prohibited transaction rules?
- Can investment advisers, banks, or other managers offer asset allocation programs to plan clients that involve investments in the advisers' own funds without violating the prohibited transaction rules?
- Can mutual funds pay 12b-1 fees, or other revenue sharing or administrative service fees to plan fiduciaries and service providers whose clients invest in the funds, without a violation?

The prohibited transaction exemptions are important to Wall Street -- unlike SEC rules, disclosure will not cure a conflict of interest under ERISA. Certain kinds of fee leveling or offsetting of compensation received against other fees may suffice. But most vendors would prefer to avoid fiduciary status and to avoid triggering these restrictions altogether.

One component in particular that should get close attention from DoL is compensation for "embedded advice," paid for by 12b-1 or "trail fees," often described as part of a target date or other asset allocation option. What should plan sponsors know in order to prudently evaluate these investment options on which an exceptional degree of reliance is placed? Sellers insist to the SEC that these fees compensate for the time brokers must allot to advising clients, while at the same time insisting to DoL that this money is not for advice but for compensating record keepers. DoL and SEC have said they are continuing to develop guidance that will address target date funds – that work must continue.

If a strong case can be made for re-examining prohibited transactions, it should be made. Legislative modifications are not unprecedented. Regulatory modifications are well within DoL's existing authority. In fact, DoL has pending now a proposal to update its current procedure for granting prohibited transaction exemptions. But avoiding fiduciary status by denying that advice is being rendered is not acceptable.

<u>ERISA does not define "advice" – so the SEC is the logical place to look – and ordinarily that is what the financial services industry urges.</u>

Typically, financial industry players commenting to DoL urge deference to the SEC on matters of investment regulation and disclosure, limiting its own rules so as not to require anything incompatible with SEC guidance, and conformity even though DoL is administering a different statute with different policy goals. But in this proceeding, industry comments are different and urge DoL to avoid using the '40 Act definition of advice as sufficient to define advice for ERISA purposes. Is advice really different in the ERISA world than it is in individual investing outside a pension plan?

SEC efforts are underway to update the definition of investment advice for purposes of addressing the duties owed to retail investors, the obligations of municipal advisors and the duties of swap dealers toward special entities including ERISA and other retirement plans. ERISA's definition should be developed in coordination with specifics in these other contexts. DoL has taken a constructive step in proposing that what the SEC determines to be advice for '40 Act purposes will constitute advice for ERISA purposes such that if other required factors are present, the advice provider will be an ERISA fiduciary. DoL recently dedicated two days of agency hearings to this issue and heard from a long line of Wall Street witnesses, assuring them the consultation is taking place. That is the way regulatory consultation should work.

<u>EBSA's proposed update eliminates several of the unexpected limitations and opens the door to a more practical understanding of what kind of input constitutes advice:</u>

EBSA reports that this update is needed to more fully implement ERISA's ability to address abuses by those who recommend investments in exchange for undisclosed kickbacks from investment providers, engage in bid rigging, mislead plan trustees about the nature and risks associated with investments, fail to disclose fees, misrepresent compensation arrangements, or give biased or incompetent valuation opinions.

The proposed rule will better address these risks to pension plans by, among other things:

- specifically including the provision of appraisals and fairness opinions in the investment-related advice and recommendations that trigger fiduciary duty;
- specifically including advice and recommendations as to the management of securities or other property, including for example advice and recommendations regarding the exercise of rights attached to stock ownership, such as voting proxies;
- deleting the requirement that only advice provided *on a regular basis* triggers fiduciary duty; and
- deleting the condition that fiduciary status is only triggered with a mutual understanding that advice will form the primary basis of decisions, since the relative importance of the individual advisor's input does not control whether it is in fact advice or subject to a fiduciary obligation.

EBSA notes that trustees often seek out the assistance of other kinds of particular expertise. Pension consultants and advisors are able to shape their roles to escape falling under the fiduciary obligations that do cover those seeking their assistance, and so avoid triggering a duty to disclose their compensation or conflicts of interest. Reversing the unnecessary limits on the scope of ERISA's fiduciary duty for advice-givers will help to address what right now is a "buyer beware" situation not in keeping with the high fiduciary standard ERISA otherwise provides.

EBSA also modified the test to make more explicit its long-standing position that fiduciary status may result from the provision of advice, not only to a plan fiduciary, but also to a plan participant or beneficiary.

<u>Retirement Rollovers and Distributions should not be carved out of protections – they can represent a lifetime of retirement savings at a very vulnerable point.</u>

EBSA also invited comment as to whether it should reconsider its 2005 conclusion that advice rules would not include recommendations related to taking a distribution from the plan at retirement.

EBSA is right to seize this moment – while it is considering ERISA advice and while the SEC is considering retail investor advice – to revisit its 2005 guidance suggesting that advice about taking a plan distribution was not advice under ERISA. Advice about plan accumulations should not change legal status when it becomes advice at the point of converting an account balance to a "benefit" or to another investment vehicle. The biggest investment most people will make is what to do with retirement benefits at their eligibility to retire. It is creative to suggest that plan protections should end at the point of figuring out what to do with the plans' "benefit." Coordinated definitions by DoL and SEC should put an end to this effort to avoid fiduciary duty just when it is needed most.

Retirement Platforms require a closer look – one that goes beyond their role in narrowing investment options and examines their concentration of market power

Another offshoot of the asset allocation issue is the use of retirement "platforms" to narrow available investment options that might be used to set up individual employers' plans. This may consist of an insurer's wrap product or an "architecture" set up by a fund company, wirehouse or brokerage. Serious questions have been documented publicly regarding the use of these platforms as gatekeepers to plan purchasers who may have outsize economic ability to control the price of access, to shape the "shelf space" for investment products, and to squeeze the margins of competing investment products and distributors who need access to broader distribution networks. EBSA invited comment on how platforms should be treated under its proposed fiduciary definition; several analyses made public by Edward Seidle, former SEC official, now with Benchmark Financial Services, Inc., are illuminating on this issue and we urge EBSA's attention to the interplay they reveal.[1]

Several industry groups have suggested that no serious conflict of interest is presented by investment options that provide different levels of revenue sharing to the brokers who provide "education and guidance" to plan participants. They suggest that variations in broker compensation generated by allocations to investment options with different embedded revenue sharing are not a real incentive to distort advice offered. But that approach is not the right way to see how conflicts can be embedded and how participants' investment choices and risks and costs are shaped by those incentives.

A better illustration is provided in a 2007 submission to DoL's ERISA Advisory Council by a registered investment adviser and consultant. This submission shows that it is not the person-by-person difference in broker compensation that reveals the troubling conflict of interest. Instead, it is the way in which investment menus are assembled in order to ensure that the investment expenses paid by participants generate sufficient revenue sharing payments from the investment providers to the financial advisor and the plan sponsor. As a result, no billable fees will be assessed, the "plan" will appear to be "free," and the seller

[1] "Secrets of the 401k Industry: How Employers and Mutual Fund Advisers prospered as Workers' Dreams of Retirement Security Evaporated", "'Capping' 401k Revenue Sharing: Recordkeepers Block Rebates to Participants" and "The Siedle Guide to the Securities Industry", both by Edward Siedle.

will be attractive for repeat business.[2] That practice, known as "solving for X," deserves careful attention in unraveling the kinds of decisions or recommendations that go into assembling an investment menu and might trigger fiduciary status.

AFSCME urges caution regarding the "sellers' exception" that DoL has put out for comment.

It appears that DoL has tried to carve out a category of communications that would clearly fall outside the definition of advice and fiduciary activity because it would include an explicit label of a sales message not intended to be independent or unbiased investment advice. AFSCME can appreciate the effort to not only broaden fiduciary activity but help define what would not be fiduciary activity. However, we suspect that the sellers' exemption is not likely to work as intended.

Major providers with household names will easily continue a marketing pitch that says, in essence, "We are experts at helping you plan for the future. Naturally we also offer products built from the best of our in-house expertise and of course we are proud to bring you those, too – what else would we offer you but the products we built ourselves and know best and believe in?" It seems that would satisfy the notice DoL has suggested, and yet it could come across more as a proud endorsement, rather than a clear statement that "this does not constitute investment advice, neither the company nor the individual broker or agent or advisor is a fiduciary with an obligation to act in your best interest; therefore I have no obligation to forego added compensation from the products I sell you and no obligation to limit or disclose it, either." AFSCME strongly suggests that this exception go back to the drawing board and we would be happy to join you in trying again to craft something more effective.

The bottom line is this - DoL is right to act now.

DoL's proposal is a well-timed and necessary complement to the investor protections in Dodd-Frank; they must be updated in coordinated fashion if they are to deliver the added protection consumers, workers and investors expect.

Clearly, in the last 35 years, much has changed -- plans have changed, individuals' responsibilities for making decisions about how to participate in plans have changed, and the financial industry that serves plans and participants has changed – including the products, services and combinations that are made available to employers and employees. EBSA is right to take on this issue now. The

[2] Testimony Before the ERISA Advisory Council Working Group on Fiduciary Responsibilities Update and Revenue sharing, September 20, 2007, by Michael J. Malone of MJM401k.

financial sector is facing a wide variety of proposals to improve outdated regulatory tools. None will substitute for this – none should be allowed to delay or dilute this protection.

* * *

We appreciate the opportunity to express our views on this matter. Should you have questions regarding our comments, please contact Lisa Lindsley at (202) 429-1275.

Sincerely,

Gerald W McEntee

GERALD W. McENTEE
International President