Gerald W. McEntee
President
Lee A. Saunders
Secretary-Treasurer

Vice Presidents

Ken Allen
Portland, OR
Henry L. Bayer
Chicago, IL
George Boncoraglio
New York, NY
Anthony Caso
Boston, MA
Greg Devereux
Olympia, WA
Danny Donohue
Albany, NY
David R. Fillman
Harrisburg, PA
Michael Fox
Harrisburg, PA
Albert Garrett
Detroit, MI
Raglan George Jr.
New York, NY
Sherryl Gordon
Trenton, NJ
Lakesha Harrison
Oakland, CA
Danny J. Homan
Des Moines, IA
Salvatore Luciano
New Britain, CT
John A. Lyall
Worthington, OH
Roberta Lynch
Chicago, IL
Glenard S. Middleton Sr.
Baltimore, MD
Gary Mitchell
Madison, WI
Veronica Montgomery-Costa
New York, NY
Doug Moore
San Diego, CA
Henry Nicholas
Philadelphia, PA
Eddie L. Parks
Westerville, OH
Randy Perreira
Honolulu, HI
George E. Popyack
Oakland, CA
Greg Powell
Austin, TX
Laura Reyes
San Diego, CA
Eddie Rodriguez
New York, NY
Lawrence A. Roehrig
Lansing, MI
Joseph P. Rugola
Columbus, OH
Kathy J. Sackman
Pomona, CA
Eliot Seide
South St. Paul, MN
Mary E. Sullivan
Albany, NY
Braulio Torres
San Juan, PR
David Warrick
Indianapolis, IN
Jeanette D. Wynn
Tallahassee, FL

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

American Federation of State, County and Municipal Employees, AFL-CIO
TEL (202) 429-1000 **FAX** (202) 429-1293 **TDD** (202) 659-0446 **WEB** www.afscme.org 1625 L Street, NW, Washington, DC 20036-5687

21 435-10
7/10

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.

---

[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]

Use Caution when Limiting the "Plans" that are considered Special Entities

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

---

[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.

The Independent Representative

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.

Coordination with Other Regulations and Regulators is Vital to Effective Implementation

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

[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
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]

---

[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.

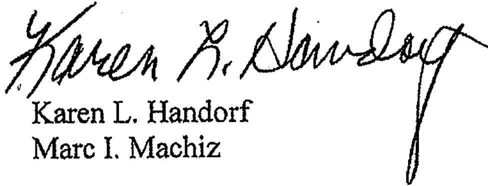
The argument that exemptions from ERISA's prohibited transaction rules will not solve the problem is based on the erroneous assumption that swap dealers will necessarily be ERISA fiduciaries. Section 406(b) of ERISA, 29 U.S.C. § 1106(b), prohibits fiduciaries from acting on both sides of a transaction. 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.

---

[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
Marc I. Machiz

Appendix B

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.

---

[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

[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,

---

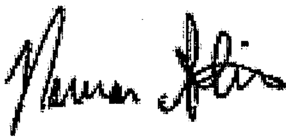
[17] *Id.* See also *Walsh v. Principal Life Insurance Co.*, 49 EBC 1344 (S.D. Iowa 2010).

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

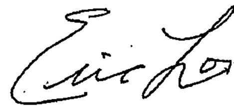
Conclusion

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.

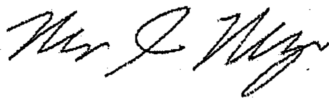
Respectfully submitted,



Norman Stein
Senior Policy Adviser
Pension Rights Center



Eric Loi
Staff Attorney
Pension Rights Center



Marc I. Machiz
Cohen Milstein Sellers & Toll PLLC
Consultant to the Pension Rights Center

Terisa E. Chaw
Executive Director
National Employment Lawyers Association

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