



1401 H Street, NW, Washington, DC 20005-2148, USA  
202-326-5800 www.ici.org

July 21, 2015

Email: [e-OED@dol.gov](mailto:e-OED@dol.gov)

Office of Exemption Determinations  
Employee Benefits Security Administration  
Attention: D-11712  
U.S. Department of Labor  
200 Constitution Avenue N.W., Suite 400  
Washington, DC 20210

Re: ZRIN 1210-ZA25: Proposed Best Interest Contract Exemption

Dear Sir/Madam:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the proposed exemption (the “Best Interest Contract Exemption” or “BIC Exemption”),<sup>2</sup> which the Department of Labor (the “Department”) published in connection with the proposed rule (the “Proposed Fiduciary Rule”) defining who is a “fiduciary” of an employee benefit plan under the Employee Retirement Income Security Act of 1974 (“ERISA”).<sup>3</sup> The Proposed Fiduciary Rule also would revise the definition of a “fiduciary” of an individual retirement account (“IRA”) under section 4975 of the Internal Revenue Code of 1986 (“Code”). If adopted, the Proposed Fiduciary Rule would result in persons who provide services to employee benefit plans, plan fiduciaries, plan participants or beneficiaries, IRAs, or IRA owners (collectively, “Retirement Investors”) being fiduciaries under ERISA and the Code “in a wider array of advice relationships than the existing ERISA and Code regulations.”<sup>4</sup>

---

<sup>1</sup> The Investment Company Institute is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s U.S. fund members manage total assets of \$18.2 trillion and serve more than 90 million U.S. shareholders.

<sup>2</sup> Notice of Proposed Best Interest Contract Exemption (“BIC Exemption Notice”), 80 Fed. Reg. 21960 (April 20, 2015).

<sup>3</sup> Notice of Proposed Rulemaking – Definition of the Term “Fiduciary”: Conflict of Interest Rule – Retirement Investment Advice (“Fiduciary Rule Notice”), 80 Fed. Reg. 21928 (April 20, 2015).

<sup>4</sup> *Id.* Under the proposed BIC Exemption, the term “Retirement Investor” generally means a participant or beneficiary of an ERISA plan, the beneficial owner of an IRA, or a plan sponsor of a non-participant-directed ERISA plan with fewer than

The Department's stated intent in proposing the Best Interest Contract Exemption is to facilitate the continued provision of advice to Retirement Investors if the Proposed Fiduciary Rule is adopted.<sup>5</sup> The BIC Exemption would allow certain investment advice fiduciaries to receive various forms of compensation that, in the absence of an exemption, would not be permitted under ERISA and the Code. The BIC Exemption requires, in addition to an extensive list of other conditions and exclusions, that investment advice fiduciaries provide advice that is in the "best interest" of the Retirement Investor.<sup>6</sup>

The Institute strongly supports a "best interest" standard that applies with respect to all investors, including all Retirement Investors (ERISA plans and IRAs alike). The Department, however, has added to that standard a multitude of additional conditions and exclusions that make the proposed exemption simply unworkable. The result is that, if adopted, the Department's rule proposal will significantly restrict the ability of Retirement Investors—in particular, low and middle-income individuals and small businesses—to receive the personalized investment assistance that they need to make informed investment choices, including whether or not to establish a plan or retirement account.<sup>7</sup> This result fails to serve the best interests of Retirement Investors and it impedes access to widely used advice service models in contravention of Congress' intent.<sup>8</sup>

This result can be avoided if the Department implements the principles-based approach that Department Secretary Perez described in recent testimony.<sup>9</sup> There, he stated that the proposal is

---

100 participants. 80 Fed. Reg. 21960, 21988. For purposes of this letter, we use a broader definition of "Retirement Investor" as the context dictates.

<sup>5</sup> Fiduciary Rule Notice, 80 Fed. Reg. 21928, 21929.

<sup>6</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21983.

<sup>7</sup> Our comments on the BIC Exemption are necessarily guided by the impact the Proposed Fiduciary Rule will have on expanding the range of interactions that service providers have with Retirement Investors as being treated "investment advice" and therefore subject to ERISA's fiduciary prescriptions. The Institute has provided comments on the Proposed Fiduciary Rule pursuant to the undersigned's letter of July 21, 2015, available at [www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_def\\_ltr.pdf](http://www.ici.org/pdf/15_ici_dol_fiduciary_def_ltr.pdf). As explained in detail in our letter, the effect of the Proposed Fiduciary Rule will be that all common educational, marketing and sales interactions with a Retirement Investor—whether an existing client or prospect—that involve a discussion of investments or investment strategies will be deemed a fiduciary service subject to ERISA's prescriptive prohibited transaction rules. Therefore, continued access to even basic investment assistance and information for Retirement Investors will be dependent on the availability of the BIC Exemption.

<sup>8</sup> In promulgating interpretations of ERISA, the Department is charged with protecting the interests of retirement plans and their participants and beneficiaries in a manner that ensures that "established business practices of financial institutions" in interacting with employee benefit plans are not disrupted. *See* ERISA Conference Report, P.L. 93-406, at 309.

<sup>9</sup> Testimony of the Honorable Thomas E. Perez, before U.S. House of Representatives Education and the Workforce Committee, hearing on "Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees," June 17, 2015.

“grounded in a basic principle—that investment advisers should act in their clients’ best interest, not their own.” If the Department had stayed true to that tenet, our comments on its proposal would be far more supportive. Instead, the Department took a straightforward proposition—that advice should be in the best interest of Retirement Investors—and burdened it with complex and costly additional conditions. Those additional conditions, not the “best interest” standard, make the BIC Exemption and the Proposed Fiduciary Rule unworkable.

Clearly, critical changes are necessary to make the BIC Exemption (and the other impacted exemptions) valuable to ensure the provision of necessary services to Retirement Investors and therefore to serve those investors’ “best interests.” Those changes are summarized below.

- The Department must simplify the BIC Exemption in at least three ways:
  - The Department must modify the BIC Exemption’s disclosure regime. The BIC Exemption’s granular and redundant disclosure requirements will only overwhelm Retirement Investors—not inform them—if those disclosures are read at all. The disclosure regime also will be very costly to implement, with little, if any, benefit. The Department has adopted far more workable approaches under ERISA sections 408(b)(2) and 404(a), and should utilize those approaches in the BIC Exemption.
  - The Department should eliminate the BIC Exemption’s required contractual warranties. They are not needed to adequately protect Retirement Investors and only serve to expose firms to significant new litigation risk—drawing such firms into lawsuits whenever there is an inevitable downturn in the financial markets. The Department must similarly eliminate or extensively modify and clarify the BIC Exemption’s written contract requirements to make the exemption workable.
  - The required written policies and procedures for “material conflicts of interest” present unattainable compliance hurdles for advice providers. As proposed, the policies and procedures would mandate inflexible fee-leveling, a result contrary to the Department’s stated intent in issuing the BIC Exemption. The Department must simplify them and clarify their intended application.
- The Department must modify the scope of the BIC Exemption as follows:
  - The BIC Exemption contains a proposed list of favored investment choices. The exemption is not available for investment choices not on that list. As such, it unnecessarily restricts Retirement Investors’ choices. Enumerating a list of approved investments is a departure from Department precedent and must be abandoned.

- The Department must expand the BIC Exemption to cover advice provided to all small employers. There simply is no reason to exclude sponsors of small plans from access to information and advice about the retirement plans they sponsor and administer.
  - The BIC Exemption must cover the full range of distribution discussions, including rollovers to IRAs and other eligible retirement plans. These are very important discussions that must be facilitated, not discouraged or effectively prohibited.
  - The BIC Exemption must provide tailored relief for the recommendation of managed accounts and other advisory programs that are beneficial to many Retirement Investors.
- The Department must modify the proposed exemption for pre-existing transactions so that it does not unnecessarily harm investors by prohibiting ongoing advice on assets invested prior to the Proposed Fiduciary Rule's applicability date.

In addition, the Department causes confusion by raising questions about a “streamlined” exemption from ERISA’s prohibitions for so-called “high-quality low-fee” investment products. The Department does not actually propose such an exemption and also does not specify with any detail how such an exemption would work, nor what investments would qualify. We have grave concerns about the feasibility and wisdom of such an exemption, and we note that the Department has not provided the public with enough information about this aspect of its proposal to comment in any meaningful way.

Finally, we cannot emphasize enough that the applicability date does not provide sufficient time for the extensive system and policy changes needed to comply with the BIC Exemption. The Department must propose a workable structured implementation of the Exemption’s conditions over an appropriate number of years and must adopt a “good faith” compliance mechanism, consistent with previous regulatory initiatives.

Each of the foregoing points, including recommended changes to the BIC Exemption necessitated by the concerns raised, and the changes the Department is proposing to existing exemptions, are discussed more fully below.

## **I. The Best Interest Contract Exemption**

The Department’s stated goal in proposing the BIC Exemptions is to facilitate the continued provision of advice to Retirement Investors. It proposes to do this by permitting advice providers to receive various forms of compensation that, in the absence of an exemption, would not be permitted under ERISA and the Code.<sup>10</sup> While asserting that the BIC Exemption is intended to permit such

---

<sup>10</sup> Fiduciary Rule Notice, 80 Fed. Reg. 21928, 21929.

variable compensation arrangements to continue, the Department's Regulatory Impact Analysis depends on the substantial elimination of such arrangements to substantiate its conclusions.<sup>11</sup> Despite these inapposite positions, representatives of the Department have repeatedly assured the public that the Department is open to making changes and modifications to the BIC Exemption that are necessary to meet the exemption's intended goal of ensuring the continued availability of advice to Retirement Investors.

The BIC Exemption must be substantially revised, in part, because of the severe consequences associated with an advice provider's inability to meet even one element of the many conditions of the exemption. Specifically, advisers and financial institutions would be exposed to significant excise tax penalties under the Code (15 percent of the amount involved assessed each year the transaction is not corrected, and compounded every year) for even inadvertent violations of the BIC Exemption. Those service providers also would risk lawsuits under ERISA for losses to plans and equitable relief, and potential lawsuits for breach of contract. Indeed, the Department expressly contemplates class action litigation, presumably in state courts, to enforce contractual provisions by carving out such litigation from arbitration.<sup>12</sup>

With this backdrop, the BIC Exemption must be simplified to eliminate the many compliance traps and barriers for financial advice professionals and their firms. In reliance on the Department's good faith in requesting such suggestions, we recommend modifications in the discussion below intended to make the BIC Exemption more workable and yet meet the Department's stated policy goals.

---

<sup>11</sup> See DOL, *Fiduciary Investment Advice Regulatory Impact Analysis* (Apr. 14, 2015), available at: <http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf>, at p. 130. Our comments concerning the Department's Regulatory Impact Analysis are provided under separate cover pursuant to the letter dated July 21, 2015 from the Institute's Chief Economist, Brian Reid and General Counsel, David Blass, available at [www.ici.org/pdf/15\\_ici\\_dol\\_fiduciary\\_reg\\_impact\\_ltr.pdf](http://www.ici.org/pdf/15_ici_dol_fiduciary_reg_impact_ltr.pdf). As explained in detail in that letter, the Department's Regulatory Impact Analysis offers little justification for the Proposed Fiduciary Rule. Not only does it fail to demonstrate the DOL's assertion that there is a "substantial failure of the market for retirement advice," but it also does not properly consider the consequence of the Proposed Fiduciary Rule in actually limiting retirement savers' access to guidance, products, and services. Given the lack of justification for the Proposed Fiduciary Rule and, as currently proposed, the infeasibility of the BIC Exemption to meet the Department's stated goal of ensuring the continuing availability of advice services to Retirement Investors, the Department is obligated to pursue more tailored rulemaking. See Executive Order 13563, Section 1(b), 76 Fed. Reg. 3821 (Jan. 21, 2011).

<sup>12</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21973 and 21985.

A. As Proposed, the BIC Exemption's Disclosure Regime is Simply Unworkable

The proposed disclosures would be excessively granular, costly, and likely useless – the Best Interest Contract Exemption would require a multitude of voluminous disclosures in addition to the contractual disclosures discussed above, including:

- (1) a hyper-granular point of sale disclosure provided prior to the execution of an investment transaction showing the all-in cost and anticipated future costs of recommended investments in a summary chart, including the total cost to the investor for 1-, 5-, and 10-year periods expressed as a dollar amount, assuming an investment of the dollar amount recommended by the adviser, and reasonable assumptions about investment performance (which must be disclosed);
- (2) a public webpage showing the direct and indirect material compensation payable to the adviser, financial institution, or any affiliate for services provided in connection with each investment that a Retirement Investor is able to purchase, hold, or sell through the adviser or financial institution, and that a Retirement Investor has purchased, held, or sold within the last 365 days, the source of the compensation, and how the compensation varies within and among investment classes; and
- (3) an individualized annual written disclosure provided within 45 days of the end of the applicable year showing
  - a. a list identifying each investment purchased or sold during the applicable period and the price at which the investment was purchased or sold,
  - b. a statement of the total dollar amount of all fees and expenses paid by the investor, directly and indirectly, with respect to each asset purchased, held, or sold during the period, and
  - c. a statement of the total dollar amount of all compensation received by the adviser and financial institution, directly or indirectly, from any party, as a result of each investment sold, purchased or held by the investor during the period.<sup>13</sup>

Without explanation, the required disclosures significantly exceed those established by regulations under ERISA sections 408(b)(2), 404(a) and 408(g), which were developed over numerous years in an effort to provide appropriate disclosure without unnecessarily overwhelming the recipients of the disclosures.<sup>14</sup> Instead, the proposed disclosures are likely to overwhelm Retirement Investors

---

<sup>13</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21985.

<sup>14</sup> See, e.g., Preamble to participant disclosure final rule. 75 Fed. Reg. 64910, 64918 (Oct. 20, 2010).

with burdensome and confusing data points of questionable value, if they are read at all. The BIC Exemption's disclosure requirements also are unduly burdensome, commercially unworkable, and will require costly systems changes and ongoing updates.<sup>15</sup> For example –

- The proposed disclosures regarding thousands of potential investments typically available to an investor would result in multiple phone-book size disclosures of little, if any, practical utility to Retirement Investors.
- It is not possible to calculate, as proposed, the ongoing costs of funds because such costs vary based on numerous and unpredictable factors.
- It is not clear how an adviser could provide total indirect compensation information attributable to an individual on an annual basis.
- It is not operationally feasible to provide the total direct and indirect costs paid by an IRA account with mutual fund holdings over a 365 day period.
- The one-, five-, and 10-year cost disclosures—to be based on unspecified assumptions—raise issues under the securities laws and are not useful to Retirement Investors as a source of comparison. This is because, as discussed below, the disclosures will vary from firm to firm *for the very same investment* based on each individual firm's assumed rates of return. And the lower the assumed return, the less costly the same investment will appear to be. Presumably this was not the Department's intent.
- Real-time disclosure of “total cost” is not operationally feasible and is incompatible with “best execution obligations” because the delay resulting from provision of that disclosure could cause the desired investment to no be longer available at the same price.<sup>16</sup> A new disclosure would be needed at the time of investment decision, further delaying the transaction in a self-perpetuating cycle.

The BIC Exemption's required projections conflict with federal securities law – The requirement to project future performance in calculating anticipated future costs would cause mutual

---

<sup>15</sup> In proposing its own point of sale requirements that were never finalized, the SEC estimated that costs associated with producing and distributing the proposed point of sale disclosure document would exceed \$450 million initially, with ongoing costs in excess of \$975 million annually. See SEC Release Nos. 33-8358 (Jan. 29, 2004), 68 Fed. Reg. 6438, 6473 (Feb. 10, 2004). These potential costs are not accounted for in the Regulatory Impact Analysis justifying the Proposed Fiduciary Rule.

<sup>16</sup> See SEC Investment Advisers Act Release No. 232 (Oct. 16, 1968) (“One of the basic duties of a fiduciary is the duty to execute securities transactions for clients in such a manner that the client's total cost or proceeds in each transaction is the most favorable under the circumstances....”).

funds to violate SEC and FINRA rules and guidance, absent specific relief granted by the SEC and FINRA. As a general rule, mutual funds do not publish projected performance information. The SEC does not permit future performance projections in connection with the offer or sale of mutual funds. Rule 156(b)(2) under the Securities Act of 1933 provides that representations in “sales literature”<sup>17</sup> about past or future investment performance could be misleading because of statements or omissions made involving a material fact, including situations where representations, whether express or implied, are made about future investment performance.<sup>18</sup> SEC Rules 482 and 34b-1 likewise do not permit performance projections and require performance information to be presented based on certain standardized methodologies and to be accompanied by standardized disclosures about performance and other general statements. It is uncertain whether the SEC would be willing to provide needed relief with respect to the BIC Exemption’s disclosure requirements and we question the prudence of doing so because those projections could be inherently misleading.

FINRA Rule 2210, which sets forth the basic standards applicable to all FINRA member communications with the public, generally prohibits communications from predicting or projecting performance, implying that past performance will recur or making an exaggerated or unwarranted claim, opinion or forecast.<sup>19</sup> Also under FINRA Rule 2210(d)(A)(i), performance sales material<sup>20</sup> must include the standardized performance information mandated by SEC Rules 482 and 34b-1. While FINRA conceivably could determine that the point of sale disclosure is a communication that satisfies the content and filing requirements of Rule 2210, FINRA also could condition any relief granted on lengthy explanations and/or footnotes, which would pose an additional obstacle to investor comprehension and would certainly detract from the clarity of the presentation.

---

<sup>17</sup> Applies to “any communication (whether in writing, by radio, or by television) used by any person to offer or sell or induce the sale of securities of any investment company.” See Rule 156(c) under the Securities Act. This includes not only supplemental sales literature, but also tombstone advertisements, Rule 482 advertisements, prospectuses, and shareholder reports that are used to sell fund shares.

<sup>18</sup> The Commission has reiterated the importance of Rule 156 protecting against the potential for investor misunderstanding in the context of target date funds. See *Investment Company Advertising: Target Date Retirement Fund Names and Marketing*, SEC Release Nos. 33-9126, 34-62300, IC-29301 (June 16, 2010), available at <http://www.sec.gov/rules/proposed/2010/33-9126.pdf>.

<sup>19</sup> “Investment analysis tools” are exempted from this prohibition. See FINRA Rules 2210(d)(1)(F) and 2214. An “investment analysis tool” is an interactive technological tool that produces simulations and statistical analyses that present the likelihood of various investment outcomes if certain investments are made or certain investment strategies or styles are pursued. *Id.* The proposed point of sale disclosure model chart would not fall under this exemption.

<sup>20</sup> Defined as member communications with the public, other than institutional sales material and public appearances, which present non-money market performance information. See *Self-Regulatory Organizations; National Association of Securities Dealers, Inc.; Order Approving a Proposed Fiduciary Rule Change and Notice of Filing and Order Granting Accelerated Approval of Amendment No. 4 to the Proposed Fiduciary Rule Change Relating to Disclosure of Fees and Expenses in Mutual Fund Performance Sales Material*, SEC Release No. 33-54103 (July 5, 2006), available at <https://www.sec.gov/rules/sro/nasd/2006/34-54103.pdf>.



The Department can better serve Retirement Investors by implementing a more practical and useful disclosure regime – As a workable alternative, the Department should create a more streamlined and operationally workable disclosure regime, based on the following:

- A simple and direct point of sale disclosure as suggested in the BIC Exemption Notice that would direct customers to the availability of disclosure components based on the disclosure regime established under ERISA sections 408(b)(2) and 404(a).<sup>21</sup> The Department spent several years determining the appropriate level of information that would be helpful to plan fiduciaries and plan participants without overwhelming them. It is only logical to turn to these carefully-crafted disclosure regimes—408(b)(2) for plan sponsors and 404(a) for plan participants and IRA owners—for purposes of disclosure under the BIC Exemption. The same elements of information can be relevant for plan sponsors and individual participants and IRA owners making decisions about whether to follow an adviser’s recommendation.

The disclosures required under section 408(b)(2) by service providers who are section 3(21) fiduciaries should be sufficient for plan sponsors or plan fiduciaries who are covered advice recipients under the BIC Exemption (currently limited to non-participant directed plans with fewer than 100 participants). Those rules are intended to ensure that plan sponsors fully understand the compensation arrangements of their service providers, including indirect compensation paid to the service provider, and any conflicts of interest that may exist.

ERISA section 404(a) should serve as a model for plan participants and IRA investors. The disclosure elements included in the Department’s regulation at §2550.404a-5 are intended to provide participants with key information necessary to make informed decisions on how to invest their retirement assets and not overwhelm the individual with too much information that would only serve to confuse and discourage. As the Department noted, the participant disclosure requirements “strike an appropriate balance between accommodating, on one hand, the increasing innovation and complexity of the types of investments that are available to plan participants and beneficiaries and, on the other hand, participants’ and beneficiaries’ need for complete, but concise and user-friendly, information about their plan investment alternatives.”<sup>22</sup> The Department should strike a similarly appropriate balance under the BIC Exemption.

Although the participant disclosure rules do not apply to IRAs, the Department should import the section 404a-5 disclosure elements for use in this context. In this respect, the

---

<sup>21</sup> This would be more consistent with the “cigarette warning” idea referenced by the Department, but would also direct the Retirement Investor to a single source for the relevant information. *See* BIC Exemption Notice, 80 Fed. Reg. 21960, 21974.

<sup>22</sup> *See* Preamble to participant disclosure final rule. 75 Fed. Reg. 64910, 64915 (Oct. 20, 2010).

section 404a-5 rules rightly focus on the fees and expenses paid by the participant, without getting into the compensation received by service providers, which would necessarily be reviewed by plan sponsors pursuant to the section 408(b)(2) obligations. For purposes of the disclosure elements applicable to IRA owners then, the Department could also import an element from the 408(b)(2) rule, requiring disclosure of information about the direct and indirect compensation the advice provider and its affiliates expect to receive in connection with the advice or recommendation.

- The Department should designate the internet as the primary medium for point of sale disclosure. Service providers should provide disclosures by referring investors to information on a website or by e-mailing investors a link to the website.<sup>23</sup> Providers should be required to refer to this information at the time of executing a particular transaction recommended to an investor.
- If the Department requires future cost information to be provided at the point of sale, the exemption should permit use of a hypothetical investment amount (such as \$1,000 or \$10,000) and a standardized rate of return assumption (such as the 5 percent assumption used in the prospectus fee table). A mutual fund's prospectus fee table contains projected expense information with required standardized assumptions regarding performance and investment amount.<sup>24</sup> The fee table expense example requires an estimate of cost for one-, three-, five- and 10-year periods expressed as a dollar amount, with standardized assumptions including a \$10,000 investment in the fund and a five percent investment return. The expense example additionally assumes that the fund's operating expenses remain the same.<sup>25</sup> Although this expense example contrasts with long-standing disclosure policy prohibiting the use of performance projections as inherently misleading, the SEC intended the assumption of a standardized five percent investment return to provide a relatively simple means for investors to compare all of the disparate expenses of different funds.<sup>26</sup> In its proposing release, the SEC explained the five percent assumption as "a rate

---

<sup>23</sup> The BIC Exemption should provide that, when required point of sale or ongoing information is provided via the internet, a provider satisfies his or her disclosure obligation by referring the investor to the provider's website (or e-mailing a link) to obtain the information.

<sup>24</sup> Item 3 of Form N-1A outlines the required content and format of the prospectus fee table. Form N-1A is the SEC's registration form for open-end management investment companies.

<sup>25</sup> See Instruction 4 to Item 3 of Form N-1A.

<sup>26</sup> Consolidated Disclosure of Mutual Fund Expenses (Adopting Release), SEC Release Nos. 33-6752 and IC-16244 (Jan. 28, 1988).

sufficiently conservative to discourage its use as a table of projections.”<sup>27</sup> The Department should follow the SEC’s lead, given the SEC’s expertise and significant study on this issue.

- The Department should eliminate the annual disclosure. That disclosure is not needed in light of the annual reporting requirements associated with Schedule C of Form 5500 (service provider fees and other compensation) and the annual and quarterly fee disclosures required under the Department’s participant disclosure regulation (§2550.404a-5). Much of the information proposed to be required under the proposed BIC Exemption is duplicative of the information required under these other disclosure rules, and, as recommended above, the Department should make use of these other rules as a basis for disclosures under the BIC Exemption. The quarterly statements distributed to IRA holders provide a similarly sufficient level of disclosure to allow such individuals to access the performance and costs associated with the accounts for each quarterly period and at year end.

B. The Department Should Eliminate the Expansive Required Contractual Warranties

The Department should discard entirely the warranty provisions of the BIC Exemption. Providing a “warranty” that all federal and state laws are complied with is unrealistic and unattainable. An adviser would need an enormous and, frankly, unavailable compliance structure to allow it to guarantee to every one of its retirement clients that the institution is 100 percent compliant, 100 percent of the time. The requirement also does not take into account reporting and compliance protocols that are designed to identify and correct situations of non-compliance—any such event, even one that is corrected, would be a basis of a class action lawsuit. In short, the assumption underlying this requirement is not realistic.

As currently structured, the warranties create compliance traps and the risk of unnecessary litigation with few benefits to consumers since the financial institution and adviser will be subject to a “best interest” standard that is actionable in the absence of the warranty provisions.<sup>28</sup> It makes no sense to allow litigation over contractual warranties if the adviser in fact meets the best interest standard of care. A “principles-based” exemption should focus on regulating the conduct of the advice provider, not creating litigation over administrative compliance matters.

The Institute understands that the Department intends to make the best interest standard enforceable by Retirement Investors, including IRA owners. But any contractual claims must be

---

<sup>27</sup> Consolidated Disclosure of Mutual Fund Expenses (Proposing Release), SEC Release Nos. 33-6730 and IC-15932 (Aug. 18, 1987).

<sup>28</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21984 (There is no specific warranty covering the best interest standard of care. Rather it is a part of the impartial conduct standards required to be incorporated in the contract).

limited solely to the best interest standard of care. No other aspects of BIC Exemption compliance should be actionable under ERISA or under contract law. If the Department does not intend to heed our strong recommendation to entirely eliminate those warranties, at a bare minimum, it should modify the requirement to encompass the concept of “material” compliance or “good faith” compliance efforts based, in part, on the sufficiency and comprehensiveness of the financial institution’s procedures intended to meet the requirements.

C. The Department Must Make Practical Other Aspects of the Written Contract Requirements

As drafted, the BIC Exemption cannot be operationalized without changes to the written contract requirements. Several significant practical and operational concerns arise from that fact, including the following:

The parameters of the relationship must be understood before a written contract can be executed – A major impediment to implementing the Best Interest Contract Exemption is the timing of the contract requirement, *i.e.*, that the adviser and financial institution must enter into a written contract with the Retirement Investor *prior to* making a covered recommendation.<sup>29</sup>

It is not realistic to require a signed, written contract before a client relationship has been established, especially in the context of recommending services for the Retirement Investor or any other investor to consider. Given the expansive fiduciary definition described in the Fiduciary Rule Notice, the “recommendation” will often occur at the very inception of the relationship between the adviser and Retirement Investor—before any actual client relationship is established. A Retirement Investor diligently “shopping” for an adviser, for example, should be unwilling to enter into a fiduciary contract every time he or she speaks with a potential adviser. If the Retirement Investor does not act upon advice given by a prospective adviser, furthermore, the adviser presumably will receive no compensation and therefore no fiduciary relationship exists. Moreover, the scope of the anticipated relationship (*e.g.*, mandate, investment purpose and goals) is most likely unknown before there is at least some discussion and therefore cannot adequately be documented in a pre-relationship contract.

To address these concerns, the Institute recommends that the Department not expressly require a written contract. As discussed below, a requirement that the adviser affirmatively undertake to act in the Retirement Investor’s best interest generally is enforceable by that investor and should suffice to meet the Department’s goals. Specifying that the undertaking be included in a contract is elevating form over substance.

---

<sup>29</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21984.

If the Department determines to retain the proposed contract requirement, it must permit the contract to be entered into before the time the transaction resulting from the advice relationship occurs, not prior to the time the recommendation occurs. This would allow the Retirement Investor to consider all relevant information before authorizing or otherwise agreeing to enter into a business relationship or otherwise implement the adviser's recommendation.<sup>30</sup> In this case, the adviser's fiduciary status could be retroactive to the time of the recommendation much like other conduct standards already used in the financial services industry.<sup>31</sup>

If the Department continues to require a contract, it must allow the adviser to create the contract by an undertaking or by implied consent – While the Department did not specify a form of execution requirement in the BIC Exemption, it is critical that the Department acknowledge the impracticality of obtaining signatures in connection with advisory relationships that, under the BIC Exemption, need to be established prior to the provision of a recommendation. It simply is impossible to obtain signatures to amend the millions of existing IRA contracts (and other retirement plan contracts) to comply with the BIC Exemption's written contract requirements. For these reasons, we urge the Department to confirm that it does not object to establishing contracts and amending existing contracts by written undertaking prominently disclosed on a website or similar means, or by negative consent and through electronic delivery, provided a binding contractual relationship is established.

Given the inclusion of a best interest standard in section 404 of ERISA, the standard would be legally imposed and enforceable without a written contract.<sup>32</sup> For IRAs, established contract law precedents and the doctrine of promissory estoppel would ensure the enforceability of a unilateral contract acknowledged by the advice provider. In a unilateral contract, only one of the contracting

---

<sup>30</sup> Even with this change to the timing requirement, there are certain transactions that may not be workable under the proposed framework. For example, if the contract were required prior to a transaction taking place, last-minute IRA contributions will be difficult. Individuals commonly make IRA contributions on or near the April 15 deadline for designating a contribution for the prior year. In that case, there may not be enough time to enter into a contract prior to implementing the individual's instructions, due to the taxpayer deadline. To solve this problem, at least for IRA contributions, the BIC Exemption could permit the contract to be entered into within a reasonable time after the time the transaction occurs. Any risk associated with this approach could be mitigated by the investor's right to revoke the IRA within 7 days and/or "free-look" the annuity contract.

<sup>31</sup> See, e.g., FINRA Regulatory Notice 12-55.

<sup>32</sup> This would similarly be true for standards adopted by the SEC and FINRA.

parties makes a promise; the other party manifests assent by performance.<sup>33</sup> The unilateral contract is supported by the same consideration that would support a signed bilateral contract.<sup>34</sup>

The components of a unilateral contract are clearly compatible with the BIC Exemption, where only the advice provider and not the Retirement Investor is assuming new duties and responsibilities. This can be achieved by requiring firms making use of the BIC Exemption to post a statement on their website (or other venue accessible by the potential customer) acknowledging acceptance of such duties and responsibilities and agreeing to act in a manner consistent with those duties and responsibilities when providing covered investment services. The client would be advised of these duties and responsibilities and where to review them at the time covered services were offered. This could be done orally, when the interaction is by telephone or in person, or in writing, when the interaction is computer-based. The client would accept the firm's offer by proceeding to use the firm's services, thereby forming an enforceable agreement under basic principles of contract law.<sup>35</sup>

These well-established legal principles are sufficient to bind the advice provider to the duties and responsibilities required of the BIC Exemption without the unnecessarily cumbersome and costly difficulties associated with an actual signed written agreement. The doctrine of promissory estoppel would serve as an additional safeguard for ensuring the enforceability of the BIC Exemption's contractual requirements. Under promissory estoppel, a party that acts or forbears from acting in reliance upon a clear and unambiguous promise, can enforce the promise even though the essential elements of a contract are not present.<sup>36</sup>

---

<sup>33</sup> *Corbin on Contracts* § 1.23 (3d ed. 2004); see also *United States ex rel. Modern Elec., Inc. v. Ideal Elec. Security Co.*, 81 F.3d 240, 241 (D.C. Cir. 1996) (citing the "well-recognized" principle that "in a unilateral contract, performance constitutes acceptance of an offer"). Accordingly, "[t]he legal result is that the promisor is the only party who is under an enforceable legal duty. The other party to this contract is the one to whom the promise is made, and this promise is the only one in whom the contract creates an enforceable legal right." *Corbin on Contracts* § 1.23.

<sup>34</sup> *17A Am. Jur. Contracts* § 173; see also *Allen v. National Video, Inc.*, 610 F. Supp. 2d 612, 631 (S.D.N.Y. 1985) citing *Williston, Law of Contracts* §90A ("[A] written contract need not be signed to be binding against a party, so long as the party indicates through performance of its terms or other unequivocal acts that it intends to adopt the contract"); see also *Wells v. JPC Equestrian, Inc.*, No. Civ.A.13-2575, 2015 U.S. Dist. LEXIS 3776 (M.D. Pa. Jan. 13, 2015) citing *Sullivan v. Allegheny Ford Truck Sales, Inc.*, 423 A.2d 1292 (Pa. Super. Ct. 1980) ("A document signed by one party may be enforceable as long as both accept and act under its terms.")

<sup>35</sup> See *Corbin, supra*; see also *Coulier v. United Airlines, Inc.*, 2015 WL 2452393, at \*5 (S.D. Tex. May 21, 2015) (the portion of defendant's website guaranteeing lower price for tickets purchased on the website was a "unilateral contract that the customer must accept by performance"); *Edquist v. Bidz.com, Inc.*, at \*1 (D. Mass. Mar. 29, 2013) ("[A] person such as the plaintiff who accepts the terms offered by the defendant on its website by participating in an online auction governed by those terms has entered into a contractual relationship with the defendant.").

<sup>36</sup> Restatement (Second) of Contracts § 90; see also *Williston on Contracts* § 8:7 (4th ed. 2008) ("[B]oth versions of the Restatement recognize that in certain circumstances, a promise might be enforced despite the absence of consideration – and, according to some courts, despite the absence of other elements necessary to form a traditional contract – based on the

In the context of the BIC Exemption, an advice provider would represent to its customers that it abides by best interest standards when providing services, and acknowledge its understanding that the customer accepted those services in reliance on that assurance. In these circumstances, regardless of the enforceability of the contract, the doctrine of promissory estoppel could be used to enforce the advice provider's representations.

The Department also should expressly make clear that an advice provider seeking to establish or amend contracts to comply with the BIC Exemption can do so by the use of implied consent. The Department has long permitted implied, or negative consent in connection with plan investments. In Advisory Opinion 97-16A, the Department provided guidance under which the "negative" consent of a second fiduciary will be deemed to be the second fiduciary's independent act and not that of the original fiduciary.<sup>37</sup> In this situation, the amendments made to existing contracts would be for the benefit of the Retirement Investor. The revisions would impose a higher standard of care upon advisers to IRAs and any attempted liability limitations would be prohibited by the BIC Exemption. Given that the Department has permitted negative consent in instances where investment options are changed and fees are increased, the Department also should permit using an acknowledgement of undertaking or negative consent to add protective provisions to a contract in favor of the Retirement Investor under circumstances where only the advice provider is assuming new duties and responsibilities.

The Department must eliminate the three-party contract requirement, which is unnecessary and impracticable – Firms do not use three-party agreements in the ordinary course of business. Doing so for purposes of the BIC Exemption would create a re-papering burden each time an adviser is reassigned to a different client team or moves firms. This burden would be felt by both the firm and consumer. Additionally, it is unclear how this requirement could be implemented in a call center context, as the adviser selected will likely depend on call placement. Additional complexities would arise when an adviser moves firms or a Retirement Investor uses multiple advisers. The three-party contract requirement simply should be eliminated.

D. The Department should Simplify and Clarify Requirements for Written Policies and Procedures for "Material Conflicts of Interest"

The Institute has significant concerns regarding the proposed policies and procedures requirement.

---

promisee's foreseeable, reasonable, justified and detrimental reliance on the promise"); *Allen v. A.G. Edwards & Sons, Inc.*, 606 F.2d 84, 87 (5th Cir. 1979) (recognizing promissory estoppel where broker-dealer, "[h]aving benefitted from oral agreements transacted through local agents, appellant cannot now be heard to complain of failure to observe formalities").

<sup>37</sup> See also DOL Advisory Opinions 2001-02; 97-16; 85-16; 85-15.

The Department must clarify the requirement for policies and procedures for adviser compensation – As currently drafted, the BIC Exemption requires that a financial institution’s policies and procedures not authorize compensation or incentive systems that “would tend” to encourage individual advisers to make recommendations that are not in the best interest of Retirement Investors.<sup>38</sup> The Department provided a series of examples of how this requirement could be met in the BIC Exemption Notice. These examples are very restrictive and suggest that compliance with this requirement would preclude individual advisers from having any conflicts of interest—regardless of the existence of policies and procedures designed to mitigate any those conflicts of interest. It is impossible to square this guidance with a “principles based” exemption and the Department’s stated goal of preserving existing business models.<sup>39</sup>

The low bar and subjectivity of the “tend” standard—combined with severe consequences of a failure to meet even a single condition of the BIC Exemption—effectively prohibit the sale of mutual funds with different sales loads, 12b-1 fees and revenue sharing that might be shared between an individual adviser and the firm, even though other aspects of the Exemption suggest that those compensation forms are being preserved. Therefore we request that the Department delete “would tend to” and replace the phrase with “does.”

On this point, the Department should also provide further clarity and examples in order for advice providers to have enough of a framework to at least be able to attempt to craft compliant mitigation policies and procedures. In this respect, the current language provides advice providers with not even the most minimal context as to how the Department intends the condition to apply to compensation practices the BIC Exemption is purportedly designed to permit. These additional examples must include at least one example describing compensation that is not “levelized,” as none of the current examples provide such guidance—although, again, the intended purpose of the BIC Exemption is to allow such compensation practices to continue.

We strongly encourage the Department to conclude that compliance training and monitoring designed to manage and mitigate conflicts, consistent with the FINRA report on conflicts (“Report”),<sup>40</sup> is sufficient for compliance with the written policies and procedures condition of the BIC Exemption. The Report summarizes FINRA’s observations following an initiative, launched in July 2012, to review conflict management policies and procedures at a number of broker-dealer firms. The Report focuses on approaches to identifying and managing conflicts of interest in three broad areas: enterprise-level conflicts governance frameworks; new product conflicts reviews; and compensation practices. With

---

<sup>38</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21984.

<sup>39</sup> See Fiduciary Rule Notice, 80 Fed. Reg. 21928, 21929.

<sup>40</sup> See FINRA Report on Conflicts of Interest (October, 2013); <https://www.finra.org/sites/default/files/Industry/p359971.pdf>



respect to potential conflicts of interest in compensation arrangements, focusing particularly on brokerage and other compensation for associated persons, the Report highlights the following examples of effective practices used by firms to mitigate instances where the compensation structure may potentially affect the behavior of registered representatives:

- Avoiding compensation thresholds where a registered representative can increase his or her compensation disproportionately after reaching a certain threshold of sales.
- Using neutral compensation grids, which avoids favoring one product (within a particular product type) over another by having a flat payout percentage regardless of product type sold.
- Introducing fee-caps (*i.e.*, capping the gross dealer concession that will be credited to a representative's production) to minimize the incentive to favor one mutual fund over another.
- Refraining from higher compensation or other rewards for the sale of proprietary products when there are comparable products.
- Implementing surveillance and monitoring to ensure that registered representatives are not being unduly motivated by thresholds that qualify the representative to receive a back-end bonus, qualify the representative to participate in a recognition club, or move the representative to a higher payout level in the firm's compensation grid.
- Monitoring the suitability of recommendations around key liquidity events in the investor's lifecycle where the recommendation is particularly significant.
- Using red flag processes and clawbacks to penalize employees for not properly managing conflicts of interest. FINRA suggests that firms establish compensation governance structures that mandate identifying and managing the conflicts that compensation structures may create.

FINRA acknowledges in the Report, as should the Department, that actual practices used to appropriately mitigate conflicts will vary from firm to firm.<sup>41</sup> This approach best enables advice providers to tailor their compliance programs to their businesses and relationships with customers. Being able to leverage the compliance programs utilized by institutions for FINRA purposes also has the advantage of potentially reducing overall BIC Exemption compliance costs. The Department and

---

<sup>41</sup> Report at p. 36.

other applicable regulators would be able to review provider policies and procedures, websites and other available information to determine compliance with these requirements in the course of inspections.<sup>42</sup>

Finally, the Department's definition of Best Interest includes language that generally tracks the duty of prudence under ERISA section 404. The Best Interest definition, however, augments the duty of prudence with a requirement that an adviser must act "without regard to the financial or other interests of the Adviser, Financial Institution or any Affiliate, Related Entity, or other party." There is no similar language in ERISA and there is concern that the language could be construed by a court to establish a different and more stringent standard than ERISA's existing fiduciary duties. For example, the language has been read by some to require a complete prohibition of any financial interest by an adviser acting in a transaction. We do not believe the Department intended to deviate from ERISA in this manner and the Department has said as much.<sup>43</sup> We instead believe that the "without regard to" language was simply intended to reflect the duty of loyalty and not to modify the established law that a fiduciary could discharge its duty of prudence and loyalty even where its own actions might affect its own compensation, provided it is relying on an exemption that permits it to receive such compensation. In fact, this is a fundamental purpose of the BIC Exemption as we understand it. As such, we ask the Department delete the "without regard to" language entirely.

The Department must clarify the phrase "reasonably designed to mitigate the impact of Material Conflicts of Interest" – The Department must provide specificity for how advice providers should comply with this requirement. This is critically important, as any deviation from compliance, even if inadvertent, could be the basis for litigation. The Department should provide examples of safe-harbor policies and procedures, based on existing FINRA or SEC guidance.<sup>44</sup> FINRA Rule 3110(b), for example, requires a firm to establish, maintain and enforce written procedures to supervise the types of business in which it engages and the activities of its associated persons that are reasonably designed to achieve compliance with applicable securities laws and regulations and FINRA rules. Under FINRA Rule 3110(a), a firm is also required to have a supervisory system for the activities of its associated persons that is reasonably designed to achieve compliance with the applicable securities laws and regulations and FINRA rules, and sets forth the minimum requirements discussed for a firm's supervisory system.

---

<sup>42</sup> Significantly, FINRA currently performs audits that examine these policies and procedures. FINRA frequently instructs its members to make improvements where necessary.

<sup>43</sup> See BIC Exemption Notice, 80 Fed. Reg. 21928, 21938 ("the best interest standard is intended to mirror the duties of prudence and loyalty, as applied in the context of fiduciary investment advice under sections 404(a)(1)(A) and (B) or ERISA).

<sup>44</sup> See, e.g., FINRA Rule 3110(a) (Supervisory System), based on NASD Rule 3010(a), and FINRA Rule 3110(b) (Written Procedures), based on NASD 3010(b). See also FINRA Regulatory Notice 14-10 (March, 2014), available at <http://www.finra.org/sites/default/files/NoticeDocument/p465940.pdf>.

Similar to the BIC Exemption's requirement that written policies be "*reasonably designed* to mitigate the impact of Material Conflicts of Interest," the above FINRA rules also require that a firm's policies and supervisory system be "*reasonably designed*" to achieve compliance with applicable federal securities laws and regulations. Importantly, FINRA rules recognize that such systems cannot guarantee firm-wide compliance with all applicable laws and regulation and FINRA rules.<sup>45</sup> The Department also should acknowledge expressly that no written policies and procedures—no matter how thorough and well supervised—can guarantee firm-wide compliance with all applicable laws and regulation at all times.

E. The Department Must Clarify the Range of Investment Options Provisions

The Department must clarify and provide examples of the standards a financial institution should consider prior to making a specific written finding that the limitations it has placed on the assets made available to Retirement Investors do not prevent the adviser from providing advice that is in the best interest of Retirement Investors. In this regard, we request that the Department eliminate its higher standard of reasonableness for service providers who limit investment options (*i.e.*, "reasonable in relation to the value of the specific services provided"). At a bare minimum, this more restrictive standard should be explained and guidance should be provided as to how this standard is to be applied and met.

Several areas regarding the range of options require additional clarification and unambiguous guidance. In this respect, the Department should further clarify the meaning of the phrase "broad range of investments" with respect to a financial institution limiting its products. We suggest that the standard under ERISA section 404(c) should be a guide since it is a well-established and simple standard.<sup>46</sup>

We also urge the Department to clarify that financial institutions that limit the investment products to proprietary investments are *per se* considered to have "a range of Assets that is broad enough to enable the Adviser to make recommendations with respect to all of the asset classes reasonably necessary to serve the Best Interests of the Retirement Investor . . ." The Department should take great care not to exclude a product sponsor from servicing the IRA and small plan markets simply because it does not offer products the Department in its sole determination considers necessary to make available "a broad range of investments." In this respect, Section 913 of the Dodd-Frank Act made clear Congress' intent that "[t]he sale of only proprietary or other limited range of products by a broker or

---

<sup>45</sup> See Notice to Members 99-45 (June 1999) (noting that NASD Rule 3010's "reasonably designed" standard "recognizes that a supervisory system cannot guarantee firm-wide compliance with all laws and regulations" but that the "reasonably designed" standard requires that the system "be a product of sound thinking and within the bounds of common sense, taking into consideration the factors that are unique to a member's business").

<sup>46</sup> See 29 C.F.R. §2550.404c-1

dealer shall not, in and of itself, be considered a violation of<sup>47</sup> standards of conduct that apply to investment advisers.<sup>47</sup>

We are concerned that, in the absence of the clarifying language discussed above, a product sponsor offering only proprietary products could never be confident that it will not be subject to prohibited transaction excise taxes or that it will be able to adequately defend itself in lawsuits under private right of actions brought pursuant to claims that a broad range of assets was not made available. Many mutual fund companies offer IRAs that can invest in any fund offered by the fund company, which generally affords substantial diversification opportunities to consumers. We believe that an institution can meet the first general provision of section IV(a) of the BIC Exemption, offering a range of assets broad enough to make recommendations as to all reasonably necessary asset classes, while limiting the available products to proprietary products. Therefore, the requirements of section IV(b) should not apply in such cases, or should be expressly limited to focus on the ability to make recommendations regarding *a broad range of asset classes*, not *all asset classes or products*.

#### F. The Department Must Expand the Scope of the BIC Exemption

In its current form, the BIC Exemption is much too limited in scope to serve its intended purpose of preserving access to investment advice for Retirement Investors. The Department must expand the BIC Exemption to cover advice made available to small employers, the full range of rollover and distribution discussions, recommendations with respect to advisory programs, all asset types (consistent with the Department's well-established precedents),<sup>48</sup> and computer-based or "robo advice" services.

Advice to large and small employer plans, and other fiduciaries – The BIC Exemption should be available with respect to all participant-directed plans—small and large. The exclusion of smaller participant directed plans is especially problematic since small plans are not subject to the Proposed Fiduciary Rule's counterparty carve-out.<sup>49</sup> Sponsors of small plans often need the most advice and guidance from their advisers. They operate under the same fiduciary duties as larger employers and there is no basis to assume that they will not be able to carry out their fiduciary duties in receiving advice from advisers that rely on the BIC Exemption.

Advisers to plans, both participant-directed and non-participant-directed, should also have the option of relying upon the BIC Exemption in addition to the counterparty carve-out. Finally, the definition of Retirement Investor should also be expanded to include trustees, fiduciary committees and

---

<sup>47</sup> Dodd Frank Act Section 913(g), *amending* Section 15 of the Securities Exchange Act of 1934 (15 U.S.C. 78o).

<sup>48</sup> *See, e.g.*, Preamble to Reg. §2550.404a-1 at 44 Fed. Reg. 37255 (June 26, 1979).

<sup>49</sup> Fiduciary Rule Notice, 80 Fed. Reg. 21928, 21957.

other fiduciaries, not just plan sponsors, as many of these persons need investment information and advice.

Coverage of distribution and rollover advice – We understand and appreciate that the Department intended the BIC Exemption to provide a wide range of relief for distribution and rollover activity where a potential conflict of interest is present. A number of important clarifications and expansions are needed, however, to ensure that Retirement Investors can access quality information at the time they make these critical decisions.

It seems clear that the BIC Exemption would cover advice on how to invest assets within an IRA once rolled over. The Department should clarify, however, how firms should address any potential conflicts associated with the full range of rollover discussions as outlined below.

- A participant may decide to remain in a plan (rather than roll over to an IRA) based on information received by a service provider (such as the plan's record keeper), but that might result in the continued accrual of a per-capita recordkeeping fee under the plan by the service provider. Would this suggest receipt of prohibited compensation? If so, we ask that the Department provide relief for discussions that result in retirement assets being maintained in an employer-sponsored plan.
- A participant may receive advice to "roll in" amounts from a prior employer's plan to a new employer's plan. The Department should expand the BIC Exemption to permit a potential conflict associated with that transaction (*e.g.*, the advice comes from an affiliate of the record keeper of the participant's new plan).
- A financial institution may receive a small custody fee from an IRA that it recommends as a vehicle for receiving a rollover. The Department should permit this potential compensation.
- The Department should modify the BIC Exemption to permit the recommendation of a rollover to a manager or advisory product that itself does not need to comply with the BIC Exemption. It is not clear that such a recommendation is currently covered, nor is it clearly an "Asset" as defined by the exemption.

The Department must expand the BIC Exemption to permit recommending advisory programs – Recommendations and advice regarding utilization of managed account or advisory services would appear to trigger fiduciary status under the Proposed Fiduciary Rule, but it is unclear that such advice is subject to prohibited transaction relief. An advice provider that recommends utilizing herself or an affiliate, for example, would appear to have provided conflicted covered advice. Notably, such

recommendations were not seen as prohibited under the examples given in the Department's existing ERISA regulations (29 C.F.R. §2550.408b-2(f), examples (1), (3) and (4)).

The Department should revise the BIC Exemption, or propose a separate targeted exemption, to permit recommendations to invest in managed account and other fee-based advisory programs. Allowing advisers to promote managed account and other advisory services will help further the Department's goal of limiting leakage from the retirement system by promoting the use of IRAs rather than risking pre-retirement distributions of account balances.

Critically, if the recommended managed account or advisory service itself does not need the BIC Exemption due to fee leveling or rebating fees back to plans and IRAs, then considerably fewer requirements should apply. For example, it would be inappropriate to impose any asset restrictions and related investment disclosures in such circumstances. Point of sale disclosures should only include a description of the program and the compensation earned by the advice provider (all encompassed in a Form ADV and related contractual documents). The other disclosure requirements of the BIC Exemption are clearly not appropriate. Similarly, the contractual warranty requirements are not needed.

The Department should expand the BIC Exemption to cover all asset types given its other significant consumer protections – It simply is unreasonable to restrict investor choice to asset types, as the proposed BIC Exemption would do. Creating a permitted list of assets is contrary to the Department's previous embrace of modern portfolio theory. Indeed, in Advisory Opinion 2013-01A the Department made clear that there is a role for derivatives and other forms of sophisticated investments in a modern portfolio. Therefore, no restrictive asset list should apply given that under the "best interest" standard of care, only assets that are appropriate to a particular consumer's needs can be recommended.

To the extent the Department determines to retain, over our objection, its limitation on "Assets," it should expand the BIC Exemption or the Principal Transactions Exemption to cover Unit Investment Trusts ("UITs").<sup>50</sup> As discussed in greater detail below, UITs are effectively "passive" registered investment companies that buy and hold securities. They have no board of directors or active management and thus are not "managed" investment companies. While the term "Assets" covered by the BIC Exemption include shares or interests in registered investment companies, Section I(c)(2) of the BIC Exemption excludes principal transactions from the exemption's coverage. Therefore, although UITs, as registered investment companies, would be included within the definition of "Asset" under the BIC Exemption, investments in UITs are generally conducted on a principal basis and a special rule or clarification is needed under the BIC Exemption or relief is needed under the Principal Transactions Exemption.

---

<sup>50</sup> See text accompanying footnotes 73 through 76, *infra*.

Finally, service providers will need assurances that they will not be considered to provide investment advice and thereby assume fiduciary status simply by informing a potential client that they would need to liquidate assets not covered by the BIC Exemption in order to receive services.

The Department should foster reliance on the PPA exemption – Congress endorsed certain advisory programs in the Pension Protection Act (“PPA”) through the establishment of a statutory exemption (*i.e.*, ERISA sections 408(b)(14), 408(g)). The Department has issued comprehensive and consumer protective regulations implementing the PPA exemption. The Department should clarify that the PPA exemption covers the recommendation to use an advisory program that otherwise complies with the PPA exemption. The Department should not burden firms that have developed programs that comply with the PPA exemption with complying with both the BIC Exemption and the PPA exemption to market such advisory programs.

The Department must clarify the status of so-called robo advice – The Department should clarify the status of computer based “robo advice.” Access to nondiscretionary computer based programs can be helpful and cost beneficial to many consumers and it is unclear how such programs would be treated given their exclusion from the BIC Exemption. Service providers should have the choice of utilizing a simplified BIC Exemption for “robo advice” if they choose to do so, in lieu of relying on ERISA section 408(g). Absent such clarification, Retirement Investors may lose access to these useful programs available to consumers generally.

The Department should expand the BIC Exemption to cover in-house plans of financial institutions – The BIC Exemption would not allow a financial institution to rely on the exemption to provide investment advice to participants in the plans that it maintains for its own employees. The preamble to the proposal states that due to the “special nature” of the employment relationship, the financial institution should not be permitted to profit from the investments of employees because that would not be in the best interests of the plan participants.<sup>51</sup>

This approach is inconsistent with the Department's historical treatment of financial institutions as plan sponsor. For example, the Department stated in the preamble to the proposed ERISA section 404(c) regulation:

The Department is persuaded, however, that in the case of plans sponsored by certain financial institutions which have appropriate professional expertise in investment management, the designating fiduciary need not be independent. In enacting ERISA, Congress recognized the need to accommodate such plans by fashioning special rules. For example, section 408(b)(4) of ERISA permits a bank to invest the assets of an in-house plan in deposits of that bank and

---

<sup>51</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21968.

section 408(b)(5) permits an insurance company to issue contracts to a plan covering its own employees. The stated Congressional policy underlying these exemptions is that it would be “contrary to normal business practice” for a bank or insurer to purchase the products of another company of its own in-house plans. Moreover, the Department has recognized in certain administrative exemptions that it would be contrary to normal business practice for a company whose business is financial management to seek financial management services from a competitor, *e.g.*, Prohibited Transaction Exemptions 77-3 and 82-63.<sup>52</sup>

There is no reason why these long standing positions should not be reflected in the BIC Exemption so as to cover investment advice provided to employees of financial institutions. In many cases, for compliance reasons, those employees are required to maintain their financial assets with the firm itself. Denying those firms the ability to provide employees investment advice would result in such employees without access to advice, unless a third party advice provider is hired at additional expense.

#### G. Impartial Conduct Provisions

The impartial conduct standard appears intended to create a new “fiduciary plus” standard of care that goes beyond existing law. We have the following concerns and suggestions regarding the impartial conduct standards:

Creates redundant and confusing standard for ERISA plans – The Department should not require the best interest standard in contracts with ERISA plans if, as the Department states in the BIC Exemption Notice,<sup>53</sup> the standard is truly meant to mirror ERISA’s fiduciary requirements to which fiduciaries are already subject.<sup>54</sup> Imposing additional contract language simply increases litigation exposure for financial institutions without increasing consumer protection. Such additional exposure will drive up the cost of providing services to ERISA plans.

Unambiguous standards must guide “reasonableness” of compensation – The Institute also recommends that established and objective criteria should govern “reasonableness” of compensation in relation to the level of services performed. It is crucial that the highly competitive marketplace for investment products determine reasonable compensation. Both the Department and the courts previously have endorsed this approach.<sup>55</sup> In addition, comprehensive regulation and oversight applies

---

<sup>52</sup> 56 Fed. Reg. 10724 (March 13, 1991).

<sup>53</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21970.

<sup>54</sup> Fiduciary Rule Notice, 80 Fed. Reg. 21928, 21938.

<sup>55</sup> The “reasonableness” of compensation is determined in light of the value of services rendered to the plan, not the cost of providing such services. *See* Information Letter to John DiVincenzo (Dec. 9, 1986); Adv. Op. 2002-08A (selection of service provider involves assessment of quality of services, reasonableness of charges in light of services provided, and cost of comparable services in the market); *McLaughlin v. Bendersky*, 705 F. Supp. 417, 421 (N.D. Ill. 1989) (service provider’s



to the payment of various fees by mutual funds, and, therefore, such fees should be considered *per se* reasonable for purposes of the exemption.<sup>56</sup> The Department should not require that a financial institution have identical fee agreements with mutual fund companies since the variety of services provided to fund companies varies widely.

#### H. Other Concerns with the Best Interest Contract Exemption

Clarify scope of prohibited exculpatory provisions – We request that the Department clarify that the BIC Exemption’s limitation on disclaimers does not preclude a provider from specifying in the written contact that it is only responsible as a fiduciary for the specific activities and services that constitute investment advice under the Proposed Fiduciary Rule. Further, we request that the Department confirm the limitations on liability for non-fiduciary services are not prohibited by the BIC Exemption. For example, a limitation of liability related to providing basic asset allocation information that is subject to the education carve-out provided by the Proposed Fiduciary Rule should not violate the conditions of the BIC Exemption.

Disclosure and recordkeeping requirements should be modified – The governmental disclosure and recordkeeping requirements in connection with the BIC Exemption are quite broad and need to be appropriately revised to limit the requirements to those necessary to meet the intended purpose of the condition. In this respect, we request that the Department clarify that trade secrets do not need to be disclosed to the Department as a condition of this exemption. Further, we request that the Department explain how it will use the data financial institutions are required to maintain to assess the effectiveness of the BIC Exemption. We are gravely concerned that the disclosure requirement will, in essence, open up a financial institution’s records to any fiduciary, contributing employer, participant or beneficiary. Further, we request that the Department agree that, if upon examination, it finds that a financial institution technically failed to maintain a minor or immaterial aspect of the recordkeeping

---

costs and profits are irrelevant to determining whether compensation is reasonable). 29 C.F.R. § 2550.408b-2(c)(1) (iv)(D) also discusses the use of prevailing market rates in recordkeeping cost disclosures.

<sup>56</sup> See, e.g., Section 15(c) under the Investment Company Act of 1940 (requiring, in connection with initial and subsequent annual reviews of registered funds’ investment advisory agreements, that fund boards request and evaluate (and investment advisers furnish) “such information as may reasonably be necessary to evaluate the terms of any contract...”; Section 36(b) under the Investment Company Act (stating that registered funds’ investment advisers “have a fiduciary duty with respect to the receipt of compensation for services...”, and providing for private rights of action by shareholders against investment advisers and their affiliates for breaches of this fiduciary duty); Rule 12b-1(e) under the Investment Company Act (requiring, in connection with initial and subsequent annual reviews of registered funds’ plans of distribution, that fund boards conclude “in light of their fiduciary duties... that there is a reasonable likelihood that the plan will benefit the company [i.e., the fund] and its shareholders”); and FINRA Rule 2830(d) (imposing, indirectly through regulation of FINRA members, specific limits on registered funds’ aggregate sales charges (e.g., front-end, deferred, and asset-based sales charges) and service fees).

requirements for the past six years, it will not revoke the availability of the BIC Exemption for the initial transaction.

## **II. Exemption for Pre-Existing Transactions**

The proposal includes an exemption for pre-existing transactions, under which a financial professional who, prior to the applicability date of the new rule, provided advice that was not considered fiduciary advice, could continue to receive ongoing periodic compensation after the applicability date that is attributable to a transaction occurring prior to the applicability date.<sup>57</sup> The exemption also would apply to fiduciary advice transactions occurring prior to the applicability date implemented in accordance with the terms of a prohibited transaction exemption that has since been amended. A number of conditions would apply to the pre-existing transaction exemption, including that the financial professional does not provide additional advice to the investor regarding the investment after the applicability date. While this exemption is certainly helpful, it is too limited in scope to cover the full range of situations that should be grandfathered.

We urge the Department in the strongest terms to provide a blanket exemption to all investments existing as of the effective date. It is simply unfair to impacted Retirement Investors to retroactively apply the new rules to existing investments that were made in compliance with existing law. The exemption should not prohibit ongoing advice on these pre-existing assets.

Without this change, Retirement Investors will likely give up certain advantageous rights flowing from existing compensation agreements. For example, (1) in many cases, the customer has already paid for continuing guidance on whether to hold, sell, or exchange the investment, such as through a front-end sales load coupled with a small trailing fee, and (2) changes will likely lead to customers giving up certain rights (*e.g.*, rights of accumulation, aggregation, conciliation for fee breaks) flowing from existing compensation agreements. In fact, this condition would serve to discourage advisers and financial institutions from providing information and advice on pre-existing assets, which will harm Retirement Investors.

Moreover, the exemption's prohibition on ongoing advice is fundamentally inconsistent with a registered representative's obligation to review the ongoing suitability of each investment. A commission paid in connection with the sale of a mutual fund is compensation for the transaction, as well as a prepayment for ongoing investment advice (*e.g.*, investment reviews, reallocation decisions). The investor pays a commission equal to a percentage of the initial investment and then the mutual

---

<sup>57</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21987.

fund typically pays the advice provider an annual amount equal to up to 0.25 percent of the value of the account. These payments entitle the shareholder to ongoing service.<sup>58</sup>

Without a grandfather rule, millions of impacted Retirement Investors will forfeit their pre-paid right to ongoing advice at very modest cost. Even a recommendation to hold on to an investment and stay the course during a period of market turmoil or to exchange to a different fund within a fund family to reflect changing needs of the investor would be discouraged—even though new commissions typically are not generated in those circumstances. Existing relationships between retirement savers and their long-time advice providers would have to be restructured—either to satisfy the untenable conditions of the BIC Exemption or to move to a fee-based arrangement and incur new fees as a result. Such a restructuring would result in significant investment churn with uncertain benefits. Other impacted retirement savers will be orphaned and will effectively become self-directed accounts with no one to guide them through market and life changes.

Therefore, we strongly urge that under the pre-existing transaction exemption, the Department should permit advice providers to make ongoing recommendations with respect to existing investments (and reinvested dividends), including exchange recommendations, as long as such investments do not trigger a new commission or otherwise change the advice provider's compensation.

We recommend certain additional clarifications to the pre-existing transaction exemption outlined in the proposal. First, we believe the exemption should cover all assets, not just the Department's approved list of investments. Otherwise, firms will have to encourage the untimely sale of these assets, further harming consumers. We also ask that the Department clarify that the exemption conditions applicable to pre-existing transactions would not require separate disclosure of compensation received after the applicability date. Finally, we request clarification that the pre-existing transaction exemption is not lost (for compensation attributable to pre-applicability date advice) if subsequent advice is provided after the rule's applicability date, and that subsequent advice complies with the BIC Exemption, as modified in accordance with these comments.

### **III. The Department's Questions about a High-Quality/Low-Fee Streamlined Exemption Raise Multiple Concerns**

The Department states that it is considering a streamlined exemption with fewer conditions than the Best Interest Contract Exemption. This exemption would allow advisers and financial institutions (and their affiliates and related entities) to receive otherwise prohibited compensation in connection with "high-quality and low-fee" investments. The Department does not define investments

---

<sup>58</sup> Even in the absence of an upfront commission, for example, where the load is waived in a rollover, the initial investment entitles the shareholder to substantial benefits, including reduced sales charges on future investments through rights of accumulation, ongoing advice at a very modest cost, and the right to exchange investments within the fund family without additional commissions.

that would qualify as high-quality and low-fee. The Department acknowledges that it is “unable to operationalize this concept and therefore has not proposed text for such a streamlined exemption.”<sup>59</sup> Nonetheless, the Department seeks public input about the design, utility and consequences of such an exemption.

We applaud, in principle, the Department’s consideration of a streamlined exemptive approach. Indeed, the proposed Best Interest Contract Exemption could serve that purpose were the Department to revise it to focus on the best interest conduct standard, rather than the excessively burdensome contractual, compliance and disclosure conditions that make that exemption unworkable as proposed. Such an approach would be far superior to any attempt at an exemption written only for a narrow range of investments, as presumably would be the result of its high-quality low-fee approach.

We have serious concerns with the concept of a high-quality low-fee exemption. The discussion in the BIC Exemption Notice suggests that the Department believes investment advice should favor certain investment options, such as target date funds that are passively managed, over others. The discussion puts forward the idea, for example, that “a long-term recommendation to buy and hold a low-priced (often passively managed) target date fund that is consistent with the investor’s future risk appetite trajectory is likely to be sound.” Such an investment option may be a sound one for many Retirement Investors. We strongly disagree, however, if the Department intends that a fiduciary should favor a passively managed target-date fund over other options for all savers simply on the basis of relative cost and passive management.<sup>60</sup>

Fees and expenses should be a factor that a fiduciary should take into account. But cost should not and cannot be the sole factor in making an investment decision. The Department has acknowledged as much in other rulemakings.<sup>61</sup> Nor does trust law, in articulating the nature of fiduciary duty, sanction low cost as a consideration exclusive of others.

---

<sup>59</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21978.

<sup>60</sup> We have long objected to regulatory proposals that favor one investment strategy over others. *See, e.g.*, Letter to the Department regarding its February 2010 proposal to implement the investment advice provisions of the Pension Protection Act (May 4, 2010), available at: [www.ici.org/pdf/24282.pdf](http://www.ici.org/pdf/24282.pdf). The needs of retirement savers, and investors generally, are simply too diverse to limit investment options or to favor certain options over others.

<sup>61</sup> Department of Labor, *Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans*, RIN 1210-AB07 (Oct. 20, 2010) (adopting a rule requiring a statement indicating that “fees and expenses are only one of several factors that participants and beneficiaries should consider when making investment decisions.”). The Department has also informed fiduciaries that costs “are only one of several factors fiduciaries need to consider in deciding on service providers and plan investments.” Department of Labor, *Meeting Your Fiduciary Obligations*, available at: [www.dol.gov/ebsa/publications/fiduciaryresponsibility.html](http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html).

Though far from clear, the Department might have in mind marrying “low-cost” with “high-quality,” to form a narrow set of investment options that would be subject to the streamlined exemption. Attempting in regulation to identify “high-quality” for these purposes is a vain undertaking. There is no simple metric for identifying objectively which investment products are “high-quality” and which are not. No simple set of criteria for this purpose could take into account the diverse portfolio needs of the millions of American retirement savers.

Employers clearly recognize the benefits of different forms of portfolio investing when they select menus of investment options for 401(k) plans. A survey by the Profit Sharing/401k Council of America (now known as the Plan Sponsor Council of America) found that respondents commonly used actively managed funds in 2012, the most recent year in which such data is available.<sup>62</sup> It would depart dramatically from existing regulations, and establish a very troubling precedent, were the Department to begin to pick and choose among funds and investment styles, effectively overriding the conscientious decisions of employers fiduciaries and Retirement Investors.

We thus have deep concerns about the conceptual framework the Department has laid out for its streamlined high-quality low-fee exemption. More fundamentally, we do not believe that the Department has published enough detail about any specific proposed terms of such an exemption to provide the public a meaningful opportunity to comment on those terms before incorporating them into any final rule. The Department simply has not provided sufficient clarity and specificity for us to understand what it might have in mind in terms of an implementable exemption. If the Department is considering any high-quality low-fee streamlined exemption, it must therefore decide upon and publish the actual proposed terms, provide an explanatory rationale consistent with those terms, an explanation of the economic impacts of the exemption, and an explanation for how the exemption would function. We believe the Administrative Procedure Act (“APA”)<sup>63</sup> requires all of these elements if the Department is to “operationalize” such a proposed exemption, which it recognized that it currently is unable to do.<sup>64</sup>

Merely raising a theoretical concept and asking a series of questions about it does not provide adequate notice and an opportunity to provide meaningful comment.<sup>65</sup> Rather, under the APA, an agency must “describe the range of alternatives being considered with reasonable specificity. Otherwise,

---

<sup>62</sup> Profit Sharing/401k Council of America, 56th Annual Survey of Profit Sharing and 401(k) Plans, Reflecting 2012 Plan Year Experience (Oct 17, 2013). (The survey did not ask about indexing in certain investment categories like real estate funds.)

<sup>63</sup> Pub.L. 79–404, 60 Stat. 237.

<sup>64</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21978.

<sup>65</sup> See, e.g., *Prometheus Radio Project v. FCC*, 652 F.3d 431, 450 (3d Cir. 2011).

interested parties will not know what to comment on, and notice will not lead to better-informed agency decision-making.”<sup>66</sup> Two examples from the Department’s discussion illustrate the point.

First, the Department says that it is “considering whether the streamlined exemption would be available to funds with all-in fees below a certain amount.”<sup>67</sup> The Department does not provide any indication of what such an amount might be, citing a lack of available data about “the characteristics of mutual funds with low all-in fees.”<sup>68</sup> There are reams of data and studies about mutual fund fees the Department could analyze but apparently has not. And the Department gave no indication of what that “certain amount” might be to qualify as low cost—not a specific amount, not a range of amounts, not even an analytical framework that the Department might use to arrive at an amount.<sup>69</sup>

This information is critical—not merely supplemental—to understanding and commenting upon a regulatory action addressing costs. In similar circumstances, courts have held that agencies that do not provide key data or information about key terms in a rule proposal have failed to provide notice sufficient to allow the agency to adopt a rule as final.<sup>70</sup> If the Department uses fee thresholds for eligibility for the conceptual streamlined exemption, information about those thresholds would be central to an understanding of the exemption. If the Department wishes to pursue such a fee-based

---

<sup>66</sup>*Horsehead Res. Dev. Co. v. Browner*, 16 F.3d 1246, 1268 (D.C. Cir. 1994) (*per curiam*). See also *Time Warner Cable Inc. v. FCC*, 729 F.3d 137, 170 (2d Cir. 2013) (a proposed rulemaking’s “solicitations” “on whether the FCC should ‘adopt rules to address the complaint process itself’ and, specifically, whether it ‘should adopt additional rules to protect [programming networks] from potential retaliation if they file a complaint,’” was “too general to provide adequate notice that a standstill rule was under consideration as a means to provide such protection”); *Env’tl. Integrity Project v. EPA*, 425 F.3d 992 (DC Cir. 2005) (Environmental Protection Agency failed to provide adequate notice and comment when its final interpretation was merely mentioned in the proposal preamble). We note that the Department expressly acknowledges that it is not proposing a streamlined exemption for “high-quality low-fee” investments, but is asking questions about the concept. The Department notes that much of its discussion is theoretical. See, e.g., 80 Fed. Reg. 21960, 21978 (“In theory, a streamlined exemption with relatively few conditions could be constructed around such investments.”) (emphasis added).

<sup>67</sup> BIC Exemption Notice, 80 Fed. Reg. 21960, 21978.

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

<sup>69</sup> Indeed, the Department rightly notes that “there may be no single, objective way to evaluate fees and expenses associated with mutual funds (or other investments) and no single cut-off to determine when fees are sufficiently low. One cut-off could be too low for some investors’ needs and too high for others’. A very low cut-off would strongly favor passively managed funds. A high cut-off would permit recommendations that may not be sound and free from bias. Multiple cut-offs for different product categories would be complex and would risk introducing bias between the categories. In addition, it is unclear whether mutual funds with the lowest fees necessarily represent the highest quality investments for Retirement Investors.” 80 Fed. Reg. 21960, 21978.

<sup>70</sup> See, e.g., *Portland Cement Ass’n v. Ruckelshaus*, 486 F.2d 375 (DC Cir. 1973), *cert. denied*, 417 U.S. 921 (1974) (“it is not consonant with the purpose of a rule-making proceeding to promulgate rules on the basis of inadequate data, or on data that, [to a] critical degree, is known only to the agency.”)

exemption, over our objection, the APA requires that it be done after proper notice and with a genuine opportunity to comment.

The Department is similarly silent as to how it would define “high-quality.” For reasons set forth above, we believe that “high-quality” depends on myriad considerations that cannot be captured in a single regulatory exemption such as the Department has described. But in any event, before it could finalize a rule with such an exemption, the Department would need to put forward a specific definition of “high-quality,” and allow the public to comment.

Second, the confusing reference to conditions that would be added to the exemption, beyond “low-cost” and “high-quality,” lacks any content or detail and does not permit a meaningful opportunity for comment. The discussion states, for example, that “some of the required disclosures proposed in the Best Interest Contract Exemption would likely be imposed in the streamlined exemption.” The proposed Best Interest Contract Exemption includes a host of disclosure conditions, many of which it is not possible to comply with, as we explain elsewhere in this letter. The Department can and must do better if it intends to adopt any exemption.

The APA—and basic fairness—require an identification of conditions the Department may be considering for the streamlined exemption and an explanation of how those conditions best address the problem the Department is seeking to solve, why reasonable alternatives do not suffice, and the implications of the choices it is considering. The Department did not provide this information in the preamble.

#### **IV. Effective Date/Applicability Date Must be Extended and “Good Faith” Compliance Permitted**

We cannot emphasize enough that the applicability date does not provide sufficient time for the extensive system and policy changes needed to comply with the BIC Exemption. Therefore we suggest that the Department make any conditions of the BIC Exemption, as modified pursuant to the recommendations made in this letter, applicable not earlier than two years after the initial applicability date. Of course, if the recommended changes are not made to the proposed BIC Exemption, the applicability date should be extended from two years to no earlier than 36 months to allow for the significant systems changes that will be needed to generate the point of sale and annual individualized disclosures.

Additionally, the BIC Exemption, the Principal Transactions Exemption and the definitional changes contemplated by the Proposed Fiduciary Rule have unprecedented complexity and unrealistic compliance deadlines. At the same time, the exemptions impose “warranties” and “policies and procedures” that mandate near perfect compliance for certain conditions, and a disclosure regime that is incredibly granular and subject to implementation challenges. The Institute strongly urges the Department to revise the BIC Exemption and Principal Transactions Exemption so that financial

institutions can rely on the exemptions provided they act in good faith and with reasonable diligence and provided that they correct any errors within reasonable time periods upon discovery. The adoption of good faith compliance, plus an opportunity to cure, is an approach the Department recently adopted in the service provider disclosure regulation—a far less complex regulation which had longer compliance deadlines.<sup>71</sup> Indeed, the Department has historically provided similar good faith compliance and cure periods, dating back to its insurance company general account regulation and the contract and disclosure regime surrounding it.<sup>72</sup>

#### V. **Principal Transactions Exemption**

Clarify the Principal Transactions Exemption – Facilitating principal transactions offers many benefits to consumers. In particular, firms that buy and sell as principal provide critical liquidity to consumers in market downturns. The proposed exemption will limit their provision of liquidity to consumers because, for example, disclosing the “mark-up” or “mark-down” in connection with a principal transaction is problematic. First, it can change between the time of the exemption’s required disclosure and the time of execution based on changes in trading price. Second, it can change depending on what instrument is sold from inventory (the margin could vary based on the price it was originally bought for). Third, it is not always clear in advance of the investor’s order whether it will be fulfilled on an agency or principal basis. At a minimum, the Department should eliminate this disclosure or replace it with a disclosure of a potential range.

The proposed exemption also uses undefined terms, such as the requirement that the debt security possesses no greater than a “moderate credit risk” and that the security be “sufficiently liquid” such that it could be sold at or “near” its fair market value within a “reasonably short period of time.” The Department should eliminate or clarify these terms. The Department appears to have incorporated these terms from Rule 6a-5 under the Investment Company Act of 1940. For the sake of clarity and consistency, the Department should make clear that those terms will be interpreted in the same manner as under Rule 6a-5.

Finally, requiring two counterparties to provide pricing severely diminishes the utility of this exemption. Obtaining two contemporaneous independent prices may not be possible and at a minimum it will delay the execution of the transaction.

UITs should be included under the exemption’s coverage – To the extent not covered under the BIC Exemption, UITs should be included under the coverage of the Principal Transactions Exemption. In this respect, as discussed above, UITs are investment vehicles that are generally passive and tend to buy and hold without active management. Like open-end mutual funds and closed-end

---

<sup>71</sup> See 29 C.F.R. § 2550.408b-2(c)(1)(iv)(F)(2), 29 C.F.R. § 2550.408b-2(c)(1)(vii).

<sup>72</sup> 29 C.F.R. § 2550.401c-1(i)(5).



funds, UITs are registered under, and governed by, the Investment Company Act, and the rules and regulations promulgated thereunder.<sup>73</sup> UITs are professionally selected pooled investment vehicles in which a portfolio of securities is selected by the sponsor and deposited into the trust for a specified period of time—usually ranging from 12 months to as many as 25 years. UITs generally follow a “buy and hold” strategy and typically will make a “public offering” for a specific time period. Investors purchase units of the trust that represents an undivided ownership interest in the assets held in the UIT. A network of underwriters and dealers sell UITs and UITs trade on a principal basis at a price based on net asset value of the underlying securities plus a specified sales charge. Although units of a UIT are purchased from the UIT sponsor on a principal basis, these principal transactions are typically “riskless principal” transactions to fill orders placed by investors. Units are redeemable every day at net asset value and there are strict rules to assure investors pay uniform prices.<sup>74</sup>

We understand that the Department intends to limit the BIC Exemption to provide relief for otherwise prohibited compensation generated by investments only if such investments are of certain types commonly purchased by Retirement Investors. As discussed above, the “Assets” covered by the BIC Exemption are limited to what the Department considers to be commonly purchased investments, including shares or interests in registered investment companies. Section I(c)(2) of the BIC Exemption, however, excludes principal transactions from coverage under the BIC Exemption. Therefore, although UITs, as registered investment companies, would be included within the definition of “Asset” under the BIC Exemption, fiduciaries seeking relief under the BIC Exemption would be precluded from obtaining that relief for the distribution of UITs.

We disagree with any limitation by the Department on asset classes, as discussed above. If the Department determines to keep those limitations over our objection, we wish to point out that UITs do not raise the same types of issues the Department described as raising concern in proposing relief pursuant to the Principal Transactions Exemption—they do not receive mark-ups and mark-downs similar to debt securities that trade on a principal basis. Investors primarily pay a sales charge for the purchase of units in a UIT.

Because of the fixed character of a UIT portfolio, ongoing trustee and sponsor fees are minimal and there is no ongoing investment advisory fee. UITs are subject to the same pricing requirements and restrictions under Section 22 of the Investment Company Act as open-end registered investment companies. In this respect, Section 22(d) of the Investment Company Act prohibits the sale of open-end fund shares and UIT units at any price other than the current public offering price described in the

---

<sup>73</sup> See Section 4 of the Investment Company Act, which categorizes investment companies into three basic types: face amount certificates, unit investment trusts, and management companies which include open-end mutual funds and closed-end funds.

<sup>74</sup> Many UIT sponsors, however, will maintain a secondary market, which allows unit holders to sell them back to the sponsors and allows other investors to buy UIT units from the sponsors.

prospectus (“Retail Price Maintenance”). Most UITs waive or decrease the sales load for certain defined groups of investors pursuant to SEC rules.<sup>75</sup> These Retail Price Maintenance rules require the UIT, its principal underwriter and selling dealers to apply the reduced load to all purchasers of units in the class or transactions specified which would include, for example, quantity discounts and sales charge discounts for investors purchasing multiple products. FINRA rules further require adherence to the same Retail Price Maintenance concepts, thus eliminating any issues related to undisclosed mark-ups and mark-downs that are present with respect to debt securities traded on a principal basis. All investors purchasing units pay the net asset value of the underlying assets in the UIT plus the specified sales charges notwithstanding any principal transactions along the distribution chain that occurred prior to the investor’s order being filled.

UITs have features making them an attractive strategic option for Retirement Investors, including providing a simple method for such investors to own a diverse basket of securities, professionally researched and screened, with a single purchase. In addition, like open-end investment companies generally, UITs are liquid investments, redeemable on a daily basis at net asset value.

As discussed above, in the event the Department does not revise the BIC Exemption to provide relief for UITs, we respectfully ask that UITs be covered under the Principal Transactions Exemption.<sup>76</sup>

## **VI. Changes to Existing Exemptions**

### **A. Impartial Conduct Standards**

We reiterate that the proposal to amend Prohibited Transaction Exemptions (“PTEs”) 75-1, 77-4, 80-83, 83-1, 84-24, and 86-128 to require all fiduciaries relying on any of these exemptions to adhere to the same impartial conduct standards required by the BIC Exemption raises the same issues as raised under the BIC Exemption.<sup>77</sup>

The Institute also requests that the Department reconsider imposing the impartial conduct standards to existing PTEs 77-4 and 86-128. These exemptions have worked well for years and have been generally relied on for discretionary management programs rather than advisory programs. As the Department notes throughout the exemption proposals, fiduciaries to ERISA covered plans are already subject to a fiduciary standard under ERISA section 404, which already encompasses the concepts of

---

<sup>75</sup> Rules promulgated by the SEC under Section 22(d) permit variations in sales load for particular classes of investors or transactions.

<sup>76</sup> For the reasons discussed above, we also urge the Department to clarify that the term “Mutual Fund,” as used in Prohibited Transaction Class Exemption 86-128 (defining the term as “an open end investment company registered under the Investment Company Act of 1940”), is intended to include UITs as well.

<sup>77</sup> BIC Exemption Notice, 80 Fed. Reg. 21960; *see also* amendments to existing PTEs, 80 Fed. Reg. 22004 – 22042.

acting in the client's best interest, only charging reasonable compensation and refraining from misleading investors and as such, additional standards should not be imposed. With respect to fiduciaries (to ERISA plans and IRAs) who rely on PTE 77-4, the imposition of impartial conduct standards is particularly unnecessary. In this regard, the existing conditions regarding compensation (eliminating double payments for advice) effectively address conflicts of interest without the imposition of new impartial conduct standards, and distinguishes PTE 77-4 from PTEs 75-1, 84-24 and 86-128.

B. PTE 84-24

Section III of the proposed revised PTE 84-24 provides that the combined total of all fees, insurance commissions, mutual fund commissions, and other consideration received by the insurance agent or broker, pension consultant, insurance company, or investment company principal underwriter (1) for the provision of services to the plan or IRA and (2) in connection with the purchase of insurance or annuity contracts or securities issued by an investment company, not be in excess of “reasonable compensation.” Given that the burden of proof is on the entity seeking to rely on the exemption, we request that the Department provide specificity regarding the definition of “reasonable compensation” in the context of the exemption.

Section IV of the proposed revised PTE 84-24 provides that the written disclosure need not be repeated unless (1) more than three years have passed since the disclosure was made with respect to the same contract or security, or (2) the contract or security being recommended for purchase, or the insurance commission or mutual fund commission with respect thereto, is not materially different than the contract or security referenced in prior disclosures. We request that the Department (1) provide clarity regarding the term “materially different,” and (2) clarify that additional fixed annuity contract purchases does not include subsequent contributions to an existing contract.

Finally, while PTE 84-24 still covers the purchase and sale of securities issued by an investment company (though it is no longer available for advice to IRAs), the exemption has been revised to only cover a narrowly drawn category of compensation associated with such transactions. Specifically, the exemption as revised only covers “Mutual Fund Commissions” received by principal underwriters of the investment company. This term is defined to cover sales loads, but it does not cover the receipt of 12b-1 fees. Thus, common payments in the distribution of affiliated mutual funds are left uncovered, rendering the exemption unusable.

\* \* \* \*

We appreciate that the Department has stated it will take comments on the BIC Exemption seriously. If you need additional information or you have questions regarding our comments, please feel

Office of Exemption Determinations  
ZRIN 1210-ZA25  
July 21, 2015  
Page 36 of 36

free to contact either David Abbey, Deputy General Counsel – Retirement Policy, at (202) 326-5920 or [david.abbey@ici.org](mailto:david.abbey@ici.org), or David Blass, General Counsel, at (202) 326-5815 or [david.blass@ici.org](mailto:david.blass@ici.org). We welcome the opportunity to discuss these comments further or to provide additional information to you and your staff as you work on this important issue.

Sincerely,

/s/ David M. Abbey

David M. Abbey  
Deputy General Counsel – Retirement Policy

/s/ David W. Blass

David W. Blass  
General Counsel