**National Association of Insurance and Financial Advisors**

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Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Conflict of Interest Rule
Room N-5655
U.S. Department of Labor
200 Constitution Ave., NW
Washington, DC 20210

**RE: RIN 1210-AB32 - Proposed Definition of Fiduciary Investment Advice**

To Whom It May Concern:

The National Association of Insurance and Financial Advisors ("NAIFA") appreciates this opportunity to comment on the Department of Labor's ("Department") proposed definition of fiduciary "investment advice" under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Internal Revenue Code of 1986 ("Code").[1]

Founded in 1890 as The National Association of Life Underwriters (NALU), NAIFA is one of the nation's oldest and largest associations representing the interests of insurance professionals from every Congressional district in the United States. NAIFA members assist consumers by focusing their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. NAIFA's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

## BACKGROUND & EXECUTIVE SUMMARY

NAIFA members—comprised primarily of insurance agents, many of whom are also registered representatives—are Main Street advisors[2] who serve primarily middle-market clients, including individuals and small businesses. In some cases, our members serve areas with a single financial

[1] NAIFA has filed a separate comment letter on the Department's proposed prohibited transaction exemptions, which is attached hereto as Exhibit 1.

[2] For purposes of this comment letter, the term "advisor" refers generally to a NAIFA member who provides professional advice to clients in exchange for compensation.

advisor for multiple counties. And often, our members' relationships with their clients span decades and various phases of clients' financial and retirement planning needs.

These long-term relationships between advisors and clients begin with a substantial investment of time by the advisor to get to know the client and to develop trust. For an individual client, an advisor commonly holds multiple initial meetings to discuss the client's needs, goals and concerns in both the short and long term. During the course of the advisor-client relationship, our members provide advice during the asset accumulation phase (when clients are saving for retirement), as well as the distribution phase (during retirement), which is especially critical for low- and middle-income investors. For small business owners, our advisors initially encourage them to establish retirement savings plans for their employees, and then, following in-depth discussions to ascertain specific needs and concerns, help them to implement those plans.

Many of our members work in small firms—sometimes firms of one—with little administrative or back office support. Often, their business practices are dictated by the broker-dealer with whom they work, including the format and provision of client forms and disclosures. They are also subject to transaction-level oversight and review by the broker-dealer.

The retirement products most commonly offered by NAIFA members are annuity products (fixed and variable) and mutual funds. Some of our members are independent advisors working with independent broker-dealers; others are affiliated with (or captives of) product providers and are restricted to some degree in the products they are permitted to sell. It is our belief that nearly all of our advisors, regardless of whether they are independent or affiliated, will be significantly impacted by the Department's proposal.

Virtually all NAIFA members working in the individual IRA space will have to rely on the Department's proposed Best Interest Contract ("BIC") Exemption, which represents a far more onerous compliance regime than any of our members have previously faced. Thus, the proposal portends a *dramatic* shift in the way our members will interact with their clients and conduct their businesses, and a significant increase in the cost of conducting their business. NAIFA does not oppose a "best interest" fiduciary standard for its members. However, any new standard must be operationalized in a fashion that is workable for Main Street advisors and their clients.

As discussed in more detail below, NAIFA has significant concerns about the workability of some portions of the Department's proposed rule, and recommends several adjustments to the proposal. Namely, NAIFA strongly encourages the Department to adopt a final fiduciary investment advice definition that:

- Requires some investor reliance on the investment advice;
- Requires a mutual understanding between the investor and the advisor;
- Excludes referrals to other financial professionals;
- Excludes distribution-related advice that is not investment advice;
- Excludes welfare benefit plans with no investment component;
- Excludes, or includes a carve-out for, marketing and sales activity for all products, services and investors;
- Includes a carve-out for advice relating to employer plan design;
- Allows for meaningful investor education by including a broad education carve-out;

- ➢ Allows advisors to place reasonable limitations on the scope and duration of the fiduciary relationship; and
- ➢ Includes an enforcement timeline of at least thirty-six months.

In its current form, the proposed rule presents major—and in some cases, insurmountable—obstacles for NAIFA members serving middle-market retail investors (i.e., those who need the most encouragement and assistance when it comes to retirement savings). NAIFA hopes that the objective of the Department's proposal is not to limit or take away advisory services for Main Street investors, and we greatly appreciate your thoughtful consideration of these comments.

## I. FORESEEABLE CONSEQUENCES OF THE DEPARTMENT'S PROPOSAL FOR NAIFA MEMBERS AND THEIR CLIENTS

During a hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions on June 17, 2015, Secretary Perez acknowledged that "we have a retirement crisis" in this country and "we need to save more."[3] This problem should not be underestimated. According to the Federal Reserve, one in five people near retirement age have *no money saved.*[4] As reported by the *Washington Post*, "[o]verall, 31 percent of people said they have zero money saved for retirement and do not have a pension. That included 19 percent of people between the ages of 55 and 64, or those closest to retirement age."[5] Roughly 45% of people said they plan to rely on Social Security to cover expenses during retirement, whether they have personal savings or not.[6]

In other words, it is more important than ever that Americans are encouraged to save, have access to professional advice, and have access to appropriate retirement savings products. Specifically, employers need reliable advice on the design and investment options of their retirement plans, and employees need to be educated on the importance of saving early for retirement, determining their risk tolerance, and evaluating the investment options available through their workplace retirement plan. Employees also need professional advice when rolling over retirement plan assets from one retirement plan to another plan or an IRA, and when taking distributions during retirement. And individuals without access to an employer retirement plan need education and guidance about other retirement savings vehicles.

Simply put, American investors need *more* personalized assistance and more options with respect to retirement planning and saving, not less. Unfortunately, the Department's proposed

[3] Hearing of the House Education and Workforce Subcommittee on Health, Employment, Labor, and Pensions, *Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees*, June 17, 2015 (hereinafter "June 17 Hearing"), hearing webcast available at http://edworkforce.house.gov/calendar/eventsingle.aspx?EventID=399027.

[4] Marte, Jonnelle, *Almost 20 Percent of People Near Retirement Age have not Saved for It,* Washington Post, Aug. 7, 2014.

[5] *Id.*

[6] *Id.*

rule, along with its proposed amendments to existing prohibited transaction exemptions ("PTEs"), threatens to be counterproductive with respect to this country's retirement crisis by making it harder, not easier, to provide investors—particularly those who need it most—with the services and products that could help them live independently during their retirement.

### A. Fewer Services and Less Education for Small Businesses and Small Account Holders

As drafted, the proposed rule and proposed PTE amendments will result in less retirement education and services for small businesses and individuals with low-dollar accounts.

First, faced with a multitude of new fiduciary obligations, which entail substantial cost and administrative burdens, brand new business models and fee structures, as well as increased litigation exposure, some advisors may no longer offer services to small plans or individuals with small accounts.

Second, given the proposed rule's restrictive definition of investment "education," advisors who do not wish to trigger fiduciary status will no longer be able to provide any meaningful education to their clients.

Third, even when an advisor is willing to serve in a fiduciary capacity, unsophisticated investors and low-income clients will be reluctant to sign complicated, lengthy contracts (as required under the Best Interest Contract Exemption for fiduciary advice to retail investors) and unwilling or unable to pay upfront out-of-pocket fees, and thus will forego advisory services. In fact, a NAIFA survey found that two-thirds of advisors anticipate that the Department's proposal will result in the loss of clients because they believe clients will be intimidated or unwilling to sign the contract required under the proposal, and because the proposal's burdensome requirements would make it impossible for advisors to continue to serve small or medium-size accounts.

And finally, the proposal could result in some advisors exiting the market entirely, which for some rural communities, could result in a complete void of professional financial services. The proposal's burden on independent advisors and registered representatives (discussed in more detail below) is tremendous, and some advisors simply will not be in a position to bear the cost of compliance.

Reduced access to advisors, fewer services, and less education is not a desirable outcome, and presumably, is not the aim of the Department. The fact is, advisors help people plan and save for retirement by helping employers set up retirement plans and by providing advice to individual investors outside of the workplace. Overall, advised investors are better off than non-advised investors.

An Oliver Wyman survey from 2014 found that 84% of individuals begin saving for retirement via a workplace retirement plan, and workplace-sponsored defined contribution plans represent the primary or only retirement vehicle for 67% of individuals who save for retirement with a tax-advantaged retirement plan.[7] And small businesses that work with a financial advisor are 50%

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[7] Oliver Wyman Study, The Role of Financial Advisors in the US Retirement Market (July 10, 2015) (hereinafter "Oliver Wyman Study"), at 5 (citing Oliver Wyman Retail Investor

more likely to set up a retirement plan (micro businesses with 1-9 employees are almost twice as likely).

Moreover, according to a May 2015 LIMRA Secure Retirement Institute Consumer Survey, 18% of households that do not work with a financial advisor have *no retirement savings*, compared to only 2% of advised households.[8] Similarly, an Oliver Wyman study published July 10, 2015, found that advised individuals have a minimum of 25% more assets than non-advised individuals, and for individuals aged 65 and older with $100,000 or less in annual income, advised individuals have an average of 113% more assets that non-advised investors.[9] The LIMRA survey also shows that *consumers want more education* with respect to retirement planning, not less.[10]

B. <u>More Expensive Advice for Small Businesses and Small Account Holders</u>

For low- and middle-income clients who do continue to receive professional retirement advice, that advice is likely to get more expensive for them under the proposed rule. The Department's proposal (including the proposed rule and PTE amendments) effectively leaves advisors with three choices:

> (1) do not give investment advice, as defined under the proposed rule, and avoid becoming a fiduciary;
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> (2) become a fiduciary and turn all of your compensation arrangements into flat fee-for-service arrangements or wrap accounts (with no third-party compensation); or
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> (3) become a fiduciary, retain current compensation arrangements, and comply with a PTE.

As discussed above, the first option leaves clients with no meaningful guidance whatsoever because investment "education" is defined so narrowly under the proposal. The second and third options will harm consumers by increasing their costs.

With respect to the second option, traditional commission-based compensation models can—as discussed below—*benefit* low- and middle-income investors and should not be discouraged. Unlike for high-wealth consumers, the alternatives—upfront flat fees and wrap account arrangements—are not workable or palatable for our members' Main Street clients. First, clients who are deciding whether they have the resources to save for retirement at all will be unable or unwilling to pay a substantial out-of-pocket fee that represents a significant portion of the assets

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Retirement Survey 2014). The Oliver Wyman Study has been submitted separately to the Department through the formal comment process under this rule-making.

[8] LIMRA Secure Retirement Institute 2015 Consumer Survey (hereinafter "LIMRA Survey"), at 3, attached hereto as Exhibit 2.

[9] Oliver Wyman Study, at 6.

[10] LIMRA Survey, at 13.

they may have to invest. For those who are rolling over retirement account balances, opting to pull these fees from the rollover amount will have tax implications and result in greater cost. Moreover, fees will have to be set high enough to compensate for anticipated services during a given timeframe, taking into account the fact that client needs can vary dramatically at various times (e.g., during the initial strategy phase, while transitioning between accumulation and distribution phases, in light of major life events, etc.).

These fee-based arrangements only make sense—and in fact, are only currently used—for accounts with high balances. Indeed, advisory fee-based accounts usually carry account balance minimums. The Oliver Wyman study estimates that 7 million current IRAs would not qualify for an advisory account due to low balances.[11] The study also reports that 90% of 23 million IRA accounts analyzed in 2011 were held in brokerage accounts, and found that retail investors face increased costs—73% to 196%, on average—shifting to fee-based advisory compensation arrangements.[12] Thus, ultimately, fee-based models actually will *raise* costs for many investors with small or mid-level accounts, or cut them off from advisory services entirely.

Under the third option, for advisors who keep commission-based arrangements and rely on a PTE, low-and middle-income and small business clients will still wind up paying more. The *high* cost of compliance with the proposed PTEs (particularly the BIC exemption, upon which many of our members ultimately will have to rely) will be borne by someone. The regulated entities (e.g., broker-dealers, advisors, registered reps) will look for ways to pass on those costs. Inevitably, consumers will bear some part of that cost burden, which may be significant.

Naturally, more paperwork and new contractual and disclosure requirements will mean increased costs. But the cost burden on advisors goes further. New litigation exposure will dramatically increase the overall risk and cost of doing business through ongoing compliance and monitoring, and through actual litigation expenses. According to NAIFA's survey, 87 % of advisors anticipate that the Department's proposal will result in higher errors and omissions ("E&O") insurance premiums for their practices; and 58% of those said they expect premiums to increase "substantially." The Department's proposal will also cost advisors and investors a substantial amount of time. For instance, NAIFA members believe that 77% of their existing clients would require a face-to-face meeting to explain and execute the Department's proposed BIC exemption contract.

Adding to the overall cost of the Department's proposal is the real threat of conflicting regulatory regimes when the SEC proposes its own fiduciary rules for advisors dealing in securities products. Section 913 of the Dodd-Frank Wall Street Reform Act gives the SEC authority to promulgate a rule-making on a standard of care for advisors who serve retail investors. Specifically, the SEC is authorized to impose the same fiduciary standard as that currently in place under the Investment Advisers Act and to require certain limited disclosures. To the extent any SEC action in this space does not (or cannot, by statute) mirror the Department's rule-making, advisors will be faced with multiple complex and potentially contradictory compliance regimes. Again, this could cause some advisors to exit the market, and

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[11] Oliver Wyman Study, at 6.

[12] *Id.*, at 7.

dual regulation could also lead to consumer confusion surrounding different standards and disclosures.

All of these costs will have real consequences for consumers. If the Department's proposal is enacted, NAIFA members anticipate that, on average, they will not be able to affordably serve clients with account balances below $178,000. Currently, only 26% of respondents to NAIFA's survey have minimum account balance requirements for their clients. Not surprisingly, 78% of NAIFA members say that, under the Department's proposal, they will have to establish minimum account balances or will have to raise their current minimum balance requirements, further diminishing availability of services for small account holders.

C. Fewer Guaranteed-Income Products Will Be Sold

The Department's proposal also will result in fewer annuity products being sold, which again, is especially harmful to low- and middle-income consumers. We are aware of only three ways to receive guaranteed income in retirement—annuities, Social Security, and defined benefit pensions—which explains why annuity products have always been trumpeted by the Department. Somewhat ironically, however, the Department's proposal foists a heightened burden on advisors who offer annuity products to non-fee-paying clients. Furthermore, the proposal's structure for annuities is particularly complex and confusing (i.e., splitting up rules and requirements for annuities by both investor type and by type of annuity product), which will only make offering these products more difficult and costly.

Notably, high-end, fee-for-service providers (many of whom, not surprisingly, support the Department's proposal) do not sell annuity products because their client base can self-annuitize extensive investment portfolios.[13] On the other hand, low- and middle-income Americans rely heavily on annuity products of all kinds to provide them income security in retirement. These products should continue to be available, and to be available in a broad enough range (i.e., fixed, indexed, variable) to preserve investor choice and provide sufficient options for individual investors' particular needs and retirement savings goals.

D. Confusion and Uncertainty in the Marketplace for Financial Institutions, Advisors, and Investors Alike

Between its proposed rule and proposed PTEs, the Department is attempting to usher in a brand new fiduciary regime in the retirement space. Overall, the proposal is dense, complicated, and extremely confusing. Even long-time ERISA practitioners are having a difficult time deciphering the proposal's elements and requirements. This does not bode well for every-day advisors and consumers.

It will take a substantial amount of time and resources for financial professionals and investors to fully digest and become comfortable operating under the Department's new structure. In the

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[13] The disproportionate burden, discussed in detail above, placed by the Department's proposal on advisors to middle-market clients could very well be a boon to more expensive providers who are hoping to capitalize on advisors exiting the market and potentially capture clients on the upper-middle-market cusp.

meantime, the proposal threatens to introduce a substantial amount of uncertainty into the marketplace. Presumably, financial institutions will err on the side of caution and adopt overly conservative and restrictive policies and practices, rather than face potential liability for violations of the new rules. As a result, their agents and registered representatives will follow suit. Ultimately, these developments will likely result in a near-term contraction of services and advice.

As impacted parties become more acquainted with the new rules—and perhaps more importantly, as litigation and penalty risk becomes clearer—policies and practices may be adjusted. But financial institutions and advisors in the securities space will also have to monitor and adjust to the interplay between Department rules and securities laws and regulations, which could also undergo change in the future. All of these developments will be costly and confusing, and again, will most heavily burden professionals serving the middle market and their clients.

In sum, for all of the foregoing reasons, the weight of the Department's proposal falls squarely on advisors to small businesses and ordinary Americans, and unless the proposal is significantly modified, the Department will end up penalizing those it seeks to protect.

## II. THE PROPOSED RULE

Virtually all NAIFA members will be investment advice fiduciaries for purposes of ERISA and the Code under the Department's proposed rule. The rule, along with the Department's proposed PTEs, will require major changes in our members' business practices and client relationships. While NAIFA is not opposed to a "best interest" standard of care for advisors, it is extremely important that such a standard be contained within a feasible operational structure.

As it stands, nearly all of our members who become fiduciaries will have to alter their current compensation arrangements (for at least some clients and some products) or satisfy a PTE. For the reasons discussed above, both options carry significant risk of harm to retail investors. We believe that such risk can be partially mitigated, however, if the Department addresses the specific points of concern discussed below.[14]

### A. Scope of the Proposed Definition of Fiduciary "Investment Advice"

#### 1. *The definition of fiduciary investment advice should require some investor reliance on the investment advice.*

The Department's current five-part test for fiduciary investment advisors includes a requirement that the advice serve as the primary basis for the investment decision(s) ultimately made by the investor.[15] The requirement ensures that clients actually act on the investment advice before a fiduciary relationship arises. NAIFA strongly urges the Department to maintain a similar reliance requirement under its proposed definition of fiduciary investment advice. Otherwise, advisors are forced to take on a fiduciary role, even if their investment advice is completely

[14] Again, NAIFA has submitted separate detailed comments on suggested adjustments to the Department's PTE proposals.

[15] *See* 29 CFR 2510.3-21.

ignored or has no impact whatsoever on the client's investment decisions. Given the substantial cost and burden on fiduciaries under the Department's proposal, fiduciary relationships should at least be limited to situations in which some meaningful advice or service is rendered *and* accepted.

2. *The definition of fiduciary investment advice should require a mutual understanding between investor and advisor.*

Similarly, the Department's current fiduciary investment advice test includes a requirement that the advice be given pursuant to a mutual agreement or understanding between the investor and the advisor.[16] Mutual understanding, like reliance, should be an element of the Department's new definition of fiduciary investment advice. Before a fiduciary relationship exists, both parties should, at a minimum, recognize that the advice is being given and considered for the client's particular investment needs. Without such mutuality, casual or social conversations could be misconstrued as fiduciary communications. Again, considering the burden of the overall fiduciary structure proposed by the Department, some common-sense checks should be in place before fiduciary obligations are imposed on advisors. At the very least, the impacted parties should have an awareness and understanding of what they are undertaking.

3. *Recommendations of other financial professionals should not fall within the definition of fiduciary investment advice.*

As drafted, the Department's proposed definition of fiduciary investment advice covers four general categories of advice:

> (1) A recommendation as to the advisability of acquiring, holding, disposing or exchanging securities or other property (including a recommendation to rollover assets or take a distribution);
>
> (2) A recommendation as to the management of securities or other property (again, including rollover and distribution decisions);
>
> (3) An appraisal, fairness opinion, or similar statement—verbal or written—concerning the value of securities or other property when provided in connection with a specific transaction; and
>
> (4) A recommendation of a person who is also going to receive a fee or other compensation for providing the aforementioned types of advice.

The last category—recommendations of other financial professionals—should be excluded from the fiduciary investment advice definition because it is not *investment* advice. In fact, a simple referral is several steps removed from actual investment activity. The Department's definition appears to assume that the recipient of the advice will in fact pursue the recommended professional, that the other professional to whom the prospective client is referred will be in a position (and agree) to work with the client, and that investment advice will actually be given and acted upon.

[16] *Id.*

Furthermore, inclusion of referrals under the new definition of fiduciary investment advice will effectively eliminate referrals because advisors simply will not be willing to take on fiduciary obligations in situations where the "advice" rendered is to send the investor elsewhere for services. And reducing referrals will harm investors. Professional referrals are a valuable service, particularly to unsophisticated investors or those who are new to retirement planning and saving. A list of names or advertisements in a phone book does not offer any meaningful guidance for investors to narrow down their options or find professional services that are suitable for them. Referrals from individuals in the same business, however, provide investors with some confidence that they will be talking to a reputable advisor who, in at least someone's estimation, is an appropriate advisor for the investor.

The Department's proposal to include referrals in the definition of fiduciary investment advice defies logic and will only harm consumers. Accordingly, the Department should remove this category of advice from the proposed definition.

4. *Advice regarding distributions—without accompanying investment advice—should not be included in the definition of fiduciary investment advice.*

As noted above, the Department proposes to include advice regarding distributions under the definition of fiduciary investment advice. This type of advice should be excluded, however, when it is rendered without any accompanying *investment* advice. For example, if an advisor is informed that an investor has suffered an unforeseeable financial loss and needs to take a hardship distribution—and there is no investment recommendation sought or given pertaining to the distributed funds—the advisor's non-investment advice aimed at facilitating the distribution should not qualify as fiduciary investment advice. Similarly, if an advisor counsels an investor not to take a distribution (i.e., to preserve the status quo with respect to plans and assets), that also should not be considered fiduciary advice.

In these scenarios, the advisor is not delivering advice with respect to particular investments from which the advisor may benefit, but rather is providing generic counseling and assistance for the good of consumers. Thus, the Department should clarify in the final rule that such distribution-related advice is not considered fiduciary investment advice.

5. *Welfare benefit plans with no investment component should be excluded from the rule.*

The Department's proposed rule defines "plan" as "any employee benefit plan described in section 3(3) of [ERISA] and any plan described in section 4975(e)(1)(A) of the Code." Section 3(3) of ERISA includes employee pension benefit plans and employee welfare benefit plans, which include health, life, and disability benefits. Department officials indicated at a meeting on May 20, 2015, and during a phone conversation on June 3, 2015, that the Department does not intend the proposed rule to cover welfare plans that do not have an investment component (i.e., plans that are not designed to generate income or increase wealth). NAIFA strongly urges the Department to clarify in its final rule that benefit plans like traditional health, life and disability are not covered under this rule-making.

NAIFA suggests achieving such clarification by adding a definition of "<u>other property</u>." For example, the definition could read:

> "'*Other property*' for purposes of this section does not include welfare benefit plans without an investment component, such as health, accident, disability, and life insurance products, that do not generate income or create wealth for future use."

Alternatively, the term "<u>investment</u>" could be defined as follows:

> "'*Investment*' for purposes of this section does not include the purchase, sale, holding, or exchanging of welfare benefit plans without an investment component, such as health, accident, disability, and life insurance products, that do not generate income or create wealth for future use."

In addition to these specific suggestions, there may be other ways for the Department to resolve this issue. NAIFA urges the Department to clarify, in one way or another, that welfare benefit plans with no investment component are not covered under this rule-making.

6. *Marketing of services and preliminary client development conversations should not be considered fiduciary investment advice.*

For the individuals and small businesses served by NAIFA members, effective marketing of our advisors' services can mean the difference between an employer offering a retirement plan or not, or an individual prematurely cashing out a retirement account or continuing to save. Getting good advice to consumers who need it is a goal we all share. Further, as discussed above with respect to professional referrals, we all agree that consumers should be able to make informed decisions when choosing their advisors.

Department officials said at a technical briefing on May 7, 2015 that they did not intend to capture conversations along the lines of "hire me" or "these are the services I can offer you" under the definition of investment advice. At that same briefing, officials acknowledged that there should be some opportunity for preliminary conversations with prospective clients before fiduciary status and any attendant contract or disclosure requirements are triggered. Secretary Perez echoed those comments while testifying before a congressional committee on June 17, 2015, where he stated that the Department wants consumers to be able to "shop around" and "[the Department's] goal is to make sure that shopping around can happen." However, given some elements of the proposed rule, NAIFA believes that these sentiments need to be clarified and memorialized in any final rule.

As drafted, the proposed rule applies to a recommendation:

> (1) of a person who is going to receive compensation for providing investment advice;
>
> (2) that is individualized or specifically directed to the recipient of the recommendation; and

> (3) is provided by someone who may eventually receive compensation as a result of the recommendation.[17]

It appears that this would cover one-on-one sales pitches and targeted advertising by advisors seeking to introduce their services to new clients, which creates an unnecessary barrier to services for individuals and employers who will not sift (or do not feel comfortable sifting) through anonymous advisor listings in the phone book.

The Department could ensure that these initial conversations are not captured by adopting some of the above suggestions (e.g., by requiring some investor reliance and mutual understanding between advisors and investors). Or, as discussed in detail below, the Department could resolve this issue by creating a robust seller's exception. Regardless of the approach taken, NAIFA urges the Department to carve out marketing and preliminary conversations with prospective clients from the investment advice definition.

### B. The Department should Adopt a Seller's Exception that Applies Across all Products, Services, and Investors.

The Department's proposed seller's exception (the counterparty carve-out) does not apply to small plans or IRAs at all, and is limited to sales pitches provided in connection with an arm's length sale, purchase, loan, or bilateral contract to large plan ("sophisticated") investors.[18] As drafted, the exception also does not appear to cover a discussion about an advisor's services.[19] The Department should replace its proposed counterparty carve-out or create a separate seller's exception that applies to all products, services, and investors.

A robust seller's exception will allow advisors and financial institutions to market their products and services. Marketing, as opposed to true investment advice, poses very little threat of conflicts of interest. Presumably, this is why marketing has not historically been considered fiduciary activity under ERISA or the Code. Indeed, it is unclear whether the Department has statutory authority to capture pure marketing and sales activities under the fiduciary umbrella.

Sales pitches in the financial advisor context are like sales pitches in all other retail contexts; they are take-it-or-leave-it promotions designed to attract consumers in the first instance so that products and services can *then* be delivered. And like other retail contexts, financial advisor marketing should not be limited to certain segments of the population. The Department appears to believe—without apparent justification—that small business owners (i.e., with 99 or fewer employees) are not as sophisticated as large business owners (i.e., with 100 or more employees).

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[17] *See* proposed § 2510.3-21(a)(1)(iv) (what constitutes investment advice), (a)(2)(ii) (the requirement that said advice be directed to an individual), and (f)(6) (definition of "fee or other compensation, direct or indirect").

[18] *See* proposed § 2510.3-21(b)(1)(i).

[19] Because the counterparty exception applies only to sales pitches provided in connection with an arm's length sale, purchase, loan, or bilateral contract, it is NAIFA's interpretation that it does not cover a discussion of services.

Size of a business is immaterial, however, to the financial knowledge and sophistication of a plan fiduciary. Furthermore, there is no evidence that financial sophistication is needed to understand when someone is making a sales pitch rather than delivering impartial advice. The Department's paternalistic approach is misguided, and will only prevent a large number of consumers from learning about available products and services, which is counterproductive for the retirement crisis in this country.

Any seller's exception could and should include reasonable investor protections, such as clear and explicit disclosures by the advisor that she is not providing impartial or fiduciary investment advice (i.e., the disclosure required under the proposed counterparty exception), but rather is engaged in marketing or sales activity. A full disclosure of this nature supports the Department's objective of improving consumer awareness of advisors' obligations (or lack thereof) in certain circumstances. At the same time, a broad exception allows for effective marketing and client development, which will help advisors reach those populations that are arguably in most need of professional retirement planning assistance.

### C. The Final Rule Should Include a Carve-Out for Advice on Plan Design.

An advisor's assistance to employers with menu design for participant-directed plans (including 401(k) plans, SIMPLE IRAs, and SEP IRAs) should be excluded from the definition of fiduciary investment advice. Unlike investment advice provided directly to individual plan participants or IRA owners, recommendations on menu design for participant-directed plans are a step removed from recommendations pertaining to actual investment decisions. The employer narrows down the product options (from thousands) available to employees, but the employees decide how their assets are allocated among different products.[20] Thus, the risk of a conflict of interest arising at this stage between the advisor and employee investors is minimal. Furthermore, in the plan design space, the plan administrator—regardless of plan size—*is* under a separate obligation to make informed and prudent decisions with respect to the plan.[21]

The "plan design exception" should apply when an advisor is providing recommendations to an employer:

> (1) On the types of retirement plans available (e.g., 401(k), SIMPLE IRA, etc.), and associated costs and benefits with respect to plan types;
>
> (2) On the investment options that will be made available through the plan selected (e.g., mutual fund options, annuity options, etc.), including advice related to the overall allocation of investment options and advice related to narrowing down options within general product categories; and

[20] NAIFA recognizes that individualized investment advice to plan participants or IRA owners is a different scenario with separate conflict-of-interest concerns.

[21] *See* 29 U.S.C. § 1002(21)(a)(iii) (under ERISA, a person is a fiduciary with respect to a plan to the extent he has any discretionary authority or discretionary responsibility in the administration of such plan); *see also* 26 U.S.C. § 4975(e)(3)(C) (corresponding fiduciary definition under the Code).

(3) On plan administration topics, including selection of a managing fiduciary, third-party administrators, and other administrative service providers.[22]

Employers need professional advice in each of these areas to establish and maintain a retirement plan appropriate for their specific needs and employee populations. As explained above, a plan design exception is consistent with the Department's goal of minimizing advisor conflicts of interest, as well as the overarching objective of encouraging individuals to save early for retirement by increasing the availability of employer-sponsored retirement plans.[23]

D. <u>The Final Rule Should Allow for *Meaningful* Investment Education</u>.

During a meeting on May 4, 2015 with NAIFA members, Department officials stated that one of their objectives is to preserve investor education. And Secretary Perez told members of Congress on June 17 that investor education is "exceedingly important." Unfortunately, the narrow scope of the education exception under the proposed rule will not facilitate the goal of preserving or expanding investor education. It will have the opposite result, especially for unsophisticated investors who benefit the most from such education.

Secretary Perez commented on June 17 that, in his view, the "most important part" of an educational discussion between advisor and investor "is the asset allocation conversation." And, he asserted that, under the proposed rule, those conversations do not trigger fiduciary status or obligations. The Secretary's comment is perplexing, to say the least, when one reads the proposal's narrow education exception.

There are approximately 9,000 mutual funds available today, not to mention the host of other types of products available in the retirement space. Telling an inexperienced investor to choose among mutual funds without providing any guidance as to the strength or desirability of any particular funds is not meaningful education; it is simply overwhelming. Meaningful education requires some identification and characterization of specific investment options.

The Department has not historically restricted "education" to generic, high-level conversations. Instead, the Department has allowed for meaningful education to take place, with appropriate disclosures. For instance, under Interpretive Bulletin 96-1,[24] the Department has not included within fiduciary "investment advice" asset allocation models that identify specific investment

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[22] We do not interpret the Department's proposed platform provider carve-out to be broad enough to capture these advisor services. To the extent the Department does intend for the carve-out to cover these activities, NAIFA urges the Department to make that clear in the final rule.

[23] Alternatively, if the Department chooses not to include a plan design exception, NAIFA urges the Department to finalize a more robust PTE 84-24 that would cover plan design services and advice. This alternative approach is described in more detail in NAIFA's comment letter on the Department's proposed PTEs, attached hereto as Exhibit 1.

[24] 29 CFR Part 2509.

alternatives, as long as they are accompanied by a statement indicating that other investment options with similar characteristics may be available. Bulletin 96-1 reasons: "Because the information and materials described above would enable a participant or beneficiary to assess the relevance of an asset allocation model to his or her individual situation, the furnishing of such information would not constitute a "recommendation". . . and, accordingly, would not constitute [fiduciary investment advice]."[25]

The Department's rationale in Bulletin 96-1 makes perfect sense and its approach strikes an appropriate balance between ensuring the availability of meaningful investment education and providing investor protection. NAIFA strongly encourages the Department to maintain its current rule on investment education and create an education exception under its proposed rule that encompasses this broader, more helpful approach.

### E. Advisors Should be Permitted to Put Reasonable Limitations on the Scope and Duration of the Fiduciary Relationship.

Department officials stated at the May 7, 2015 technical briefing that they do not intend the proposal's prohibition on exculpatory contractual language[26] to prohibit advisors from defining or limiting the scope and duration of the advisor-client relationship (i.e., the time period and scope of services the advisor is willing to provide to a given client). Instead, they intend to keep advisors from disclaiming responsibility or liability for fiduciary advice actually given. This point should be clarified in the final rule.

Advisors should be permitted to include language in their contracts (or notices) regarding the expiration of the advisor-client fiduciary relationship. For instance, when the relationship does not entail the provision of ongoing advice (e.g., a one-time sale relationship), the advisor should be able to make clear that the fiduciary relationship concludes with the sale and the advisor does not have perpetual fiduciary obligations to the client.[27] NAIFA encourages the Department to clarify in its final rule that such limiting language is permissible, whether in a contract or in a disclosure to the client.

## III. The Department Should Extend the Enforcement Timeline to at least Thirty-Six Months

The eight-month enforcement timeline for compliance with the new rule proposed by the Department is grossly insufficient and clearly underestimates the complexity and administrative burden of the Department's proposal. Transferring all existing and new clients—hundreds of clients for some advisors—to new business practices and, in some cases, compensation arrangements, will take well over eight months. The process will involve, at the very least: drafting and approving new client documents and business contracts between financial institutions and advisors; internal education at the carrier, broker-dealer, and advisor levels about

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[25] *Id.*

[26] *See* Proposed BIC Exemption, Section II(f)(1).

[27] A contractual term of this nature would not bar suit by the investor based on breach of fiduciary duty or interfere with any current statutes of limitation with respect to such claims.

the Department's new requirements and these parties' obligations; education at the client level about the new requirements; and then actual implementation of the new system at all levels.

The Department's proposal contains several new obligations that are shared between advisors and financial institutions. Thus, a great deal of coordination and planning will be required between those parties before any modifications to advisor-client interactions even take place. Additionally, it will take impacted entities (i.e., advisors, broker-dealers, carriers, etc.) a significant amount of time for them to fully understand their new obligations. Then, many clients served by NAIFA members will require extensive face-to-face explanation of new business practices; and for those who do not seek or require such explanation, simply getting new notices or contracts distributed and signed will take a significant amount of time.

*Each* one of the steps in this process will be complicated and lengthy. Accordingly, the Department should allow for *at least* thirty-six months between the final rule's publication and enforcement. Alternatively, the Department could adopt a "phase in" approach to enforcement, requiring a limited number of requirements to be satisfied at one time, perhaps beginning eighteen months after publication of the final rule, provided that the time between the final rule and full compliance is at least thirty-six months.

Thank you for your consideration.

Very truly yours,

Juli Y. McNeely, LUTCF, CFP, CLU
NAIFA President 2014-2015

Exhibits: NAIFA Comment Letter on Proposed Prohibited Transaction Exemptions
LIMRA Secure Retirement Institute 2015 Consumer Survey