July 20, 2015

By U.S. Mail and Email: e-OED@dol.gov

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11820
Suite 400
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Re: ZRIN 1210-ZA25

Ladies and Gentlemen:

The Securities Industry and Financial Markets Association ("SIFMA")[1] is pleased to provide comments regarding the Department of Labor's ("Department") proposed amendments to PTCE 75-1, Parts III and IV, 77-4, 80-83, and 83-1 (the "Class Exemptions") under the Employee Retirement Income Security Act of 1974, as amended ("ERISA") and section 4975 of the Internal Revenue Code ("Code") (referred to as the "Proposal"). SIFMA appreciates the opportunity to comment and hope that our comments are helpful to the Department as it assesses the impact of these changes to the current exemptions on IRAs, plans and their participants[2]. SIFMA shares the Department's interest in making sure that plans, their participants and IRAs are treated fairly in the market place and have the ability to trade effectively and efficiently in all markets.

[1] SIFMA is the voice of the U.S. securities industry, representing the broker-dealers, banks and asset managers whose 889,000 employees provide access to the capital markets, raising over $2.4 trillion for businesses and municipalities in the U.S., serving clients with over $16 trillion in assets and managing more than $62 trillion in assets for individual and institutional clients including mutual funds and retirement plans. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association (GFMA). For more information, visit http://www.sifma.org

[2] The term "plan" includes references to its participants and beneficiaries.

Attached hereto are SIFMA's submissions for the related rulemakings being undertaken by the Department. These attachments are an integral part of this submission.[3]

With respect to each of these exemptions, the Department proposes to add the following conditions:

1. The fiduciary must act in the best interest of the plan or IRA;

2. All compensation received by the fiduciary must be reasonable "in relation to the total services the fiduciary provides to the plan or IRA".

3. The fiduciary's statements about recommended investments, fees, material conflicts of interest, and any other matters relevant to a plan's or IRA owner's investment decisions, are not misleading. A material conflict of interest exists when a fiduciary has a financial interest that could affect the exercise of its best judgment as a fiduciary in rendering advice to a plan or IRA owner.

The Proposal provides that a fiduciary's failure to disclose a material conflict of interest relevant to the services the fiduciary is providing or other actions it is taking in relation to a plan's or IRA owner's investment decisions is deemed to be a misleading statement. However, the definition of Material Conflict of Interest includes no materiality test and thus, apparently would include every conceivable conflict, no matter how minor and even if no harm were to be caused by such failure. Certainly, where the consequence of a failure to meet a condition is reversal of the transaction, a requirement to make the plan or IRA whole for lost earnings (normally calculated at the highest rate that could have been earned), plus the payment of an excise tax, it is hard to conclude that every single conflict must be identified in order for the exemption to apply. The Proposal also provides that a fiduciary acts in the "Best Interest" of the plan or IRA when the fiduciary acts with the care, skill, prudence, and diligence under the circumstances then

[3] See Appendices numbered 1-8.

prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the plan or IRA, without regard to the financial or other interests of the fiduciary *or any other party* (emphasis added). These amendments apply to discretionary and advisory fiduciaries of both plans and IRAs.

We urge the Department to abandon this part of the Proposal entirely. If the Department chooses not to do so, SIFMA strongly urges the Department to eliminate this provision for Title I plans. It is duplicative of, and inconsistent with, existing requirements for plans covered by Title I. The Department acknowledges in the preamble that the best interest standard "is based on longstanding concepts derived from ERISA and the law of trusts"; in particular, the duties of prudence and loyalty imposed by ERISA § 404(a)[4]. Requiring advisers to ERISA plans or plan participants to agree to, and comply with, a best interest standard separate and apart from their existing ERISA fiduciary duty under ERISA section 404(a) is redundant and unnecessary to achieve the Department's stated goals.

For ERISA Title I plans, requiring advisers and financial institutions to adhere to a best interest standard as a condition for relief under these class exemptions significantly increases the adverse consequences of any fiduciary breach by imposing an excise tax, as well as other required corrections, on a prudence violation. We believe this result is inappropriate, contrary to the statutory framework, and Congress's intent.

ERISA plan participants and their fiduciaries have the ability to sue in federal court for any violation of section 404. Plans covered by Title I are already protected by comprehensive fiduciary requirements, and a comprehensive disclosure scheme, buttressed by a regulation issued just three years ago. Title I also has its own remedy regime that Congress carefully

[4] Section 404 of ERISA imposes the standard of care which must be exercised by a fiduciary, including, in relevant part, that "…a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries…(B) with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of a like character and like aims…" This requirement is commonly referred to as the "expert prudent man rule". A violation results in a breach of fiduciary duty, actionable under ERISA section 502.

crafted which is based on losses, not on foot faults. Under the Proposal, even the smallest, most immaterial, undisclosed conflict would allow a participant unhappy with his or her trade to seek reversal of the transaction, regardless of whether the failure to disclose a conflict was significant, or even related to the trade. We believe that is both inappropriate and contrary to Congress's intent. The Department's own regulation interpreting section 408(b)(2) is diametrically different from the Proposal, in that the section 408(b)(2) regulation provides that failures to disclose can be remedied by a correction, without loss of the relief afforded by the exemption. The standard enunciated in the Proposal itself is not administrable because it is entirely subjective, and therefore violates the requirements of section 408(a) of ERISA. Adding an excise tax penalty is duplicative and punitive and had Congress wanted to subject prudence violations to an excise tax, it would have done so.

Even for Title II plans, the Department lacks statutory authority to require compliance with a prudence rule as a condition of a prohibited transaction exemption. As noted above, the conditions regarding the "reasonable person" or "misleading disclosure" standards are not administrable and therefore do not meet the standards for issuance of an exemption under ERISA § 408(a). Additionally, Congress has issued more than 20 statutory exemptions, virtually all of which cover IRAs. Not one of those exemptions has imposed a "reasonable person" standard or a subjective "misleading disclosure" standard as a condition punishable by transaction reversal, payment of lost earnings, and an excise tax, regardless of whether there is a loss on the trade and regardless of whether the disclosure is entirely correct but simply unclear. Nor has any exemption previously issued by the Department contained such vague and subjective conditions as are contained in the Proposal. Had Congress wanted to subject Title II plans to either or both of these standards, it would have done so and as it hasn't, we question the Department's statutory authority to do so.

We note that Congress specifically included a prudence standard in ERISA and specifically excluded a prudence standard in the Code. We suggest that the reason for that distinction is the very difficulty the Department overlooks here: that the standard is not susceptible of a bright

line test for which an excise tax is appropriate. Nonetheless, the Proposal purports to condition relief under section 4975 of the Code by creating a subjective, "community-based" condition for use of the exemption, the failure of which, in any respect, would make the relief under the exemption unavailable. We do not believe that Congress intended a breach of the duty of prudence to violate the prohibited transaction provisions of ERISA and the Code.

We note that no exemption previously issued by the Department has contained such vague and subjective conditions such as these. If the Department insists on retaining compliance with non-misleading disclosure as a condition, we suggest instead that the Department explicitly adopt FINRA guidance relating to Rule 2210 regarding the term "misleading.[5] Because violation of a prohibited transaction exemption has such dire consequences, we do not believe that an inadvertent, immaterial statement taken in the wrong way by a client (or in hindsight alleged to have been misunderstood by a disgruntled client) or an immaterial omission should result in a reversal of the transaction, a guarantee of losses and an excise tax on the entire principal amount. The Proposal as drafted requires perfect disclosure, and any foot fault eliminates the relief. It shifts the burden of proof to the fiduciary to prove that a transaction was in the best interest of the client, to prove that the disclosure was perfect, and the compensation reasonable. At the very least, the condition should be that the fiduciary reasonably believed that the fiduciary's statements were not misleading.

SIFMA hopes that the Department will eliminate these amendments for all the reasons given above. Should it choose not to do so, the following comments point out additional flaws in the drafting. The Proposal requires fiduciaries to prove that advice was given "without regard to the financial *or other interests of* the … [financial institution] or *any other party*." We do not know what these references to other interests and other parties mean and the preamble does not explain them. Given the risks of penalties for prohibited transactions and the threat of class action

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[5] See e.g, FINRA Frequently Asked Questions regarding Rule 2210. http://www.finra.org/industry/finra-rule-2210-questions-and-answers

litigation for getting this wrong, we request that this language be deleted from the exemption.

The standard requires that the advice be "without regard" to the financial interests of the adviser.[6] We are concerned that under this standard as written, a fiduciary will fail any time a plaintiff can prove that the adviser did not recommend the investment that paid him or her the least. To date, neither the Department nor the courts have held that reasonable compensation means the lowest cost. Rather, as the Department notes on its website in "*Meeting Your Fiduciary Responsibilities,*" cost is an element that should be taken into account but it is not the sole determining factor.

FINRA uses a much more common sense test that does not contain a standard that cannot practically be met: it requires that the adviser make suitable recommendations based on the client's financial circumstances and needs and that the adviser put his client's interest before his own. We urge the Department to use the FINRA formulation. This formulation is found in supplementary guidance to FINRA Rule 2111 and we respectfully request that the Department use it here.[7]

Finally, we urge the Department to use a reasonable compensation standard consistent with section 408(b)(2) and the rules, regulations, advisory opinions and case law applicable to that formulation of reasonable compensation, rather than develop a totally new and unexplained standard that we believe is impossible to comply with. The industry knows what reasonable compensation means and that is the standard used in the statute. We do not believe that the phrase "reasonable in relation to the total services the fiduciary provides to the plan or IRA" will further compliance or provide any additional protection not currently available to plans and IRAs. This new formulation of reasonable compensation is unexplained. Nor does the Department attempt to justify the differences between this formulation and Congress's view of

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[6] We note that FINRA's markup/markdown rules expressly include consideration of the cost to the financial institution of obtaining and carrying the security. Rule 2121.01(b)(2) ("in the case of an inactive security the effort and cost of buying or selling the security"). Does the Department's formulation make the FINRA requirement impossible?

[7] FINRA RN 12-25, A1 (December 2012).

reasonable compensation, which does not require all compensation received by a financial institution to be justified by a particular set of services to a particular account. The Department's formulation ignores the reality that every relationship has some inherent conflict. Financial service providers are not charitable organizations and they are entitled to be compensated for the services and products they provide, taking into account the costs incurred in developing and maintaining them, the sales effort to get investors to use them, costs of regulatory compliance, etc. We believe this language is troublesome and we urge the Department to use the language it has used since the enactment of ERISA and as recently as 2012, when it entirely revised its regulations under ERISA § 408(b)(2).[8]

SIFMA and its members appreciate the opportunity to comment and look forward to meeting with the Department to discuss our concerns. For further discussion, please contact the undersigned at 202-962-7329.

Sincerely,

Lisa J. Bleier
Managing Director, Federal Government Relations
and Associate General Counsel

[8] *See* 29 C.F.R. § 2550.408b-2(d) ("Section 2550.408c-2 of these regulations contains provisions relating to what constitutes reasonable compensation for the provision of services."); 29 C.F.R. § 2550.408c-2(b)(1) ("In general, whether compensation is 'reasonable' under sections 408(b)(2) and (c)(2) depends on the particular facts and circumstances of each case.").