AMERICAN RETIREMENT ASSOCIATION
Working for America's Retirement
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April 17, 2017

Mr. Joe Canary, Director
Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Fiduciary Rule Examination
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Re: Definition of the Term "Fiduciary;" Conflict of Interest Rule – Retirement Investment Advice Department of Labor RIN 1210-AB79

Dear Mr. Canary:

The American Retirement Association ("ARA") is writing in response to a request for comment[1] with respect to the Conflict of Interest Regulation and related exemptions (collectively, the "Regulation").[2] We recognize the Department of Labor (the "Department" or "DOL") has extended the applicability date for the Regulation until June 9, 2017, and otherwise modified the transitional requirements for the related exemptions.[3] The ARA welcomes the Department's reconsideration of the regulatory burdens and costs associated with the Regulation in accordance with the President's Memorandum to the Secretary of Labor dated February 3, 2017 ("Presidential Memorandum").[4] As explained below, we believe the Regulation and related exemptions could and should be revised in ways that are consistent with the Department's goals while reducing unnecessary costs that could limit the availability of financial advice to America's investors.

The ARA appreciates the thought, time and effort the Department has put into this initiative. We agree that investment advice should be impartial, free from conflicts of interest and in the recipient's best interest. At the same time, it is important to ensure that all Americans continue to have access to workplace savings arrangements and investment professionals to help guide them through the process of preparing for and living out one's retirement years.

[1] Proposed Regulation – Definition of the Term Fiduciary, 82 Fed Reg 12319 (March 2, 2017).
[2] Definition of the Term Fiduciary, 81 Fed Reg 20946 (April 8, 2016).
[3] Definition of the Term Fiduciary, 82 Fed Reg 12319 (April 7, 2017).
[4] Presidential Memorandum Fiduciary Rule - February 3, 2017, 82 Fed Reg 9675 (February 7, 2017).

The ARA is a national organization of more than 20,000 members who provide consulting and administrative services to American workers, savers and sponsors of retirement plans and IRAs. ARA members are a diverse group of retirement plan professionals of all disciplines including financial advisers, consultants, administrators, actuaries, accountants, and attorneys. The ARA is the coordinating entity for its four underlying affiliate organizations, the American Society of Pension Professionals and Actuaries ("ASPPA"), the National Association of Plan Advisors ("NAPA"), the National Tax-deferred Savings Association ("NTSA") and the ASPPA College of Pension Actuaries ("ACOPA"). ARA members have diverse perspectives, but are united in their common dedication to America's private retirement system.

Recommendations

The ARA recommends that the definition of Level Fee in the Best Interest Contract Exemption ("BIC Exemption") be clarified to permit a Level Fee Fiduciary to receive transaction-based compensation under an offset arrangement that falls within the parameters of Advisory Opinion 97-15A.[5]

The ARA recommends that the Department revise the Best Interest Contract Exemption to eliminate the costly, inefficient and inconsistent enforcement mechanism of class action litigation.

The ARA recommends that the applicability date for the Regulation be delayed until January 1, 2018, that transitional relief with regard to the Best Interest Contract Exemption be extended until July 1, 2018, and that ultimately, a transition period of at least 24 months from the date a revised exemption (or rule) is promulgated should be provided.

Background

The Regulation was published in final form on April 8, 2016, with an effective date of June 7, 2016, and an applicability date of April 10, 2017. On February 3, 2017, the President directed the Department to review the Regulation to determine whether it may adversely affect the ability of Americans to gain access to retirement information and financial advice. The Presidential Memorandum specifically directed the Department to consider "Whether the [Regulation] is likely to cause an increase in litigation, and an increase in the prices that investors and retirees must pay to gain access to retirement services."[6]

On March 2, 2017, the Department issued a proposed rule to extend the applicability date by 60 days.[7] In addition, the notice of proposed rulemaking requested comment in regard to the

[5] DOL Adv. Op. 97-15A (May 22, 1997); *see also* Field Assistance Bulletin 2007-1 (February 2, 2007).
[6] Presidential Memorandum Fiduciary Rule - February 3, 2017, Section 1(a) (iii), 82 Fed Reg 9675 (February 7, 2017).
[7] Proposed Regulation - Definition of the Term Fiduciary, 82 Fed Reg 12319, (March 2, 2017).

Regulation and issues raised by the Presidential Memorandum. On April 7, 2017, the Department issued a final regulation extending the applicability date 60 days until June 9, 2017. The April 7, 2016, guidance also provided for a transition period for the BIC Exemption during which satisfaction of the Impartial Conduct Standards will be the only requirement to gain exemptive relief.[8] The BIC Exemption transition period is slated to be in effect from June 9, 2017, until January 1, 2018, during which time the Department will perform the examination directed by the President.

Definition of Level Fee

The BIC Exemption provides streamlined relief for Level Fee Fiduciaries. As outlined in FAQs released by the Department:

> In general, level fee fiduciaries do not have the sorts of conflicts of interest that give rise to prohibited transactions or require reliance on an exemption. However, there is a clear and substantial conflict of interest when an adviser recommends that a participant roll money out of a plan into a fee-based account that will generate ongoing fees for the adviser that he would not otherwise receive, even if those fees do not vary with the assets recommended or invested. Similarly, investment advice to switch from a commission-based account to an account that charges a fixed percentage of assets under management on an ongoing basis could be a prohibited transaction. The streamlined level fee provisions of the BIC Exemption are designed to provide relief for these discrete transactions.[9]

A person will qualify as a Level Fee Fiduciary under the BIC Exemption if the only fee received by the fiduciary in connection with advisory or investment management services is a Level Fee that is disclosed in advance.[10] A Level Fee is defined as "…a fee or compensation that is provided based on a fixed percentage of the value of the assets or a set fee that does not vary with the particular investment recommended, rather than a commission or other transaction-based fee."[11]

As currently described, the streamlined BIC Exemption is not available if the adviser or financial institution receives third party payments such as 12b-1 fees or revenue sharing payments.[12] In such circumstances, the more burdensome "full" BIC Exemption must be satisfied.[13] The inference being that the "full" BIC Exemption requirements are necessary "… to safeguard the investor from biased advice."[14]

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[8] Definition of the Term Fiduciary, section E, 82 Fed Reg 16902, 16917 (April 7, 2017).
[9] Conflict of Interest Exemption FAQs Part I, Q&A 13
[10] Best Interest Contract Exemption, Section VIII (h) 81 Fed Reg 21002, 21083 (April 8, 2016).
[11] *Id.*
[12] Conflict of Interest Exemption FAQs Part I, Q&A 18.
[13] *Id.*
[14] *Id.*

Unfortunately, this presumption, that receipt of third party payments will always result in biased advice that cannot be mitigated through an "offset" arrangement, is in conflict with the Department's position in Advisory Opinion 97-15A. It is also in conflict with Question 7 of Part II of the Department's Conflict of Interest FAQs, where the Department very specifically stated that nothing in the Regulation "…alters the analysis of Advisory Opinion 97-15A."[15] This statement recognizes that ERISA section 406(b) is not violated by a fee agreement under which third party payments received by a fiduciary are applied against a level, asset-based fee (with any excess returned to the plan).[16] That Advisory Opinion correctly concluded that in those circumstances the fiduciary received no personal benefit and did not engage in self-dealing since the third party payments it received were applied against the fees the plan was otherwise legally obligated to pay.

Applying the legal analysis of Advisory Opinion 97-15A in determing what is a "level fee" for purposes of establishing a "level fee fiduciary" is consistent with the expressed reasons for the streamlined conditions, i.e. the transaction is relatively discrete and the provision of advice thereafter generally does not involve prohibited transactions. It should not matter whether the level fee is received as an asset-based charge paid directly from a plan or IRA or, alternatively, one that is satisfied through an offset arrangement structured in a way that satisfies Advisory Opinion 97-15A. Either way, the arrangement is specifically structured so that it generally will not involve prohibited transactions.

Unfortunately, the inconsistent application of Advisory Opinion 97-15A under the current BIC Exemption creates an expensive and unnecessary compliance burden on advisers and financial institutions, one that will increase costs and potentially reduce the level of available advisory services. This is particularly true for the services of registered investment advisers who embrace their fiduciary obligations under ERISA and the Investment Advisers Act of 1940. These advisers already operate under a conflict-free, level fee model, albeit one that often relies on the premise of Advisory Opinion 97-15A to achieve level fee status for one or more of their clients.

Consider that, in addition to serving as a plan fiduciary, investment advisory firms often also provide recordkeeping and other administrative services to the plans they serve – services that would otherwise be the responsibility of the mutual fund company in which funds are invested, and for which that fund company generally receives compensation via the expense ratios of the individual fund(s). To reimburse the investment advisory firm for providing those services, the individual fund companies routinely make third party payments, sometimes referred to as "revenue sharing." These are amounts that typically were paid to the fund company in the form of sub-transfer agent fees or other service fees and are reflected in the expense ratios of the individual funds. The fund company, in forwarding these revenue sharing payments, is essentially passing through the payments it receives to perform services for a particular fund to the entity that is actually providing these services, the investment advisory firm. Under the auspices of Advisory Opinion 97-15A, the third party payments offset the fees that the plan

[15] Conflict of Interest Exemption FAQs Part II, Q&A 7.
[16] DOL Advisory Opinion 97-15A (May 22, 1997).

would otherwise be legally obligated to pay, which allow the adviser and the investment advisory firm to maintain a conflict-free, level fee arrangement.

However, without the ability to rely upon the "offset" relief granted by Advisory Opinion 97-15A, many registered investment advisers currently providing fiduciary investment advice are presented with three untenable choices; they can either continue to accept these third party payments but with the obligations of the "full" BIC Exemption, expose the plan to the risk of paying twice for these administrative services, or shift the plan's assets to non-revenue sharing share classes that don't provide the flexibility of this offset.

The first of these alternatives is very problematic because the BIC Exemption is not available for any transaction where the adviser has discretion.[17] If the "full" BIC exemption were to be relied upon, it would mean the investment advisory firm would effectively be precluded from offering the very discretionary asset management services it was likely engaged to provide. While the investment advisory firm and adviser could still make investment recommendations, the "full" BIC Exemption would require that each retirement investor be contacted to approve each individual transaction. Transactions such as these are most typically done to rebalance a client's portfolio to return it to a desired mix of assets. Although discretionary, the transactions would not generate differential compensation and would not otherwise present a conflict of interest (or a prohibited transaction) for the adviser. Thus, this first alternative would only serve to increase expenses and reduce services.

The second alternative also adds complexity and risk to these situations. If the investment advisory firm charges the client separately for these sub-transfer agent fees and advisory services, it would be made whole, but in addition to the cumbersome additional processes required, clients run the risk of being charged twice for the same service; once by the investment advisory firm, and then again by the mutual fund company as part of the costs incorporated in the expense ratio of the fund.

The third alternative requires the physical move to a separate share class that does not incorporate service and transaction fees in its expense ratios. The actual process of exchanging shares would likely be a costly and disruptive and in many cases, may not be to the benefit of the investor. Additionally, investment advisory firms have often negotiated arrangements that are more beneficial to customers invested in revenue sharing funds than for those invested in non-revenue sharing funds. For example, a fund company may offer a fund that pays the investment advisory firm a revenue sharing fee equal to 15 basis points for various services provided to a plan. That revenue sharing payment is reflected in the fund's expense ratio. A fund with "clean shares" does not offer revenue sharing payments; however, its expense ratio is often only minimally less than the revenue sharing fund. The plan is still going to have to pay the same amount for the services it receives, but now without the benefit of the subsidy previously provided by the revenue sharing payments. In other words, the conversion to a "clean share" fund would wind up generating more revenue for the mutual fund company and higher costs to the plan and its participants since the 15 basis points service fee will come directly from the plan without the benefit of a subsidy.

[17] Best Interest Contract Exemption, Section IX (c)(4), 81 Fed Reg 21002, 21084 (April 8, 2016).

In sum, the inability to rely on Advisory Opinion 97-15A to qualify as a level fee fiduciary will impose greater administrative burdens, and significantly higher fees in circumstances that fit squarely within the Department's reasoning for the streamlined BIC Exemption; the transaction is relatively discrete and the provision of advice thereafter does not result in a prohibited transaction. Consistent with its long-standing position, the Department should make the streamlined conditions of the BIC Exemption available when level fee status is achieved through an offset arrangement that is patterned on the protective structure outlined in the Advisory Opinion 97-15A. This would be a significant improvement to the BIC Exemption, reduce unnecessary costs and result in increased availability of financial advice and information, all consistent with the priorities outlined by the President.[18]

Class Action Enforcement Mechanism

The "full" BIC Exemption, when applied to IRAs and other plans not subject to ERISA, requires the financial institution to agree, in a written contract, that they and their advisers will abide by the exemption's standards.[19] In addition, the written contract may not include "…a provision under which the Plan, IRA or Retirement Investor waives or qualifies its right to bring or participate in a class action or other representative action in court in a dispute with the Adviser or Financial Institution."[20]

The Department has delayed until January 1, 2018, the provisions of the BIC Exemption that prohibit mandatory arbitration requirements on class claims.[21] During this transition period, "…the Department is honoring the President's directive to take a hard look at any potential undue burdens and decide whether to make significant revisions."[22] Among the matters the President has directed for review, "Whether the Fiduciary Duty Rule is likely to cause an increase in litigation and an increase in the prices that investors and retirees must pay to gain access to retirement services."[23]

It is a certainty that if the prohibition on mandatory arbitration of class claims goes into effect on January 1, 2018, there will be an increase in litigation. This, in turn, will result in higher administrative costs and burdens and, ultimately, reduced access to retirement services. The plaintiff's bar has already taken note, and one need look no further than the dozens of class action lawsuits filed against fiduciaries in recent years to appreciate the catastrophic impact this could have. Few of these cases have been fully adjudicated in the courts, and most of those that have – ultimately - favored plan fiduciaries. But those same defendants in the vast majority of these cases, having spent years tied up in discovery, depositions, and pleadings, instead choose to

[18] Presidential Memorandum Fiduciary Rule - February 3, 2017, 82 Fed Reg 9675 (February 7, 2017).
[19] Conflict of Interest Exemption Section II, 81 Fed Reg 21002, 21076 (April 8, 2016).
[20] *Id.*, at Section II (f)(2), 81 Fed Reg 21002, 21078 (April 8, 2016).
[21] Definition of the Term Fiduciary Section E, 82 Fed Reg 16902, 16917 (April 7, 2017).
[22] Id, at 16906.
[23] Presidential Memorandum Fiduciary Rule - February 3, 2017, Section 1(a)(iii), 82 Fed Reg 9675 (February 7, 2017).

settle – largely to the financial benefit of the plaintiff's bar, which walks away pocketing millions in contingent fees, as indicated in the table below. Millions in contingent fees that go to underwrite the next wave of litigation.

Defendant	Settlement	Attorney Fee
Ameriprise Financial	$36.5 million	$9.0 million
Bechtel	$26.2 million	$7.7 million
Boeing	$57.0 million	$20.8 million
Caterpillar	$22.3 million	$5.83 million
Cigna	$47.8 million	$12.8 million
General Dynamics	$20.9 million	$5.7 million
International Paper	$41.5 million	$11.5 million
Kraft	$14.2 million	$4.7 million
Lockheed Martin Corp	$84.3 million	$22.3 million
Nationwide	$190.0 million	$50.0 million
Novant Health	$32.0 million	$10.8 million

Source: Multnomah Group

In these lawsuits, prudent modifications of fund menus or plan designs are held forth as evidence of prior wrongdoing. Moreover, in recent months, a growing number of "copycat" suits have emerged that borrow not only the claims, but the very language used by other plaintiffs in pursuing these causes of action. Sadly, the primary output of this destructive litigation cycle seems to be little more than attention-grabbing settlements that fill the headlines and settlement terms that add to the costs and regulatory burden of maintaining a 401(k) plan as part of our voluntary retirement plan system.

An enforcement mechanism that relies on this same plaintiff's bar to act as the "sheriff" – as the current BIC Exemption appears to do - is an extremely awkward, expensive and inefficient means of ensuring compliance. It is likely to result in inconsistent interpretation and application of the impartial conduct standard as cases are litigated in venues around the country. In its current form, it is likely to enrich the plaintiff's bar at the expense of the very savers the regulation seeks to protect.

Rather than widen the door to encourage additional litigation, the Department should revise the BIC Exemption to eliminate this unnecessary and burdensome requirement. The Department acknowledges that even if the prohibition on contractual provisions mandating arbitration was found to be invalid as violative of the Federal Arbitration Act, the exemption would still be protective of the rights of participants and beneficiaries sufficiently to grant the exemption.[24]

The ARA is exploring other ideas to foster compliance without relying upon class action lawsuits. The ARA would appreciate the opportunity to discuss these ideas as part of the Department's initiative to "take a hard look" at the Regulation.

[24] Best Interest Contract Exemption, 81 Fed Reg 21002, 21045 (April 8, 2016).

Transition Period

A final concern are the applicability dates for the Regulation and any revisions that may be made. The Department has announced it will review the Regulation during the remainder of 2017.[25] The review will include consideration of the public comments filed in response to the notice of proposed rulemaking. As a result, "…some or all of the Rule and PTEs may be revised or rescinded, including the provisions scheduled to become applicable on June 9, 2017."[26]

The financial services industry has been and will continue to be challenged by shifting standards under the Regulation and related exemptions. The Department suggests the approach it has adopted addresses the concerns that have been raised about the uncertainty of regulatory standards.[27] At the same time, however, the April 7th guidance acknowledges that the review of the Regulation directed by the President could result in "significant changes."[28]

Under the approach adopted by the Department, there remains the very real possibility of shifting compliance standards. Having to undertake potentially significant system modifications to accommodate a new wave of revisions to the Regulation is unnecessary and the extra cost and time can be easily avoided by extending the applicability date while the Department completes its review. This is particularly critical because many of the financial services firms affected by the Regulation are small businesses who can least afford the expense and disruption that would be caused by rapidly changing compliance standards.

The ARA continues to believe that a better approach would be to delay the applicability date for the Regulation beyond June 9, 2017, until at least January 1, 2018, and that transitional relief with regard to the Best Interest Contract Exemption should be extended until at least July 1, 2018. This will allow the review ordered by the President to be completed in a thoughtful, considered and an efficient fashion. It will avoid shifting compliance standards should significant changes be made to the Regulation. Moreover, if the Department chooses to amend or rescind the Regulation as part of its review, the applicability date should be extended to provide adequate time for financial services firms to modify compliance systems. In view of the scope and breadth of this undertaking, a period of 24 months from the date final changes are promulgated should be the earliest applicability date to ensure an orderly transition period.

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The ARA looks forward to working with the Department to provide input throughout this process of review. We have long supported the idea of putting plan participants, beneficiaries, and IRA owners' interests' front and center under a "best interest" standard. Consistent with this

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[25] Definition of the Term Fiduciary, 82 Fed Reg 16902, 16906 (April 7, 2017).
[26] *Id.*
[27] *Id.*
[28] *Id.*

support, we believe that the changes to the Regulation outlined above will be beneficial and protective of participants, beneficiaries, and IRA owners while continuing to support and enhance the diverse range of products and services available in the ERISA marketplace. We would welcome the opportunity to discuss these comments further with you. Please contact Craig Hoffman, ARA General Counsel, at CHoffman@USARetirement.org if you have any questions. Thank you for your time and consideration.

Sincerely,

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