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Statement of the Investment Company Institute

Hearing on Redefining "Fiduciary": Assessing the Impact of the Labor Department's Proposal
House Subcommittee on Health, Employment, Labor and Pensions

July 26, 2011

The Investment Company Institute[1] is pleased to submit this statement in connection with the Hearing of the House Subcommittee on Health, Employment, Labor and Pensions on the proposal by the Department of Labor to revise the definition of investment advisory activities that trigger fiduciary status under ERISA.

Fiduciary status entails one of the highest obligations, and liabilities, known to the law. Fiduciary status underpins the entire ERISA compliance structure. An ERISA fiduciary not only must act prudently and for the benefit of participants – as virtually all fiduciaries must do – but is subject to additional limitations on conduct under the prohibited transaction rules, including restrictions on compensation that apply only to ERISA fiduciaries. Thus, rules defining who is a fiduciary under ERISA must provide certainty and avoid over-breadth. They should not impede commonplace financial interactions.

The system by which Americans save for retirement in individual accounts on a tax-favored basis has been a huge success. As of 2011:Q1, Americans have accumulated $4.7 trillion in defined contribution plans and another $4.9 trillion in IRAs.[2] (Estimates suggest that approximately half of IRA assets originate from 401(k) and other employer-sponsored retirement plans.) About half of the assets in defined contribution plans and IRAs are invested in mutual funds.

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors and advisers. Members of ICI manage total assets of $13.1 trillion and serve over 90 million shareholders.

[2] For the complete report on the U.S. retirement market in 2011:Q1, *see* Investment Company Institute, "The U.S. Retirement Market, First Quarter 2011" (June 2011), available at http://www.ici.org/info/ret_11_q1_data.xls.

Congress made clear when it enacted ERISA that it did not intend to disrupt the functioning of the securities markets, prevent employee benefit plans from accessing investments, or turn "the ordinary functions of consultants and advisers" into fiduciary functions.[3] In 1975 DOL adopted a rule drawing an important legal boundary – the line between *commonplace financial market interactions* in which plan sponsors and participants of ERISA-governed plans can freely obtain information or suggestions to consider in making their investment decisions, on the one hand, and *advisory relationships* in which those plan sponsors or participants engage providers to act on their behalf in evaluating or making investment decisions, on the other. The rule adopted in 1975 did not "narrow" the definition of investment advice, but rather implemented Congress' intent that ERISA not disrupt established business practices of financial institutions in interacting with employee benefit plans.

The rule adopted in 1975 is 35 years old and it is understandable that the Department may want to review it. What has not changed in 35 years, however, is the need to make very clear the line between commonplace financial market interactions and true advisory relationships.

As proposed, the Department's revisions represent a major rewrite of the rule that could result in fiduciary status for ordinary business interactions, discourage basic educational materials like newsletters and phone contacts with investment firms that do not undertake to provide personalized investment advice, and make it difficult for firms to help workers preserve their savings through an IRA rollover when they change jobs or retire.

In comment letters and testimony at the administrative hearing the Department held on the proposal, we have recommended that the Department redraft its proposal so that fiduciary status only attaches to genuine advisory relationships where a position of trust and confidence exists, so that simply selling a product is not a fiduciary act. We emphasize the importance of not discouraging the assistance that recordkeepers provide to help fiduciaries prudently select and monitor plan menu investments, and not impeding the ability of workers to preserve their savings at job change through an IRA rollover.[4] Adopting a revised rule that provides this clarity will require careful analysis and redrafting. Given the importance of the issues and the need for the Department to assure that the next draft is clear and not

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[3] *See* ERISA Conference Report, P.L. 93-406, at 323 ("…the ordinary functions of consultants and advisers (other than investment advisers) may not be considered as fiduciary functions…"), *id.* at 309 (some otherwise prohibited transactions "nevertheless should be allowed in order not to disrupt the established business practices of financial institutions" and directing the Secretaries of Labor and Treasury to grant an administrative exemption for brokerage services).

[4] The Institute's comment letters and testimony to the Department of Labor provide a full discussion of these recommendations. *See* letters from Mary Podesta, Senior Counsel - Pension Regulation, Investment Company Institute, to Office of Regulations and Interpretations, Employee Benefits Security Administration, Department of Labor (February 3, 2011), available at http://www.ici.org/pdf/24941.pdf and (April 12, 2011), available at http://www.ici.org/pdf/25084.pdf; Testimony of Paul Stevens before Department of Labor Hearing on Fiduciary Definitions Proposal (March 1, 2011), available at http://www.ici.org/401k/statements/11_dol_fiduciary_tmny; ICI Letter to The Honorable Phyllis Borzi,

unnecessarily broad, the Department should give the regulated community opportunity to simultaneously review and comment on both a reproposed rule and any necessary prohibited transaction exemptions. We discuss each of these points below.

1. Fiduciary status should attach only to genuine advisory relationships where a position of trust and confidence exists.

To assure the sound functioning of the ERISA statutory framework, it is essential that persons who deal with plans, participants and IRA savers be able to distinguish with clarity between those activities and functions that confer ERISA fiduciary status and those that do not. Unfortunately, the Department's proposed rule blurs the line and captures ordinary course communications and activities that no reasonable person would consider to be fiduciary in nature.

A person's conduct satisfies the proposed test if the person provides advice to a plan or participant about the value of securities or makes a recommendation as to the advisability of investing in purchasing, holding, or selling securities. As proposed, the advice need not be individualized to the needs of the plan participant or even *aimed* at a particular plan or participant. This over-breadth will impact and likely chill commonplace market interactions in which retirement savers seek information and ideas on investing. For example, any investment newsletter or expression of opinion and any column in a newspaper or financial publication, including one making general statements about classes of investments, could qualify. Mutual fund companies commonly receive calls from individuals interested in opening an IRA and investing either contributions or rollover amounts in the firm's funds. The call center representative may state that while he or she cannot provide specific individualized advice, X fund is designed to meet a particular investment objective, or Y fund is a target date fund designed for individuals who expect to retire around a certain date. This routine market and basic interaction could be caught by the rule.

The Department should redraft the rule so that recommendations and advice that could trigger fiduciary status must be personalized to the plan or participant. This will assure the rule only applies where a reasonable person would believe a fiduciary relationship exists. It also makes sense in light of the Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), which directs the SEC to study the standards of care applicable to broker-dealers and investment advisers giving personalized advice. The SEC is authorized to adopt any needed standard of care rules, including rules making the standard of conduct for all broker-dealers and investment advisers providing personalized investment advice identical to the standard of care under the Advisers Act.

Assistant Secretary, Employee Benefits Security Administration, Department of Labor (May 20, 2011), available at http://www.ici.org/pdf/25210.pdf.

The redraft needs to make clear that fiduciary status is not triggered merely because an affiliate or employee of a firm meets the definition of "investment adviser" in the Advisers Act or serves as a directed trustee. This would be consistent with a long-settled ERISA principle that a person is a fiduciary only to the extent that he or she functions as one. The mere fact that somewhere in a financial enterprise someone is an investment adviser or fiduciary should not operate to transform any interaction between a plan and another part of that organization into a fiduciary relationship.

The redraft also needs to revise the test to apply only to situations where there is a mutual agreement, arrangement or understanding that a true advisory relationship exists. This will distinguish education, or advice that is incidental to selling activities, from a fiduciary relationship of trust.

2. Simply selling an investment product cannot be a fiduciary act.

The proposed regulation contains an exemption for transactions that might entail advice if the seller can show that the recipient knows, or under the circumstances should know, that the person is providing the advice "in its capacity as a seller of a security or other property, or as an agent for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants and that the person is not undertaking to provide impartial investment advice."

Under an expansive definition, selling an investment almost always involves some sort of a *recommendation* that the seller believes the buyer should purchase the product. Investment firms offer a product to the market believing that the investment is a good one and that it should be purchased where it meets the investor's needs.

The proposed regulation's "seller's exception" should not require the seller to demonstrate that the recipient of the advice knows that the seller has interests that are adverse to those of the plan. It is unrealistic and unnecessary for the rule to assume that any non-fiduciary interaction with a plan, participant or IRA saver is "adverse." The relevant question to ask is not whether the parties' interests are "adverse" but rather, whether in the context of the transaction, it would be clear to a reasonable person that the seller is acting as or on behalf of a seller and is not holding itself out as providing impartial investment advice.

3. The rule should not discourage the assistance that recordkeepers engaged to administer plans provide in order to help fiduciaries prudently select and monitor plan investments.

The proposed rule raises questions about whether the information and assistance recordkeepers commonly provide to fiduciaries to help manage their decision-making process might be re-characterized as fiduciary investment advice. Recordkeepers commonly provide assistance to plan fiduciaries, including a sample fund line-up, in response to a plan's Request for Proposal to demonstrate an overall sense of plan cost or suggestions for commonly used objective screens or criteria *(e.g.,* peer

performance in top quartile, manager tenure over a certain number of years, a minimum Morningstar or similar rating) to narrow the universe of available funds for initial selection and to monitor investments over time. Fiduciaries often look to the plan recordkeeper for screening assistance because the recordkeeper has experience in what other clients use and has all the necessary data about platform investments. Recordkeepers also may assist with mapping decisions by suggesting funds that are similar to one that the plan's fiduciary has decided to remove.

The decision to select or monitor the plan line-up, to replace a fund or how to map assets remains with the plan fiduciaries. Yet many fiduciaries do not have ready access to the information to perform this function by themselves. If recordkeepers were to withdraw from providing assistance because of uncertainty over the nature of the assistance they provide, plans might face the burden and considerable expense of hiring an independent consultant willing to provide fiduciary advice.

4. The Department should carefully consider how the rule would relate to IRAs and to rollovers so firms can help workers preserve their savings at job change through an IRA rollover.

The Department should maintain its current position as expressed in the 2005 Deseret Advisory Opinion[5] that a recommendation to take an otherwise permissible distribution is not investment advice. Changing this position will chill the routine process in which a worker leaves a job, contacts a financial services firm for help rolling over a 401(k) balance, and the firm explains the investments it offers and the benefits of a rollover. As the Department agreed in 2005, this simply is not investment advice with respect to the old 401(k) plan, even if the result is a liquidation of the 401(k) account with the prior employer.

In addition, the Department should complete and publish an analysis of the costs of the proposal on IRA investors and providers. While the proposed rule applies to non-employer based IRAs, the Department's economic analysis, which derives from Form 5500 data, does not consider the costs of the proposal to IRA investors and providers. The proposal will generate costs for IRA savers in that the prohibited transaction rules prohibit commission compensation to fiduciaries in many instances. If financial advisers must move from a commission structure to a wrap fee in the IRA market to comply with the prohibited transaction rules, this may, in many cases, result in higher fees to IRA investors, especially given the long-term nature of IRA investments. In addition, there are costs to IRA savers if financial advisers must curtail the information and services they offer to avoid crossing into ERISA fiduciary status.

5. To provide clarity in a final rule, the Department should draft and issue a reproposed rule along with guidance on and proposed changes to prohibited transaction class exemptions.

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[5] DOL Adv. Op. 2005-23A (Dec. 7, 2005).

Department officials have stated that if a final revised rule re-classifies various service providers as investment advice fiduciaries, those providers may be able to avoid restructuring their businesses and compensation arrangements by relying on existing class exemptions or new exemptions that the Department contemplates proposing. We believe that the preferred outcome first should be to write a rule that correctly draws the line between true advisory relationships and incidental market transactions in which plans, plan participants and IRA savers obtain input for their decision-making process. Second, in those situations where a true advisory relationship of trust and confidence exists, the Department appropriately should ameliorate any unfortunate consequences of turning parties in interest under the old rule into fiduciaries under a revised rule by proposing and adopting appropriate exemptions *before finalizing a revised rule.* One of the Department's first tasks after ERISA was enacted was proposing (and finalizing) *at the same time* both the rule now under reconsideration and PTE 75-1, which ameliorated some of the effects of the current investment advice regulation. The Department should follow this precedent and propose comprehensive PTE changes along with a redraft of the rule in order to vet fully the solutions to these complex and interrelated issues.

The Department has reproposed rules in the past to get them right.[6] The record before the Department on the proposed rule supports both the need for significant changes – even in places where the Department may revise only to clarify its intent – and the need for another round of comments. The Institute strongly urges that the Department repropose this important rule. We share the interest of the Department, this Subcommittee, and the Congress for a final rule that is clear and workable and will serve plans and participants well for the next 35 years.

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[6] In 1991, the Department appropriately used the reproposal process with the 404(c) regulation, concluding that because of the "significance of the changes" made to its first proposal, interested parties should be afforded an opportunity to comment on them prior to adoption of a final regulation. *See* 56 Fed. Reg. 10724 (Mar. 13, 1991) (reproposal); 57 Fed. Reg. 46906 (Oct. 13, 1992) (final).