United States Senate

WASHINGTON, DC 20510

October 6, 2008

Office of Regulations and Interpretations
Employee Benefits Security Administration, Room N-5665
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

Attn: Investment Advice Regulations (RIN 1210–AB13, 29 CFR Part 2550) and Investment Advice Class Exemption (RIN 1210–ZA14).

Dear Secretary Campbell:

We submit these comments in response to the Department of Labor's proposed regulations and class exemption for investment advice to participants and beneficiaries of self-directed individual account plans and IRAs.

The proposed regulations and class exemption appear to contravene both the plain language of Section 601 of the Pension Protection Act of 2006 (PPA) and Congress's intent in enacting that provision.[1] We strongly urge the Department to reissue the proposed regulation with significant modifications to address concerns over participant rights raised by the current version. We also urge you to withdraw the proposed class exemption – as we believe that the current structure is incompatible with the most basic protections offered workers in ERISA – and to issue new guidance that protects U.S. workers' and retirees' hard-earned retirement savings.

The codification of two statutory exceptions resulted from extensive Congressional consideration of independent investment advice.

As a general rule, ERISA and the Internal Revenue Code prohibit the provision of conflicted investment advice. PPA codified two explicit, narrow exceptions to this rule, for (1) a "fee-leveling" arrangement or (2) an arrangement that uses a certified computer model.[2]

The enactment of these exceptions was enabled by the fact that the provision of impartial, independent investment advice has long been an important bipartisan Congressional priority.

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1 P.L. 109-280, 120 Stat. 780 (Aug. 17, 2006).

2 *See Pension Protection Act of 2006*, Pub. L. No. 109-280, 120 Stat. 780, § 601 (2006), *codified at ERISA* § 408(g)(2); *I.R.C.* § 4975(f)(8)(B).

Indeed, the Senate passed, by a 97-2 vote, pension reform legislation that included a provision supporting independent investment advice.[3] This bipartisan support reflects the recognition that while good investment advice can benefit workers and retirees, unsound advice, including advice marked by conflicts of interest from which advisers may inappropriately profit, can have irreversible and devastating impacts on workers' savings. As the Department notes in its own analysis, "absent effective controls conflicts can sometimes bias advice, although it is unclear how much or in exactly what ways. Biased advice may be less beneficial to investors than unbiased advice, or possibly even harmful in some cases."[4]

The issue of investment advice was debated at length over numerous Congresses as members of both chambers wrestled with the desire to encourage employers to offer better investment education and advice to employees in a manner that did not leave employees prey to advisers with conflicts of interest. The language that Congress included in PPA and that President Bush signed into law, while not without detractors, resulted from a carefully crafted compromise. It is therefore surprising that the Department has seemingly ignored much of this thoughtful debate and focused more on ways to allow investment advisers with conflicts of interest to have access to workers' retirement savings.

The proposed regulations and class exemption misconstrue the fee-leveling exception by rendering it inapplicable to a fiduciary adviser's affiliates and, in the case of the class exemption, applying the exception only to the individual providing investment advice.

Both the proposed regulation and class exemption create troubling loopholes in the fee-leveling exception. Because some investment advisers will be predisposed toward investment options that yield them greater fees or compensation, Congress conditioned one of its two exceptions for conflicted investment advice on a requirement that fees be level – *i.e.*, the adviser's fees will not vary with the advice provided. This requirement eliminates potential incentives for an adviser to steer an account holder in one direction or another. Yet the Department's interpretation of the PPA's fee-leveling exception would allow an investment adviser to recommend to plan participants investment options that generate revenue for an *affiliate* of the adviser. Such affiliates may be held under the same holding company or corporate parent as the fiduciary adviser – and their fortunes may rise or fall together. In this case, the investment adviser could have a powerful incentive (including holdings in company stock options, opportunities for promotion, and informal quid pro quo arrangements stemming from ongoing business relationships) to recommend investment options that provide greater benefit to an affiliate. By not considering fees received by affiliates, the proposed regulation opens the door to conflicted advice.

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3 United States Senate, 109th Congress, Recorded Vote 328 (Nov. 16, 2005).

4 73 Fed. Reg. 49896, 49910 (Aug. 22, 2008).

Second, and even more troubling, is that the Department's proposed class exemption would enable an individual providing advice to recommend investment options that generate greater revenue for his employer, as long as his personal compensation (*i.e.*, commissions, bonuses, etc.) remains level over all investment options. But even in the absence of any direct benefit to the individual adviser, the advice remains conflicted because of considerations beyond direct or indirect compensation. For example, an employee, agent, or registered representative who provides investment advice that generates greater revenue for an employer or affiliate may benefit in future job evaluations or through improved contract evaluations and opportunities.

It is precisely for these reasons that Congress used a broad scope in setting fee-leveling requirements for both defined contribution plans and individual retirement accounts. ERISA requires that "any fees … received by the fiduciary adviser for investment advice … do not vary depending on the basis of any investment option selected."[5] ERISA goes on to define a fiduciary adviser as "a person who is a fiduciary of the plan by reason of the provision of investment advice … to the participant or beneficiary of the plan" – and explicitly includes "an affiliate of the person described [above]."[6] But the Department's proposed regulation and class exemption are inconsistent with these provisions, enacted by the PPA. We are concerned that these inconsistencies could expose individuals to transactions that jeopardize their retirement savings.

The proposed regulations and class exemption also misconstrue the newly codified certified computer model exception.

In creating the certified computer model exception, Congress sought to allow an alternative avenue for fiduciary advisers who do not to qualify under a fee-leveling arrangement, to furnish advice to plan participants and IRA holders.[7] To qualify for this exception, both ERISA and the Internal Revenue Code require the computer model to consider generally accepted investment theories, participant-specific information, and objective criteria for asset allocation. The computer model must also not be biased toward investments offered by the fiduciary adviser or affiliate. In addition, the statute explicitly requires that "the only investment advice that may be provided under the arrangement is the advice generated by the computer model, and any investment transaction pursuant to the advice must occur solely at the direction of the participant or beneficiary."[8] Participants may themselves request other advice "but only if

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[5] *ERISA* § 408(g)(2)(A)(i).

[6] *Id.* 408(g)(11)(A).

[7] Congress directed the Secretary to determine if computer models exist that can be applied to IRAs, and the Department has found that it is possible to certify applicable computer models in this context.

[8] *ERISA* § 408(g)(3)(D); *I.R.C.* § 4975(f)(8)(C)(iv).

such request has not been solicited by any person connected with carrying out the arrangement."[9] The exclusivity requirement of this provision could not be clearer; the Joint Committee on Taxation Technical Explanation, which is the only legislative report accompanying the PPA's final passage, reiterates this interpretation: "if a computer model is used, the only investment advice that may be provided under the arrangement is the advice generated by the computer model."[10] The same requirements apply to computer models for both individual account plans and IRAs.

But the proposed class exemption would perform a complete end-run around this statutory requirement. In proposing the class exemption, the Department explicitly ignores the requirement that only the computer-generated advice can be provided, and instead states that computer-generated models merely provide a "context" for other forms of advice.[11] In other words, an investment adviser may provide the model and then ignore it, instead providing conflicted advice that may be based on the adviser's own motives and interests. The proposed class exemption thus creates a loophole for conflicted advice – one that would remove the objectivity provided by using computer model generated advice and thereby jeopardize workers' and retirees' savings. Congress contemplated and rejected such an approach. The Department should, too.

The proposed class exemption violates the advance notice requirement for potential conflicts of interest on the provision of advice.

Finally, in enacting the PPA, Congress explicitly required detailed advance notice to workers and retirees to ensure that they have as full an understanding as possible of the potential effect of conflicts of interest on the provision of advice. That is why the statute enumerates numerous categories of information that workers must receive in advance of the provision of any advice. Yet the Department's proposed class exemption would require that, in those cases where a participant or account holder receives advice that is not generated by computer model and that recommends investments that generate greater income than options of the same asset class, the participant or account holder receive an explanation and justification for this recommendation within 30 days after the advice has been rendered. We are concerned that this proposal makes

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[9] *Id.* (emphasis added).

[10] Joint Committee on Taxation, *Technical Explanation of H.R. 4, the "Pension Protection Act of 2006," as Passed by the House on July 28, 2006, and as Considered by the Senate on August 3, 2006* (JCX-38-06), Aug. 3, 2006, 129.

[11] 73 Fed Reg. 49925, 49926 (Aug. 22, 2008). ("The computer generated advice recommendations and investment education materials are intended to provide individual account plan participants and beneficiaries and IRA beneficiaries with a *context for assessing and* evaluating the individualized investment advice contemplated by the exemption." (Emphasis added)).

individuals vulnerable to being steered toward options that clearly benefits financial advisers, and that individuals will not be made aware of this until after the fact. In many cases, by that time an individual will have already chosen to invest his or her money, and disclosure will simply be too late to influence investment decisions. While we appreciate the difficulty of providing notice about a specific investment option before a meeting with a participant, it is absolutely vital that participants and account holders be protected from such blatant conflicts. (This is another critical reason for ensuring that participants and account holders receive potentially conflicted advice only pursuant to a fee-leveling arrangement or a certified computer model.)

Conclusion.

In conclusion, we believe that the Department's proposed regulation and class exemption run contrary both to the clear language of PPA and Congress' clear intent in enacting PPA to protect the retirement security of millions of American workers. As the recent crisis in the financial markets demonstrates, insufficient oversight over conflicts of interest can have severe implications for the savings and assets of hardworking Americans. With many workers and retirees having recently experienced precipitous declines in their retirement savings, now, more than ever, Americans need and deserve to be protected from conflicted investment advice.

The Department has an obligation to hear from the public and interested stakeholders through not only the notice and comment process but also through public hearing. We urge the Department to significantly modify the proposed regulation and withdraw the proposed class exemption immediately and to work with Congress, the public, and those representing the interests of our nation's workers to draft regulations that will ensure that they have access to impartial investment advice.

Sincerely yours,

Jeff Bingaman
United States Senator

Charles E. Grassley
United States Senator

Edward M. Kennedy
United States Senator