# W O O D A R D

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October 2, 2008

Mr. Bradford P. Campbell
Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Investment Advice Regulations
Room N-5655
U.S. Department of Labor
200 Constitution Avenue NW
Washington, DC 20210

Via E-mail to e-ORI@dol.gov

Re: Investment Advice Regulations

Dear Mr. Campbell:

I am a partner in Woodard Insurance, LLP, a Texas partnership with seven employees, and a registered representative of a 200-rep Georgia broker-dealer. My colleagues and I provide investment services to about 50 families in the North Texas area, adding a few families each year. The investment accounts we manage include non-qualified accounts and private IRAs. Most of our clients also have individual accounts in employer plans such as 401(k) and 403(b) plans. Like many investment professionals, we assist them with their investment selections in these employer plans at no charge to coordinate all their investments.

I have read the Department's proposed regulations and proposed class exemption pursuant to Section 601 of the Pension Protection Act. **I respectfully request that you delay for at least one year the finalization and implementation of any part of the regulations or class exemption that deal with private individual retirement accounts (IRAs) that are unaffiliated with employer retirement plans.** The purpose of the delay is to give the next Congress time to clarify an apparent confusion about the Congressional intent with Section 601. It was the well-publicized intent of Congress that the Pension Protection Act expand investment advice opportunities for participants in employer plans. The bill's author still promotes on his website that the purpose of Section 601 is to give "***workers*** new access to face-to-face, personally-tailored professional investment advice." The purpose of 601 was to protect workers, not to add a new layer of bureaucracy on the heavily-regulated private investment market.

As recently as October 1, a senior aide for a representative who was heavily involved in drafting the PPA told me that she thought that "IRAs are qualified plans, too." Of course, IRAs are not qualified plans under Secs. 401(a) or 403(b) and do not fall under the scope of ERISA. If you polled the Congressmen who

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voted for the PPA, most of them probably are unaware that what was intended to create a liberating mechanism for employees to receive paid professional advice on their employer-provided retirement plans has inadvertently created a chilling obstacle to the continuation of advice in the well-served private IRA market. The language of Section 601 and the Department's proposed regulations and proposed class exemption are logical in the limited-scope investment world of a 401(k) or 403(b) plan but are unworkable with the private investment world, where consumers can choose from several product types, investment classes, and fee arrangement options and an infinite number of investment choices.

No exemption needed for private IRAs. While the purpose of Section 601 was to provide an additional exemption – a liberalization – to the prohibited transaction rules so that investment advisors can assist employees with their employer-provided retirement plan accounts, no such additional exemption is necessary for investment professionals to serve private IRA owners, any more than an exemption is necessary for investment managers to manage the investment options of 401(k) plans at the employer level. IRC Sec. 4975(e)(3)(B) includes in the listing of "disqualified persons" a *fiduciary*, which it defines as one who "renders investment advice for a fee or other compensation, direct or indirect . . . ." Congress would not have defined a fiduciary – a person of trust – as a person who is paid to provide investment advice if the very provision of that advice which makes a person a fiduciary was a prohibited transaction. That would be circular logic.

That a fiduciary can provide investment advice for the owner of a private IRA is made clear by Section 4975(d)(2), which exempts from the prohibited transaction list "any contract, or reasonable arrangement, made with a disqualified person for office space, or legal, accounting, or other services necessary for the establishment or operation of the plan, if no more than reasonable compensation is paid therefor" and also by Section 4975(d)(10), which exempts "receipt by a disqualified person of any reasonable compensation for service rendered . . . in the performance of his duties with the plan . . . ." If I am advising an employer's employees with their 401(k) accounts, Sections 4975(d)(2) and 4975(d)(10) provide no relief for me, because I am not providing services for the plan but rather for the employees. But if I am providing services for the owner of a private IRA (traditional, rollover, or Roth), I am providing services to the plan.

One plan service provider, Dalbar, who has submitted comments on these regulations to the Department, opined on a PPA white paper posted on its website that "it is the view of the DOL that since advice to IRA account holders is a prohibited transaction then these individuals do not have the benefit of investment advice (notwithstanding the widespread practice of providing advice to IRA account holders)." Perhaps Dalbar is projecting onto the Department its own

thinking. Dalbar's position means that every bank, every life insurance company, every mutual fund company, every broker-dealer, and most registered representatives, investment advisors, and life insurance agents in the nation have been violating the law for decades and that the United States government has banned IRA owners from seeking any investment advice while simultaneously ignoring these law breakers for decades. If the IRS wanted to assess the 15% prohibited transactions tax on the trillions of dollars of IRAs that have been invested and exchanged throughout the last 30 years, **it could pay off our entire national debt overnight.** Dalbar's position is unsupported by the code sections I have cited above. Dalbar stands to profit from the $63,175,000 in outside audit costs that the Department has estimated in the regulations. What is an unreasonable, unnecessary financial burden to many will be a bounty to a few.

Either current law permits IRA owners to receive advice or it doesn't. And if it doesn't, then the IRS has been derelict in collecting prohibited transaction taxes for decades, because every financial institution in America has been selling investments to and advising IRA owners in plain sight. If there is any doubt that the law prior to the PPA permits financial institutions and investment professionals to provide advice to private IRA owners, including owners of rollover IRAs, Congress needs to clarify that uncertainty with specific legislation, not with a law that intended to help employer plan account holders seek advice but that unintentionally captured the entire private investment world in its scope, like a dolphin caught in a tuna net. **Please give Congress time to deal with the ambiguities that Section 601 has created and that the Department has struggled to address in its proposed regulations and class exemption.**

Including IRAs Under Sec 601 Will Reduce Quantity & Competitiveness of Advice. Section 601 and private IRAs simply do not fit. Forcing Section 601 to apply to private IRAs will disrupt the established and satisfactory advisory relationships of millions of Americans and will accomplish the opposite of the PPA's intentions. Whereas the regulations provide a tightly-controlled new mechanism for employer plan account holders to receive paid advice, they create a huge impediment to the continuation of existing private IRA advisory relationships by implying that the current exemptions under IRC 4975(d)(2) and 4975(d)(10) somehow do not apply to fiduciaries.

On top of the audit costs, the proposed regulations estimate an equivalent cost burden of $381,157,000 in the first year alone. For small firms such as mine, this cost burden will be triple the average $86 per hour that the Department has used in its calculation, because it will be the firm owner handling many of the new responsibilities, and those hours will come from her already-limited client time. We estimate that the annual legal and audit cost alone on our small office will be about $10,000, not to mention the lost time of the firm owners and staff. These

regulations will create a huge new cost on small investment businesses with no gain to investors who are pleased with their advisory relationships.

For all of our clients, IRAs are but a portion of their total assets under management with us. For example, one of our client families has about $1 million invested with us, but less than $10,000 is in private IRAs. Are we supposed to follow the extensive regulations, including completing an eligible investment advice arrangement, the disclosures, and the annual audit, for the $10,000 in IRAs that may generate $100 in annual fees or commissions while the other 99% of assets invested is not subject to the regulations? Many fine but small investment advisors, such as me, will be driven from the IRA market if these regulations are finalized. And sadly, in many cases the free assistance advisors give to their investment clients for their employer-provided individual account plans will end when the private IRA relationship ends.

I have some questions for the Department with regard to the thousands of advisors who do not become fiduciary advisors under the proposed regulations on the first day they are effective:

1. Are these advisors supposed to terminate their relationships with their IRA customers the day the regulations become effective?

2. Is the Department prepared to deal with the resulting millions of orphan IRA accounts who are no longer receiving investment advice due to the implementation of a law that was intended to increase the availability of investment advice?

3. Will banks, mutual fund companies, and insurers that pay ongoing 12b-1 fees or trail commissions on products held in IRAs to these investment professionals who have not complied with these regulations be committing a prohibited transaction?

4. Has the Department discussed companion rules with the SEC and 50 state insurance departments to modify the 12b-1 and other compensation regulations? For example, if I own mutual fund shares in my IRA, and my 15-year advisor severs his relationship with me upon the finalization of these regulations and the mutual fund company stops paying 12b-1 fees, I would want my investment returns increased to reflect the cessation of the 12b-1 fees. Administratively, that would require the mutual fund company to convert my share class to a different "advisor-less" class that charges no 12b-1 fees and then to convert it back to my old class if I locate a fiduciary advisor to take over my account. Likewise, if I purchased an annuity product for my IRA through an insurance company and my insurance agent terminates her

> relationship with me due to the enactment of these regulations, I will want the insurer to re-price my annuity contract to reflect the cessation of trail commissions paid to my former agent. All of these compensation changes will require extensive re-working of securities and state insurance laws.

IRA Advice Already Heavily Regulated. Unlike the employer-sponsored retirement plan market, where prior to the PPA employees could seek no paid investment advice, the private IRA market is well-advised by investment and insurance professionals. It is also well-regulated. For any one of our client relationships, we must answer to the SEC, FINRA, our broker-dealer, and the local state's insurance department. Any of the above entities can audit our operations to ensure compliance with numerous laws, and each of them will scrutinize the suitability and reasonableness of the investments we recommend to our private IRA owners.

Having a third-party company come in to audit our IRA business, which as noted above is a fraction of each client relationship, is adding an unnecessary layer of cost and bureaucracy. Did Congress really intend for yet another government agency to oversee every investment professional in America? **Please give Congress time to sort out the confusion over Section 601.**

Modeling & Fee-Leveling Unworkable in Private IRA Market. Most employer retirement plans, such as 401(k) and 403(b) plans, offer a limited scope of investments. Their world is a vacuum, and in a vacuum it is practical to develop a fee schedule that treats all investments equally or a computer modeling program that divides up 20 or so funds into a pie chart based on participant answers. Private IRA owners, however, do not live in a vacuum but in the vast, competitive investment world. Unlike the 401(k) account holder, they are not captive but can shop around for the investment or advice that best suits them. Therefore, neither the modeling nor fee-leveling envisioned by the proposed regulations and class exemptions are workable in the private IRA market.

**Modeling.** There is no model that will encompass all of the investment choices available to IRA owners, and therefore any such modeling software would generate recommendations that are influenced by the investment advisor, for in selecting his modeling software the advisor would have to consider its universe of investment products (fund companies, annuities, stocks, bonds, etc) and whether he is licensed and contracted to even offer those products. Therefore, such models are unworkable in the private IRA market as final investment-selection tools, and the alternative investor education material discussed in Section III(e)(2) of the proposed class exemption always would apply to private IRAs. As III(e)(2) anticipates, short of artificial limitations on the infinite investing world imposed by modeling software or the fiduciary advisor, **all** private IRAs exist in a world in

"which the types or number of investment choices reasonably precludes the use of a computer model meeting the requirements of section 408(g)(3)(B) of ERISA."

**Fee-Leveling.** The whole concept of fee leveling is meaningless and unworkable in the private IRA world, unless an advisor artificially limits his practice to fee-based advisory accounts. Many of the eligible types of fiduciary advisors under the regulations cannot legally establish fee-based advisory accounts, because they are not registered investment advisors. In many cases, the fee is built into the pricing of the product, such as with a bank CD; in others it reduces investment returns, such as with a mutual fund 12b-1 fee; and in other cases, the IRA owner pays a specific advisory fee to an investment advisor. Even for advisors who can legally charge advisory fees, advisors are negligent if they don't take into account a wide variety of investment types, assets classes, and specific products for their clients, and compensation structures for these products will vary widely.

Although Section III(e)(3) permits the fiduciary advisor to use his judgment to offer investments with varying compensation, Section III(f) appears to prohibit the recommendation of **any** investments that would generate more compensation for the employee or registered representative of an investment fiduciary than another investment. These two sections directly conflict each other in many circumstances, as explained in item 2 below.

Section III(f) says that "**any** fees or other compensation (including salary, bonuses, awards, promotions, commissions or any other thing of value) received, directly or indirectly, by an employee, agent or registered representative providing advice on behalf of the fiduciary adviser pursuant to this exemption (as distinguished from any compensation received by the fiduciary adviser on whose behalf the employee, agent or registered representative is providing such advice) do not vary depending on the basis of **any** investment option selected by a participant or beneficiary." Section III(f) of the proposed class exemption has two major problems:

1. Since the gamut of investment options available to IRA owners has widely different compensation structures, it is impossible for a broker-dealer or other fiduciary advisor to ensure that registered representatives and agents are paid the same amount no matter what products they offer.

2. In most situations it will not be clear who the fiduciary advisor is. In the private investment world, most persons advising IRA clients will be both fiduciary advisors as well as employees or registered representatives of other fiduciary advisors. For example, when I am advising my private IRA clients, I will be a fiduciary advisor under the proposed regulations and class exemption, but I also am a registered representative of a broker-dealer. That

broker-dealer does not direct my investment advice to my clients but does review my investment orders for suitability and compliance with numerous laws. So am I an investment fiduciary allowed to recommend products with differing compensation under Section III(e)(3), or is my broker-dealer the investment fiduciary, in which case they have to restrict the investments available to their representatives' clients to ensure levelized compensation under III(f), which as I have noted is impractical if not impossible to do?

I have some questions for the Department about the fee-leveling under Section 2550.408g–1 (c) of the proposed regulations as it applies to private IRAs:

1. If an IRA owner wants to invest his IRA in mutual fund A-shares, will that preclude the advisor from meeting the levelized fee exemption, since many mutual fund companies pay a lower A-share commission for bond funds than equity funds?
2. If a registered investment advisor invests most of his IRA clients in fee-based brokerage accounts with a 1.0% flat fee but invests *even one client* in variable annuities with income guarantees and a commission structure, does the mere use of a different commission structure for that single client preclude the use of the levelized fee exemption for his entire practice? Likewise, does the mere *availability* to him of multiple investment options with different compensation structures preclude his use of the levelized fee exemption?
3. Must advisors liquidate their existing IRA clients' investment options and re-invest their entire client base in investment options that have exactly the same compensation structure if they want to meet the fee-leveling exception?
4. Since as discussed above models will not work with IRAs, and all advice will therefore be "off-model," will the fiduciary advisor need to prepare a Section III(e)(4) report every time it meets with a client, every time a client adds money to its IRA, and/or every time a client changes its investment selections?

These are just a few of my questions that show that fee-leveling is unworkable in the private IRA world.

Discretionary Accounts. Section III(k) of the proposed class exemption states that "the sale, acquisition or holding of a security or other property on behalf of a plan or IRA occurs solely at the direction of the recipient of the investment advice." This rule conflicts with the many discretionary IRAs, in which registered investment advisors make trades based on their clients' suitability but without their clients' specific permission.

In summary, there are many troubling issues in trying to making Section 601 of the Pension Protection Act fit with private IRAs, and most of these issues have not yet been thought of. Section 601 and private IRAs (traditional, rollover, or Roth) do not fit, and no regulation will make them fit. I do not believe it was the intent of Congress to create an entirely new regulatory framework outside of the SEC to govern investments and investment advice, aside from those employer-provided retirement plans governed by ERISA.

In my discussions with broker-dealers and mutual fund companies this week, I have found not a single person who is familiar with the Department's proposed regulations and proposed class exemption and the massive restructuring of the nation's investment world that they will bring about. The investment industry, which already has suffered severe blows with the economic crisis our nation is enduring, is in for a very unpleasant surprise.

Although I am a small businessman with many burdens in running a business, I have spent most of this week, including two very late nights, digesting the law and the Department's proposed regulations and class exemption. The longer I ponder your proposals, the more problems I uncover and the bigger this quagmire becomes. **I believe the only prudent course is to postpone any portion of the regulations dealing with non-ERISA plans – the private investment market – and ask Congress to revisit this issue and properly consider the vast implications of what seemed to be a simple liberalization of the prohibited transaction rules for employer-provided retirement plans.**

I will be happy to discuss any of these concerns with you on the phone or fly to Washington, DC, to meet with you in person. You can contact me at my office (817-877-4405, ext. 3000) or by e-mail (blake@woodardcompanies.com).

Sincerely,

Blake Woodard

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