

December 13, 2018

Mr. Brent J. Fields
Secretary
Securities and Exchange Commission
100 F Street NE
Washington, D.C. 20549-1090

Re: Additional Comments on Applying the Protections of Regulation Best Interest to Small Retirement Plan Fiduciaries; Regulation Best Interest Release No. 34-83062; File Number S7-07-18

Dear Mr. Fields:

The American Retirement Association (“ARA”) thanks the Securities and Exchange Commission (“Commission”) for the thought and effort dedicated to its regulatory package consisting of the proposed Regulation Best Interest, 83 Fed. Reg. 21574 (May 9, 2018), Proposed Commission Interpretation Regarding Standard of Conduct for Investment Advisers; Request for Comment on Enhancing Investment Adviser Regulation, 83 Fed. Reg. 21203 (May 9, 2018), (the “Proposed Interpretation”), and Form CRS Relationship Summary; Amendments to Form ADV; Required Disclosures in Retail Communications and Restrictions on the Use of Certain Names or Titles, 83 Fed. Reg. 21416 (May 9, 2018) (collectively, the “Proposals”). We appreciate the opportunity to provide additional comments regarding the definition of “retail customer” in proposed Regulation Best Interest.

ARA is the coordinating entity for its five underlying affiliate organizations representing the full spectrum of America’s private retirement system, the American Society of Pension Professionals and Actuaries (“ASPPA”), the National Association of Plan Advisors (“NAPA”), the National Tax-Deferred Savings Association (“NTSA”), the ASPPA College of Pension Actuaries (“ACOPA”), and the Plan Sponsor Council of America (“PSCA”). ARA’s members include organizations of all sizes and industries across the nation who sponsor and/or support retirement saving plans and are dedicated to expanding on the success of employer sponsored plans. In addition, ARA has more than 25,000 individual members who provide consulting and administrative services to American workers, savers, and the sponsors of retirement plans. ARA’s members are diverse but united in their common dedication to the success of America’s private retirement system.

Executive Summary

ARA and its underlying affiliate organizations have long been supportive of initiatives by the federal government to improve the private retirement system. ARA looks forward to working with the Commission to provide input throughout the regulatory process. We support the principle underlying the Proposals, which is that investors are best served when the interests of the financial services professional and investors are aligned. In particular, ARA supports putting the interests of investors (and particularly retirement investors) front and center under a “best

interest” standard. Furthermore, we support the Commission’s efforts to tailor these rules to preserve investor choice with regard to business models and compensation practices in a manner that is workable for broker-dealers and investment advisers alike. Consistent with this support, ARA respectfully requests the Commission clarify that broker-dealers’ recommendations to non-professional fiduciaries of small retirement plans are required to comply with the best interest obligation because such fiduciaries are “retail customers” within the meaning of Regulation Best Interest.

Retail Customer in the Retirement Plan Context

The proposed Regulation Best Interest defines a “retail customer” as: “a person, or the legal representative of such person, who: (A) Receives a recommendation of any securities transaction or investment strategy involving securities from a broker, dealer or a natural person who is an associated person of a broker or dealer; and (B) Uses the recommendation primarily for personal, family, or household purposes.”¹ In the preamble to the proposed Regulation Best Interest, the Commission clarified that it had crafted this definition to “cover non-natural persons that the Commission believes would benefit . . . (such as trusts that represent the assets of a natural person).”² The Commission also stated the definition would cover recommendations given directly to the participants of plans covered by the Employee Retirement Income Security Act of 1974, as amended (“ERISA”).³ ARA believes the Commission should clarify that non-professional fiduciaries of small employer-sponsored retirement plans are included in the definition of “retail customer.”

Regulation Best Interest makes it clear that the Commission is seeking to minimize the impact of conflicts of interest within the financial services marketplace. While pursuing this worthy objective, it is important to note that a significant percentage of assets within the U.S. financial system are held in employer-sponsored retirement plan accounts. In this regard, the Commission appropriately determined that recommendations to rollover or transfer assets from a retirement plan should be covered under Regulation Best Interest.⁴

The protections afforded by Regulation Best Interest cannot start at the plan participant or IRA rollover level. If they do, the harm that participants may suffer may be irreversible. This is because once a retirement plan participant elects an investment from a retirement plan’s menu of investment options, (or, in the absence of an election, placed in the plan’s default investment alternative), they are unlikely to review and change investment strategies. When inertia takes over, this investment becomes life-long for many investors. In fact, there is a trend in the industry whereby investors are keeping their savings in their retirement plan past termination of employment and well into retirement. In many cases, terminated participants will be investing in their workplace plans for 30 or more years. As such, ARA believes that it is paramount that financial professionals, including broker dealers, be held to a fiduciary standard of care when providing investment advice to plan fiduciaries who are selecting retirement plan investment options for plan participants and their beneficiaries. Fifty-five percent of Americans households

¹ Proposed Rule § (b)(1), 83 Fed. Reg. 21574, 21595–96 (May 9, 2018).

² Proposed Rule, 83 Fed. Reg. 21574, 21596 (May 9, 2018).

³ 83 Fed. Reg. 21574, 21598 (May 9, 2018).

⁴ See 83 Fed. Reg. 21574, 21603 (May 9, 2018).

participate in employer-sponsored plans.⁵ In terms of magnitude, employer sponsored retirement plans hold \$16.9 trillion on behalf of retirement plan participants and their beneficiaries.⁶

Closing the Gap in Regulatory Coverage

Furthermore, ARA suggests that the Commission further clarify Regulation Best Interest to avoid any “gap” in regulatory coverage. Simply put, broker-dealers should be held to the same standards of conduct when providing investment advice to a small retirement plan fiduciary as when providing advice directly to an individual plan participant or IRA holder. Broker-dealers routinely advise fiduciaries of small retirement plans concerning the investments that will be made available to participants under such plans. Like individual investors, most small plan business owners acting as retirement plan fiduciaries are not sophisticated investors. Most simply do not have retirement plan investment expertise.

Moreover, the quality of investments available under a plan can have a profound impact on a participant’s accumulation of retirement savings over the course of his or her working career. For example, a 50-basis point difference in investment returns, net of fees, over the course of 35 years can mean a difference of more than \$100,000 in accumulated retirement savings.⁷ Thus, requiring recommendations to small plan fiduciaries to adhere to the Regulation Best Interest’s standard of care would redound to the benefit of tens of millions of plan participants. Further, recommendations to the non-professional fiduciaries of small plans are already subject to FINRA suitability obligations thus applying Regulation Best Interest is an important next step.⁸

A textual reading of proposed Regulation Best Interest suggests that retirement plan fiduciaries may already qualify as a “retail customer” under the language of proposed Regulation Best Interest because they act as the “legal representative” of plan participants by exercising control over participants’ beneficial interest in the retirement plan. Fiduciaries of retirement plans include persons with discretionary authority or control respecting the management of a plan or the disposition of its assets.⁹ These plan fiduciaries make investment decisions, enter into contracts, pursue legal claims, and among other things, interact with regulators, on behalf of the plans they serve.¹⁰

5 Investment Company Institute, 2018 Investment Company Factbook, 170, available at https://www.ici.org/pdf/2018_factbook.pdf

6 Id. at 171.

7 Assuming a participant contributes \$10,000 per year during a career of 35 years. The Department of Labor’s regulatory impact analysis in connection with its fiduciary investment advice regulation estimated a cost associated with broker-dealers’ conflicted mutual fund recommendations of 50–100 basis points of annual underperformance, on average. 80 Fed. Reg. 21928, 21952 (Apr. 20, 2015); Department Labor, Regulating Advice Markets: Regulatory Impact Analysis for Final Rule and Exemptions, 9 (Apr. 2016).

8 See FINRA Notice 12-25, Q.6 (May 2012).

9 See ERISA § 3(21). The type of retirement plan fiduciary that we recommend be included within the retail customer definition may be the employer sponsoring the plan or an employee or group of employees of the sponsoring employer exercising overall management over the plan’s governance. As described below, we do not believe that professional investment experts retained by the plan to perform investment advisory services in a fiduciary capacity should be included.

10 See *DOL v. Koresko*, 646 Fed. Appx. 230, 237 (3d Cir. 2016) (stating fiduciary duties attach to management of assets in which plan participants have a beneficial interest); ERISA § 502(a)(3) (providing a private right of action for ERISA fiduciaries to enforce the terms of the plan). *Schneider v. Plymouth State Coll.*, 744 A.2d 101, 105 (1999); Bogert, *The Law Of Trusts And Trustees* § 481 (2018).

At common law, a fiduciary relationship is based on a relationship of trust and confidence, where one person relies on, and is dependent on the other.¹¹ Similarly, it is well-recognized that fiduciaries may act as the legal representative of the persons they serve, meaning that retirement plan fiduciaries act as “legal representatives” of underlying plan participants and beneficiaries.¹² Therefore, the ARA suggests that the Commission clarify that non-professional small retirement plan fiduciaries are the “legal representatives” of retirement plan participants as contemplated under Regulation Best Interest, of retirement plan participants.

Small Retirement Plan as a Retail Customer

The question of where the Commission draws the line on what it considers a retail investor in the context of a small plan fiduciary is important. To answer this question, we ask the Commission to consider the following precedent. The terms-of-art “institutional account” and “institutional investor” under FINRA Rules 2111 and 2210, respectively, are informative for purposes of defining “small” plan fiduciaries. FINRA’s suitability rule (i.e., rule 2111) defines “institutional account” by reference to FINRA’s “books and records” rule (i.e., rule 4512(c)) which sets the threshold for institutional status at \$50 million. At an asset threshold, of less than \$50 million, 98.5 percent of defined contribution plans reporting assets would potentially receive the protections of Regulation Best Interest if they do not have a professional fiduciary.¹³ As an alternative, the Commission could choose to apply an asset test of less than \$50 million. At an asset threshold of less than \$10 million in assets, 92.5 percent of plans could potentially receive the protections of Regulation Best Interest if they do not have a professional fiduciary.¹⁴

The Department of Labor similarly looked to the \$50 million of plan assets as the threshold in applying (it’s now vacated) fiduciary standard of care for broker dealers who provide investment recommendations to small retirement plans.¹⁵

Furthermore, the Commission may want to consider the employee-based definition of FINRA Rule 2210 governing institutional communications. Under that rule, “institutional investor” includes both:

- (1) an employee benefit plan, or multiple employee benefit plans offered to employees of the same employer, that meet the requirements of Section 403(b) or Section 457 of the Internal Revenue Code and in the aggregate have at least 100 participants, but does not include any participant of such plans; and
- (2) a qualified plan, as defined in Section 3(a)(12)(C) of the Exchange Act, or multiple qualified plans offered to employees of the same employer, that in the aggregate have at least 100 participants, but does not include any participant of such plans.

The next question centers on when does a broker provide “recommendations” to retirement plan fiduciaries. The Department of Labor, much like the Commission, has looked to FINRA

¹¹ *Schneider v. Plymouth State Coll.*, 744 A.2d 101, 105 (1999); Bogert, *The Law Of Trusts And Trustees* § 481 (2018).

¹² See Representation by Fiduciaries and Parents, Unif.Trust Code § 303, Comment (2000).

¹³ Employee Benefit Security Administration, Private Pension Plan Bulletin Abstract of 2015 Form 5500 Annual Reports Data Extracted on 7/7/2017, Table B2, Distribution of Pension Plan by type and amount of assets, 2015

¹⁴ *Id.*

¹⁵ Vacated ERISA Reg. §2510.3-21(c)(i)(E), 81 Fed. Reg.20946, 20999 (April 8, 2016).

guidance in determining the scope of the term “recommendation.” The term is not explicitly defined by the FINRA rules and is instead a case-by-case determination. The DOL, in looking to FINRA guidance, has found that actions like offering an investment selection menu to plan fiduciaries constitutes a “recommendation” (although it is unlikely to constitute investment advice under ERISA’s 5-part test, hence the gap). When brokers offer a single group annuity, managed account and/or target date fund series for consideration by a retirement plan fiduciary, they are clearly providing an investment recommendation to the plan fiduciary but falling short of becoming an investment fiduciary under ERISA. Investment firms have devised sales strategies and protocols to carefully skirt ERISA’s five-part fiduciary test while offering investment recommendations to small plan sponsors.

The five-part test in ERISA for determining fiduciary status under ERISA is defined as a person who does not have discretionary authority over plan assets and who, for compensation: 1. renders advice as to the value of securities or other property; 2. on a regular basis; 3. pursuant to a mutual agreement; 4. the advice serves as the primary basis for investment decisions; and 5. the advice is individualized. All five prongs of the test must be met to be deemed a 3(21) investment fiduciary under ERISA.

The next question involves how the concept of a “retail customer profile” may apply in the plan fiduciary context? When a broker is providing recommendations to a small plan fiduciary, there is a customer profile that should be considered with the overall appropriateness of the investments for the plan participant population taking into account the needs of all current and future plan participants. ERISA plan fiduciaries are subject to a prudence obligation when selecting plan investments. Plan fiduciaries must invest in a low-cost diversified mix of assets. Brokers advise plan fiduciaries as to the appropriate investment strategy and individual investments that will satisfy that strategy. As is most often the case, the plan is an individual account plan offering participants' the opportunity to direct their investments, picking from a menu selected by the plan fiduciaries. Under a participant- directed individual account plan, ERISA Section 404(c) requires a small plan fiduciary to provide participants with a broad range of investment opportunities each of which is diversified and has materially different risk and return characteristics. Brokers play a critical role in helping these plan fiduciaries provide investment options that are suitable for plan participants who will invest in one or more of these options.

Additionally, ERISA plan fiduciaries are responsible for selecting qualified default investment alternatives (QDIAs) under a participant-directed individual account plans when participants otherwise who fail to make an investment election. Target date funds (TDFs) are typically used for this purpose and fit within DOL regulatory parameters. TDFs vary considerably with respect to providers, strategies (active vs. passive for example), glide paths and investment-related fees and these differences can have a significant effect on a participant’s investment performance. A prudent recommendation of a TDF requires a risk tolerance assessment particular to a given participant’s age (or alternatively, a target level of risk appropriate for participants of the plan taken as a whole). As such, the broker’s recommendation in meeting the needs of this profile is critically important to a small plan fiduciary.

Conclusion

ARA appreciates the ongoing opportunity to work with the Commission on this issue of great importance to our diverse membership of retirement marketplace participants. We would welcome the opportunity to discuss these comments further with you. Please contact Doug Fisher, Director of Retirement Policy, at [REDACTED] or Craig Hoffman, [REDACTED] if you have any questions. Thank you for your time and consideration.

Sincerely,

/s/

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/s/

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