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Working for America's Retirement

January 2, 2024

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Employee Benefits Security Administration
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Submitted via www.Regulations.gov

Re Retirement Security Rule: Definition of an Investment Advice Fiduciary--RIN 1210-AC02 and Proposed Amendment to Prohibited Transaction Exemption 2020-02--ZRIN 1210-ZA32

Dear Madam or Sir:

The American Retirement Association (ARA) thanks the Department of Labor (the "Department") for the opportunity to comment on the proposal to update and redefine fiduciary investment advice under section 3(21) of the Employee Retirement Income Security Act of 1974, as amended (ERISA), and assorted prohibited transaction exemptions. Our comments concern Proposed Regulation 29 C.F.R. § 2510.3-21(c) and the proposed amendments to Prohibited Transaction Exemption 2020-02 ("PTE 2020-02") (together, the "Proposal").

The ARA is a national organization of more than 35,000 members who provide advisory, consulting and administrative services to employers who sponsor retirement plans and the American who save in those plans. ARA members are a diverse group of retirement plan professionals of all disciplines including financial advisers, consultants, administrators, actuaries, accountants, and attorneys. 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 American Society of Enrolled Actuaries (ASEA). ARA's membership is diverse but united in a common dedication to America's employer-based retirement plan system.

Summary

The ARA and its underlying affiliate organizations have long been supportive of the Department's efforts to modernize the definition of investment advice fiduciary promulgated in 1975 (the "1975 Rule"). We agree with the principle that informs the Proposal: investors are best served when the interests of advisers and investors are aligned, and the standards owed to investors should be product neutral. The ARA writes now to:

- Express the critical need for rulemaking in this area; and
- Suggest specific revisions to the Proposal to address certain concerns.

Discussion

I. A Rulemaking is Essential

For many years, ARA has supported an expanded ERISA fiduciary investment advice definition that will be effective for plans of all size employers. We believe that revision of the definition is essential to carry out the intent and purposes of ERISA. The purpose of ERISA is to promote the interests of employees and their beneficiaries in employee benefit plans, and the fiduciary provisions of the statute are specifically designed to protect these retirement investors from those who might have the opportunity to act in their own interests when dealing with retirement plan assets.

When ERISA was enacted and the 1975 Rule was promulgated, defined benefit pension plans of large companies dominated the market. The 401(k) plan did not even exist. Individuals generally received payments of annuity distributions from their pension plans, and therefore were not making individual investment decisions related to their retirement benefits. Rather, representatives from large companies made investment decisions related to retirement plan assets. The 1975 Rule was written to carry out ERISA's purpose in protecting these larger investors.

Since 1975 the retirement plan landscape has changed dramatically. The 401(k) plan dominates the retirement plan market, the number of small business employers sponsoring plans has soared, and, as evidenced by numerous provisions in the SECURE 2.0 Act of 2022,[1] Congress continues to advocate for adoption of plans by small business employers. While plan sponsors are still involved in selecting investments, individual investors make the vast majority of the decisions for their retirement plan assets. And, regardless of whether benefits come from a defined benefit or a defined contribution plan, lump sum distribution opportunities (with the ability to roll over assets to an IRA) generally have become the rule and not the exception.

The statutory protections in ERISA apply uniformly without any regard to these significant shifts. The statute seeks to protect the retirement plan investor regardless of whether the investor is a large company or the newest participant. The regulations, however, have not been updated to reflect the shift and have left a significant population without any fiduciary protection, in clear contrast to the statutory language and intent of ERISA.

[1] Division T of the *Consolidated Appropriations Act*, 2023, *Setting Every Community Up for Retirement Enhancement Act*, 2023, Pub. L. No. 117-328, 136 Stat. 1963 (Dec. 29, 2022).

A significant gap under the 1975 Rule affects advice given to an employer with respect to its retirement plan. Under the 1975 Rule, an advisor must have a regular and ongoing relationship with the investor in order for the advisor to be considered an investment advice fiduciary under Section 3(21) of ERISA. In the context of defined benefit plans managed by large companies, this rule may have been reasonable and closely matched the needs and expectations of the parties. In today's environment, however, it does not comport with the parties' expectations and creates a significant regulatory gap. For example, when a new retirement plan is established, an investment professional can provide advice regarding the specific investment options that will be offered to participants but not be treated as providing "investment advice" because, as is often the case with smaller plans, there is no ongoing advice relationship. Because the 1975 Rule requires the advice must be given on a "regular basis," this one-time investment advice is not covered by the current regulatory definition of investment advice. Practically, this means that when most small business retirement plans are established the advice given is not subject to ERISA's fiduciary standard of care.

Additionally, the small business is not protected by SEC's Regulation Best Interest[2] ("Reg BI") because "plan-level" advice is considered "institutional advice" even when the small business owner is clearly not a sophisticated investor.[3] Similarly, although the Suitability In Annuity Transactions Model Regulation published by the National Association of Insurance Commissioners[4] ("NAIC Model Rule") has increased protections for individual purchasers of annuities in over half the states, it too does not apply to the purchase of annuity-based retirement plans by small business owners. Thus, under the current federal and state regulatory framework, small business owners establishing a retirement plan for their employees are often provided zero regulatory protection with respect to the advice given to them regarding plan investment options.

It is critical that the Department address this regulatory gap. In the context of the current market, the 1975 Rule contravenes the intent of ERISA to protect all retirement plan investors and violates a common understanding of what "investment advice" means. Simply, it is nonsensical to give an unsophisticated[5] small business owner, who is arguably making a more consequential set of investment decisions on behalf of his or her employees, *less* investor protection than that same small business owner would get with respect to investment advice received for his or her own personal investments. And because the business owner is making decisions impacting participants, ARA believes it is absolutely essential that such business owner be able to rely on the fact that their professional investment advisor will be subject to the same fiduciary standard of care that they are subject to as a plan sponsor regardless of whether such advice is provided just once or on an ongoing basis.

A transactional definition of fiduciary investment advice would better reflect the statute and carry out the purpose of ERISA to protect all retirement plan investors. Further, the change would be consistent with both SEC Reg BI and the NAIC Model Rule, which provide investor protections to individuals on a transactional basis, regardless of whether there is an ongoing advice relationship. Therefore, ARA strongly supports the Department's work to modernize the definition of fiduciary investment advice by

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[2] 84 FR 33318 (July 12, 2019).

[3] When asked to ensure business owners were protected by Reg BI in this circumstance, SEC indicated to ARA that it was an ERISA matter and should be addressed by the Department.

[4] *Available* at www.naic.org/store/free/MDL275.pdf.

[5] In this context, we use the term "unsophisticated" to describe someone who is new to investing or not very well-informed. They may not have the knowledge, experience, or sophistication in financial matters to evaluate the risks and merits of certain investments or investment transactions.

adopting a transactional view in a way that will ensure small business owners looking to provide a retirement plan for their employees are never left without regulatory protections when getting advice with respect to plan investment options.

Without diminishing ARA's strong support for a rulemaking, ARA does have specific concerns regarding the Proposal and recommends certain revisions, discussed in the remainder of this comment.

II. Regulatory Definition of Fiduciary Investment Advice

The Proposal's definition of fiduciary investment advice generally provides that a person acting in a position of trust (whether stated or implied) is a fiduciary when the person provides an investment recommendation for a fee. In enumerating the circumstances under which someone is acting from a position of trust, the Proposal provides three instances when an investment recommendation results in fiduciary investment advice: (1) the person has discretionary authority or control, (2) the person represents they are acting as a fiduciary, or (3) the person makes investment recommendations on a regular basis as part of their business and makes a recommendation to a retirement investor under certain circumstances that meet the rule (the "new regular basis test").

The ARA supports this expanded, transactional definition and believes it better aligns with the statutory language and intent of ERISA to protect all retirement investors. However, we recommend certain revisions to avoid unintended effects on certain parties and particular circumstances.

New Regular Basis Test

ARA recommends that the Department revise the new regular basis test of the Proposal to (a) avoid any chilling effect on the provision of distribution information and (b) ensure that a party does not become an investment advice fiduciary merely by indirect use of a recommendation that was not provided to the retirement investor. Specifically, ARA recommends that the Department revise § 2510.3–21(c)(1)(ii) of the Proposal as follows[6]:

(ii) The person:

- *(A)* <u>*is an employee, independent contractor, agent, or representative of a broker or dealer registered under the Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.), a financial institution described in section 3(38)(B) of the Act, or other organization that provides financial advice on a regular basis as part of its business; and*</u>
- (B) either directly or ~~indirectly (*e.g.,*~~ through or together with any affiliate~~)~~ makes investment recommendations to investors on a regular basis as part of their business; and
- (C) <u>*provides*</u> the recommendation ~~is provided~~ under circumstances indicating that the recommendation is based on the particular needs or individual circumstances of the retirement investor and may be relied upon by the retirement investor as a basis for investment decisions that are in the retirement investor's best interest; or

The need for these revisions is discussed in the remainder of this section.

[6] Italicized and underlined text in this letter signifies proposed additions; strikethroughs signify proposed deletions.

1. Distribution Information

The proposed regulatory definition can be broadly read to apply to a wide range of individuals who would not generally be considered to be investment advisors. Retirement plans have a myriad of rules and options that participants must navigate. Plan distributions are a common topic about which participants seek information. Participants rely on human resources ("HR") professionals and third-party administrative service providers to navigate their plans' rules and options. For example, it is routine for a participant to approach an internal or external service provider with a problem such as "I had an emergency come up. I need money. Can I use my retirement plan savings?" The HR or retirement plan professional then will work with the participant to determine what options are available in the participant's particular circumstances—potentially explaining pros and cons of different options (such as between a loan and a distribution or between a hardship and a natural disaster distribution). This service is critically important to participants.

Although these conversations would not commonly be considered "investment advice," they may meet the definition of fiduciary investment advice under a plain reading of the Proposal. While the Department notes in the preamble that salaries for HR professionals would not be considered compensation (and therefore a recommendation in this context typically would not be advice for a fee), given the importance of allowing for these conversations and the general anxiety plan sponsors have with respect to potential liability under ERISA we believe it would be better that the regulatory language explicitly exclude these conversations. Additionally, in the case of small business retirement plans it is fairly typical for a third-party administrator to be answering questions about loans and distributions since there will likely be no one at the business with the expertise needed to answer the questions. In both these instances, the Proposal could cause the person to become an investment advice fiduciary for engaging in routine administration conversations that are not expected or commonly considered to be investment advice.

If the definition of fiduciary investment advice is so broad as to encompass these routine conversations, ARA believes that many plan sponsors and third-party service providers will opt to reduce the level of assistance provided to plan participants in order to avoid status as an investment advice fiduciary. This would be detrimental to plan participants who rely on these conversations to provide robust information. ARA believes that avoiding chilling effects on the provision of this type of information to participants is essential.

ARA understands that the statute was intended to apply to investment advice by persons associated with the financial services industry. Revising the new regular basis test of the Proposal's definition to encompass only individuals who are employed by or affiliated with financial institutions will reduce any chilling effect on the provision of distribution information. At the same time, it preserves the Department's approach to distribution recommendations by ensuring investment professionals who advise on distributions as part of a business of providing investment advice to IRA owners are fiduciaries. Further, because exemptive relief under PTE 2020-02 is limited to investment professionals at financial institutions, limiting the definition of investment advice fiduciary to those individuals employed by or affiliated with a financial institution will better align the definition of an investment advice fiduciary with the exemption.[7] Thus the revision will align the definition and exemption while providing investors the protection of both getting robust information from non-financial advisors while getting the fiduciary protection with respect to their investment professionals.

2. Indirect Advice

ARA believes that the non-consumer facing aspects of the market are incredibly important to the healthy functioning of the industry. ARA is concerned that the Proposal's inclusion of "indirect" advice results in a tangential and tenuous chain of fiduciaries that is inconsistent with any party's reasonable expectations.

For example, ARA believes that wholesalers and platform providers could be treated as fiduciaries simply by working with a plan's investment professional. While the Department seems to believe these types of conversations would not be specific to a plan and therefore should fall outside the scope of a covered recommendation, ARA is concerned that there are numerous instances where a wholesaler or recordkeeper would be approached by a plan's investment advisor asking for a research report or list of investments that meet certain criteria. If the wholesaler or recordkeeper is aware the request is for a plan, it appears that merely providing the report could be treated as fiduciary investment advice because the advice may be "indirectly" provided to the plan.

A similar finding of tangential fiduciary status could arise when financial advisors or institutions subcontract for services. For example, when a plan sponsor elects to use a "bundled" arrangement, the plan sponsor's decision involves the hiring of a recordkeeper and an investment advisor. The investment advice may be provided by the recordkeeper, by an affiliate, or by a third party. Further, the entity providing investment advice may subcontract certain investment services to another entity. If such an entity is providing investment advice recommendations directly to the plan sponsor, ARA believes it is appropriate for the entity to be treated as an investment advice fiduciary. However, it appears under the Proposal that any subcontractor who performs sub-advisory services for a fiduciary plan advisor (and not directly to the plan sponsor) could be treated as an investment advice fiduciary if the advice is passed along to the plan sponsor.

ARA believes it is inappropriate for a service provider that is unrelated to the plan and the plan investment advisor to potentially assume fiduciary status in these situations. Fiduciary status brings significant compliance obligations, responsibilities, and potential liability. Investment professionals and institutions should be permitted to manage their exposure to fiduciary liability by appropriately designing their business operations. The Proposal would significantly undermine this ability by causing businesses who never interact with a plan sponsor or plan participant to become fiduciaries.

It appears that the Department included the term "indirectly" to ensure that a person could not avoid fiduciary status by merely performing some functions through an affiliate. ARA agrees with that intent but believes use of the term "indirectly" is overly broad and could cast the net of fiduciary status too

[7] The proposed exemption applies only to "Financial Institutions and Investment Professionals" who provide fiduciary investment advice. However, under the expanded definition, a variety of other service providers could be deemed investment advice fiduciaries for engaging in ordinary activities. These entities currently would be left without a meaningful way to comply. If 29 CFR § 2510.3–21(c) is not revised to cover only Financial Institutions and Investment Professionals, ARA recommends that the Proposal be revised to expand the exemption to permit compliance by other types of entities.

broadly. Therefore, we suggest that the provision be revised to require the recommendation be made "either directly or through or together with any affiliate."

Specific Exclusions

1. Sales of Services

It is commonplace for investment professionals to discuss with their existing clients the possibility of providing supplemental services. In this regard, the Proposal has generated concerns that an investment professional who markets and sells their *own* abilities, services, and products may be treated as providing fiduciary investment advice. Consider, for example, when a client is considering actions like moving from 3(21) to 3(38) discretionary service, adding custom target date portfolios, adding advisor-managed accounts, or adding participant advice services. ARA believes that the context of a conversation about purchasing new services is not a situation in which a plan sponsor reasonably believes that the seller of those services is acting in the best interests of the sponsor. It is reasonable to assume that retirement plan investors will know that a recommendation to "hire me" to provide additional services (even fiduciary services) as opposed to hiring another provider of those services is not a situation in which the seller has evaluated all other options in the market and determined that they are the only provider that is in the best interests of the retirement investor. Therefore, a reasonable retirement plan investor would not be relying on the seller of services to protect their interests, and the "hire me" conversation should not be treated as a recommendation for purposes of the Proposal.

The Department explains in the preamble that a person will not become a fiduciary "merely by engaging in the normal activity of marketing" or "touting the quality of one's own advisory or investment management services."[8] However, other statements in the preamble suggest that activities that occur in normal marketing, such as providing fulsome descriptions of services, can be fiduciary in nature. This ambiguity and the language of the rule itself may have a chilling effect on marketing and providing comprehensive information that is essential for fiduciaries to be able to evaluate a prospective service. Ultimately, we believe it is important to clarify in the text of the rule itself that ordinary marketing and sales conversations are not intended to be fiduciary investment advice.

Accordingly, ARA recommends that the Department make explicit that "hire me" conversations are not fiduciary investment advice by providing a ***new*** exclusion in the form of subsection (e) to 29 C.F.R. § 2510.3–21 (and redesignating subsections (e)-(h)). The new subsection (e) would read as follows:

> (e) *Marketing or Sales Conversations*. A person who engages in marketing or sales conversations with a Retirement Investor as to the advisability of engaging such person (or an affiliate) to provide investment advice or investment management services shall not be deemed to be a fiduciary within the meaning of section 3(21)(A) of the Act or section 4975(e)(3)(B) of the Code to the extent of such conversations, provided the person engaging in such conversations does not have discretionary authority or control with respect to a decision to engage the service provider and does not represent or acknowledge that they are

[8] 88 Fed. Reg. 75890, 75906 (Nov. 3, 2023).

acting as a fiduciary with respect to such decision.[9]

2. Sophisticated Investors

ARA agrees with the Department that transactions with independent fiduciaries with financial expertise should not be carved out of the definition of fiduciary investment advice. As it relates to plans and plan sponsors, ARA is not aware of any particular asset-based threshold that reasonably indicates the investor would be "sophisticated" to a degree that fiduciary protections are not necessary. In particular, ARA believes that the 2016 Rule's use of a $50M threshold does not reliably indicate an appropriate level of sophistication in the case of a retirement plan sponsor. Rather, as the Department notes, fiduciary status will depend on the understanding of the parties. ARA believes this appropriately protects retirement plan sponsors and would permit a "sophisticated" plan sponsor to engage a consultant on a non-fiduciary basis if it so desires.

ARA would, however, support relief from the disclosure requirements of PTE 2020-02 for circumstances where such disclosures may be required between financial instructions as discussed more in our comments to proposed PTE 2020-02.

Severability

The Department explains that it generally intends that discrete aspects of the Proposal be severable – that is, to be of continuing legal validity even if certain of its aspects are struck down by a court. The Department seeks comments regarding whether the Proposal would be workable and appropriate if certain aspects were severed and the rationale behind those views.

Under applicable caselaw, if a court holds portions of a Federal regulation unlawful and the issuing agency has been silent about severability, then the default remedy is to vacate the entire rule, including those portions that the court did not hold unlawful.[10] Agencies may choose to repromulgate the portions of the rule that the court did not hold unlawful but nonetheless set aside. We understand that some agencies have, in recent years, adapted the concept of severability to rulemakings, including provisions stating that if portions of the rule are held unlawful in court, other portions not held unlawful should be allowed to go into or remain in effect.[11]

Because we believe it is critical that the Department close the regulatory gap in protection for small business owners establishing and maintaining retirement plans for their employees, providing for the severability of the Proposal is important. Sponsors of small business retirement plans carry the weight of

[9] To be clear, it is not ARA's intent to exclude conversations to the extent they contain a recommendation respecting an investment transaction or strategy that is based on the particular needs or individual circumstances of the retirement investor. Rather, we believe its critically necessary to make clear that the simple offering of your own investment advisory or management services, regardless of whether it is accompanied by an actual specific recommendation of an investment transaction or strategy, should not itself constitute investment advice as defined under the Proposal. Further, we believe the reference to "other persons' in § 2510.3–21(f)(10)(ii) of the Proposal and the negative inference that is required that to conclude that it does not apply to selling your own services does not adequately provide stakeholders comfort that such marketing or sales conversations will be determined to be so excluded.

[10] *See generally American Meat Institute v. U.S. Department of Agriculture*, 760 F.3d 18 (D.C. Cir. 2014) (*en banc*); *see also Alaska Airlines, Inc. v. Brock*, 480 U.S. 678 (1987).

[11] *See* Charles W. Tyler & E. Donald Elliott, *Administrative Severability Clauses*, 124 YALE L.J. 2286, 2349–52 (2015).

the same types of responsibilities as those of large plans, but oftentimes without the expertise that large plan sponsors have. For these reasons, as discussed in the foregoing, sponsors of retirement plans are distinguishable from other types of retirement investors since they themselves are fiduciaries under ERISA when making decisions with respect to retirement plan investments or when selecting a service provider to manage or make investment recommendations regarding retirement plan assets. As such, they have a reasonable and understandable expectation that the person giving them investment advice would be subject to the same standard of fiduciary care they themselves must adhere to whether or not such advice is given once or on a regular basis. and more likely to expect to trust their fiduciary investment advisors. ARA recommends that a final rule expressly include language providing for the severability of language that provides ERISA protections to these sponsors of retirement plans. ARA supports severability in this rulemaking and to that end suggests the addition of the following language to the regulatory text of the Proposal:

> (i) *Severability.* The provisions of this section § 2510.3-21(c) as applied to plans and plan fiduciaries are separate and severable from the other provisions. If any other provision of this section is stayed or determined to be invalid, or unenforceable, it is the Department's intention that the provisions as applied to plans and plan fiduciaries shall be given effect without the invalid provision or application of the provision to other persons not similarly situated or to other dissimilar circumstances.

III. Prohibited Transaction Exemption 2020-02

With an expanded definition of fiduciary investment advice, ARA anticipates that many financial institutions that do not currently use PTE 2020-02 will rely on it in the future. Broadly, we agree with the Department's goal of setting a uniform standard for investment advice under ERISA regardless of the investment product being offered and believe that such a standard is consistent with ERISA principles.

The proposed amendment to PTE 2020-02 would have an expanded scope as well as expanded affirmation of fiduciary status and the impartial conduct standards, additional disclosure requirements, new conditions or expanding of conditions through policies and procedures, and other changes. The exemption would be expanded to cover advice provided by Pooled Plan Providers ("PPP") and their affiliates and to provide relief for Financial Institutions that provide investment advice through computer-generated models without an Investment Professional being involved ("Robo-Advice"). ARA generally supports these changes to PTE 2020-02 but recommends certain changes and clarifications.

Expanded Scope—Robo-Advisers

ARA supports treating "robo-advice" as fiduciary investment advice when all of the elements of 29 C.F.R. § 2510.3-21 are met. Thus, we support affording robo-advisors relief under PTE 2020-02, including for investment advice generated solely by software-based models or applications without any personal interaction or advice with an investment professional. We believe that the form of advice should not affect the conditions under which it may be offered, whether given by a human being or a computer based on algorithms. All providers of fiduciary investment advice should be treated the same and afforded exemptive relief under PTE 2020-02.

The use of technology in providing investment advice has evolved significantly over the last 20-30 years. Such technologies range from tools used by investment advisors as *part of* their client services to the technologies themselves serving as (i) the decisionmaker based on algorithms and (ii) advice-giver with output for investors to use (i.e., robo-advice). Most robo-advisors are believed to be registered investment advisors with the SEC,[12] but some broker-dealers may also provide robo-advice.[13] There also is a growing industry of fintech and "Insurtech" companies that could develop into the next-generation of robo-advisors. A simple internet search suggests there are over 100 robo-advisors operating in the United States and the assets under management are anticipated to continue growing.[14] While many such services have been characterized as education, ARA believes many of them could be deemed fiduciary advice under the Proposal and therefore they should be given a path to compliance through PTE 2020-02.

Expanded Scope --PEPs

The Proposal amends PTE 2020-02 to provide exemptive relief for investment advice provided by a PPP. This means that pooled employer plans ("PEPs") may be advised by PPPs in the same manner as other ERISA plans. The Proposal, however, explicitly does not provide relief for a PPP's decision to hire an affiliated or related party as an advice provider to a PEP.

ARA appreciates the expansion of exemptive relief to PPPs. PEPs provide an important avenue for small businesses to efficiently adopt and maintain retirement plans for their employees. These retirement vehicles can streamline administration and reduce the cost of offering a small business retirement plan. PEPs are required to have a named PPP who serves as a fiduciary, but they are not required to have a single investment advice fiduciary. PEPs may be structured so that the PPP provides investment advice, so that an affiliate provides investment advice, or so that the adopting employers are responsible for investments (and they may, in turn, obtain the advice of an investment professional).

The preamble is clear on the first scenario—the PPP may provide advice under the Proposal, but the PPP cannot use the exemption to hire an affiliate. However, it does not provide guidance on the other two scenarios. ARA suggests the Department clarify that while a decision to hire an affiliate is not covered by PTE 2020-02, simply designing the PEP arrangement to require use of an affiliate as an investment advice fiduciary (so that the employer's decision to participate in the PEP, includes a decision to hire the affiliate as an investment advice fiduciary) is not a prohibited transaction. This would be similar to bundled arrangements for any other type of plan, and will help ensure that PPPs – through themselves, affiliates and/or third parties – are able to provide the services necessary for the PEP to meet its objectives.

Conditions for Relief—Disclosures

1. Fiduciary Status

The disclosure requirements in Section II(b) of the exemption require an investment advice fiduciary to acknowledge fiduciary status. The Proposal presents two concerns: (A) whether the language of the acknowledgement can be conditioned on actually making a recommendation and (B) that the disclosure will misrepresent the investment professional's obligations to the retirement investor, exposing the

[12] SEC Risk Alert: Observations from Examinations of Advisers that Provide Electronic Investment Advice (Nov. 9, 2021.)

[13] Conflicts of Interest Associated with the Use of Predictive Data Analytics by Broker-Dealers and Investment Advisers, 80 Fed. Reg. 53960 (proposed August 9, 2023).

[14] https://www.statista.com/outlook/fmo/wealth-management/digital-investment/robo-advisors/united-states.

professional to liability. To address these concerns, ARA recommends that Section II(b)(1) be revised to read as follows:

> (1) A written acknowledgment that*, when making an investment recommendation that is relied upon by the investor,* the Financial Institution and its Investment Professionals are providing fiduciary investment advice to the Retirement Investor and are fiduciaries under Title I, the Code, or both ~~when making an investment recommendation~~;

A. Acknowledgement Conditioned Making a Recommendation

As written, the Proposal is unclear about whether an investment professional's disclosure must unconditionally acknowledge that he/she is providing fiduciary investment advice or whether the disclosure may say the investment professional is providing fiduciary investment advice when making a recommendation. The ambiguity arises due to placement of the phrase "when making an investment recommendation" in Section II(b)(1). Further, the language of the preamble to the Proposal has led many readers to believe that any statement short of "I am a fiduciary" will not be treated by the Department as a compliant disclosure.

An ability to provide a conditional disclosure is necessary to ensure accuracy of the notice and to avoid unnecessary exposure to liability. In many cases, the required disclosures are likely to be given before any recommendations are made and potentially before the provider is certain whether a recommendation will be made. For example, when helping a plan sponsor establish a new plan, the investment professional may intend to provide investment recommendations and, therefore, as part of the engagement process, will provide the PTE 2020-02 disclosure. However, particularly in the small retirement plan market, it is common for the plan sponsor, after the retirement plan is "sold" and the engagement has begun, to subsequently make investment choices and decisions without consulting the investment professional. A disclosure that requires the investment professional to acknowledge fiduciary status without being able to take into account that a recommendation may never be provided may expose the professional to possible liability and mislead the investor into thinking the professional has undertaken additional obligations, such as to ensure a recommendation is in fact made.

ARA requests that the Department clarify that the required acknowledgement of fiduciary status may be conditioned on actually making a recommendation. Moving the phrase "when making an investment recommendation" as suggested, clarifies that such phrase applies to both parts of the acknowledgment—that the person is providing fiduciary investment advice, and that the person is a fiduciary under ERISA and/or the Code.

B. Acknowledgement Should Include Need for Reliance

ARA is concerned that the required acknowledgment of fiduciary status may create erroneous expectations for retirement investors, particularly among the significant number of unsophisticated investors that will now be receiving disclosures under the Proposal, which may expose investment professionals to unintended liability.

While experienced professionals understand the obligations of an ERISA fiduciary, and therefore know that a fiduciary is not required to convince their client to follow advice or "go to the ends of the earth" to protect a client from his or her own poor decision-making, the average retirement investor does not inherently understand this. Rather, use of the term "fiduciary" is often thought to mean someone who is going to protect another. In this line of thinking, an uninformed investor reading a disclosure that says

"I'm a fiduciary when I make an investment recommendation" might be misled into thinking the investment professional is undertaking an obligation beyond simply acting in the investor's best interest when making the recommendation and has agreed to do more than ERISA requires.

In practical application, the fiduciary status of an investment professional allows the retirement investor to seek recovery from the fiduciary if the investor relies on advice that was not made in the investor's best interest. The text of the exemption does not allow the fiduciary to make this clear. This is a critical point for investors to understand because, in the small business retirement plan market, it is common for a plan sponsor to not rely upon advice. For example, an investment professional may provide investment recommendations to a small business owner when establishing a new retirement plan. However, the small business owner often then makes investment choices and decisions without regard to the investment professional's advice. In this instance, the investment professional is not liable for the plan sponsor's decisions under ERISA, but the plan sponsor may believe that, because the professional declared himself or herself a fiduciary, he or she accepted additional obligations, such as pursuing the sponsor to convince them to follow the recommendation. In that case, the plan sponsor may seek to recover from the investment professional under state law concepts of fiduciary duty.[15] ARA believes this misunderstanding is more likely to occur with the broader class of investors who will be receiving the disclosures, and therefore the exemption should be revised to better inform the investor.

Clarifying in the disclosure that reliance is needed for the investor to benefit from the fiduciary protections will help the average retirement investor better understand the role of the investment professional and will appropriately limit the investment professional's potential exposure to an investor's misunderstanding of fiduciary obligations.

2. <u>Pre-Transaction Disclosure</u>

ARA recommends that the Department clarify when the disclosure required by PTE 2020-02 is required by adding a new paragraph (9) to Section II(b):

> (9) For purposes of the disclosures required by Section II(b)(1)-(4), the Financial Institution or Investment Professional is deemed to engage in the transaction on the later of (A) the date the recommendation is made or (B) the date the Financial Institution or Investment Professional becomes entitled to compensation (whether now or in the future) by reason of making the recommendation.

The Proposal requires the disclosure to be provided before engaging in the transaction. However, under the broadened definition of what constitutes fiduciary investment advice, an investment professional may provide a recommendation before knowing whether or not they will receive compensation. For example, it is common in the retirement plan market for a plan fiduciary to ask specific investment questions or request a sample recommendation as part of an RFP or sales conversation. Under the definition, providing this information could be fiduciary investment advice if the service provider is then hired and receives a fee. It is unclear when the transaction would be treated as "engaged in" under these circumstances.

[15] Even if not ultimately successful, defending a lawsuit just through the summary judgment phase routinely would cost $100,000 or more. As the margins for performing retirement plan services have shrunken, this $100,000 potential exposure for doing nothing wrong is more and more meaningful.

Under the most natural meaning, a transaction occurs when all of the conditions are satisfied. In this case, the retirement plan investor is paying the investment professional for advice. Thus, the transaction should be "engaged in" once both elements—advice and compensation—have been satisfied. In the example provided above, this would allow an investment professional to provide specific investment commentary during an RFP process but provide the required disclosures after the person has been selected and before a contract with the investor is signed. This common-sense approach will allow disclosures to be provided sufficiently in advance to protect the retirement investor and still be in the normal course of business.

3. Disclosures of Sub-Contracted Financial Institutions

Currently, the exemption requires the financial institution providing fiduciary investment advice to provide the disclosures set forth in Section II(b)(1)-(4) to the retirement investor. The raises two concerns for financial institutions who work together to provide investment advice: (A) the rule unnecessarily limits the ability to decide which party provides the required disclosure and (B) the institutional investors may have to provide disclosures to each other.

A. Entity Providing the Disclosure

Section II(b) of the Proposal requires the Financial Institution providing the advice to make the required disclosure to the retirement investor. ARA believes that it is important for retirement investors to receive the disclosure, but that it is not necessary for the disclosure to come directly from the Financial Institution providing the advice. For example, in a bundled arrangement, a plan sponsor may have a relationship with one financial institution, who then subcontracts a portion of the investment advice services to another financial institution (with whom the sponsor has no direct relationship). In this instance, we believe the parties should be able to decide which financial institution will provide the required disclosures to the retirement investor. Allowing the parties to determine who will provide the required disclosure will streamline the disclosure (e.g., by allowing the plan's "primary" financial advisor to provide a single disclosure covering all subadvisors). It will also reduce the potential for confusion that may arise if a retirement investor receives a disclosure from a party with whom the investor has not directly contracted.

To permit any party to ensure the disclosure is provided to the retirement investor, ARA recommends that the Department revise the first sentence of Section II(b) to read as follows:

> Prior to engaging in a transaction pursuant to this exemption, the ~~Financial Institution provides~~ *Retirement Investor is provided* the disclosures set forth in (1)-(4) ~~to the Retirement Investor~~:

B. Disclosures to Financial Institutions

Additionally, the Proposal could require provision of disclosures from one financial institution to another. Because the definition of "retirement investor" includes a fiduciary to a plan, a financial institution that contracts to provide services for another financial institution that is serving as a plan fiduciary may be required to provide a disclosure to the financial institution. In these instances where fiduciary investment advice is being provided to an institutional investor other than a retirement plan, ARA believes the parties are sufficiently knowledgeable such that that the disclosures, which are intended for consumers, are unnecessary. Eliminating this unnecessary disclosure will reduce the costs and burdens of the exemption without reducing the protections to the average investor.

Thus, to provide that an investment advice fiduciary is not required to provide the disclosure required by PTE 2020-02 to a retirement plan investor who is also a Financial Institution, ARA recommends that the Department add the following *new* paragraph (10) to Section II(b):

> (10) The disclosures required by Section II(b)(1)-(4), are not required where the Retirement Investor is a Financial Institution unless the Retirement Investor is the Plan's named fiduciary or administrator.

Policies and Procedures

ARA recommends that the Department strike the second sentence of Section II(c)(2) (reading "Financial Institutions may not use quotas, appraisals, performance or personnel actions, bonuses, contests, special awards, differential compensation, or other similar actions or incentives that are intended, or that a reasonable person would conclude are likely, to result in recommendations that are not in Retirement Investors' Best Interest."). The revised Section II(c)(2) should simply read:

> (2) The Financial Institution's policies and procedures mitigate Conflicts of Interest, *including conflicts relating to compensation and personnel evaluations*, to the extent that a reasonable person reviewing the policies and procedures and incentive practices as a whole would conclude that they do not create an incentive for a Financial Institution or Investment Professional to place their interests ahead of the interests of the Retirement Investor. ~~Financial Institutions may not use quotas, appraisals, performance or personnel actions, bonuses, contexts, special awards, differential compensation, or other similar actions or incentives that are intended, or that a reasonable person would conclude are likely, to result in recommendations that are not in Retirement Investors' Best Interest~~.

ARA appreciates and shares the Department's desire to avoid conflicts of interest relating to compensation and personnel assessments. However, the second sentence of Section II(c)(2) of the Proposal carries a presumption that particular types of payments are conflicted. If this list is included in the final exemption it will interfere with existing business and compensation models by creating a clear negative presumption against all these forms of compensation. In other words, evaluation of these named forms of compensation is not principles-based and it is likely to result in an absolute prohibition of certain practices—in effect a chilling effect due to the inclusion of the proscriptive list in the text of the exemption—regardless of whether the compensation structure would actually encourage recommendations that are not in the retirement investor's best interest.

Notably, there may be situations where these particular types of compensation are reasonable and appropriate and do not encourage recommendations that are not in the retirement investor's best interest. The existing requirement that financial institutions structure and monitor compensation systems to prevent conflicts of interest has been effective to protect retirement plan investors, and it is unnecessary to now prohibit compensation models that are designed with appropriate protections.

Further, ARA is particularly concerned with the prohibition of certain differential compensation models—both the textual presumption against them and the strong language of the preamble. There are numerous examples of differential compensation being entirely appropriate and in the best interests of plan sponsors and participants because such differential compensation relates to specialized investment options offering different levels of services or features. ARA strongly believes that no compensation model should be referenced in the text or the preamble as either per se or presumptively conflicted. We believe the rule should be neutral as to the compensation model so long as conflicts of interest are appropriately monitored and managed, and the advice is clearly made in the investor's best interests. We note that in its opinion in *Chamber of Commerce* v. *United States Department of Labor*[16], the Court of Appeals for the Fifth Circuit observed that ERISA's definition of a "fiduciary" does not explicitly prohibit differential compensation structures. Rather, the Court maintained, ERISA's fiduciary standard focuses on ensuring that advisers act in the best interests of their clients, and that differential compensation arrangements, when properly regulated, could coexist with this standard. Thus, we believe that maintenance of the principles-based requirement, as clarified with our language suggested, will also strengthen the resilience of the final rule.

Web Disclosure

The Department requests comments on whether, as a condition of exemptive relief under PTE 2020-02, Financial Institutions should be required to maintain a website containing disclosures for the Retirement Investor and the "investing public". The preamble suggests the posting of a description of the Financial Institution's business model, associated conflicts of interest, and a schedule of typical fees. ARA recommends that the Department not adopt a web disclosure requirement. We are concerned about the breadth and scope of such a potential requirement and believes that such a disclosure will not actually assist Retirement Investors to make better choices with their retirement accounts. Moreover, making disclosures available to the "investing public" should not be a consideration of exemptive relief relating to retirement investors. A considerable amount of information is already publicly available and existing disclosure regimes under ERISA provide significant transparency. Rather than create a new set of disclosures, the Department should rely on existing disclosure structures, which will also help to control costs. Rather than helping Retirement Investors with investment decisions regarding their accounts, the main result of any required web disclosures will be the risk of publicly revealing trade secrets and other business information.

IV. Effective Date of the Final Rulemaking

The Department has proposed to make amendments to the definition of fiduciary investment advice and the prohibited transaction exemptions effective 60 days after they are published in the Federal Register. ARA recommends that the Department instead provide that they become effective one year after publication in the Federal Register.

The Proposal makes significant changes to the definition and to how many service providers must operate in order to comply with certain prohibited transaction exemptions. These changes will require investment professionals and financial institutions to re-evaluate who is a fiduciary and also review and revise a potentially wide variety of policies and procedures in order to comply with the revised prohibited transaction exemptions. This will take a significant amount of time to implement—much longer than 60 days. A year-long period will allow affected investment professionals and financial institutions to properly respond to the final rulemaking and exemptions.

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[16] 885 F.3d 360 (5th Cir. 2018).

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ARA appreciates the opportunity to work with the Department on these issues 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 Allison Wielobob, ARA's General Counsel, at AWielobob@USARetirement.org with respect to any questions regarding the matters discussed herein. Thank you for your time and consideration.

Sincerely,

/s/
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