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August 16, 2012

By Electronic Mail

The Honorable [Full Name]
United States House of Representatives
Washington, DC 20515

Re: SEC and DoL Coordination on Fiduciary Rulemaking

Dear Mr./Mrs./Ms. [Last Name]:

Fi360, Inc. ("fi360")[1] is writing in response to a joint letter by some Members of Congress to Secretary Solis regarding the definition of the term "fiduciary," which the Department of Labor (the "Department" or "DoL") may repropose in the near future. The congressional letter[2] urges the Department to closely coordinate its efforts with the Securities and Exchange Commission (the "Commission" or "SEC") on a similar project, and a desire that both agencies arrive at a "workable, consistent set of rules."

Upon initial review, this would appear to be a reasonable request. However, fi360 suggests that when examined from a much broader public policy perspective, the effort to fully match rule for rule would appear to work at cross-purposes with the original intent of Congress to protect investors and workers saving for retirement. Moreover, it would bring into question decades of jurisprudence on which fiduciaries have traditionally relied under the Employee Retirement Income Security Act of 1974 ("ERISA") and the Investment Advisers Act of 1940 (the

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[1] Fi360's mission is to promote a culture of fiduciary responsibility and improve the decision making processes of investment fiduciaries, including investment advisors, managers, and stewards. With legally substantiated Practices as the foundation, fi360 offers training, tools, and resources in support of that mission. Fi360 also manages the Accredited Investment Fiduciary® (AIF®) and Accredited Investment Fiduciary Analyst™ (AIFA®) designation programs. At present, there are more than 5,600 active AIF and AIFA designees. For more information, please go to www.fi360.com.

[2] *See* June 25, 2012, letter by Honorable Richard E. Neal, *et al*, to Secretary Solis, Department's project to update the definition of "fiduciary" under the Employee Retirement Income Security Act of 1974.

"Advisers Act"), as well as raising other legal questions concerning the principles followed in the administration of trusts under state and banking laws.

In practice, it is not uncommon for a financial advisor to be asked to review a client's household assets, such as a non-retirement brokerage account and a tax-deferred 401(k) account, for the purpose of assessing the client's retirement goals. A review of these particular accounts would, of course, involve oversight in overlapping jurisdictions of federal securities and pension laws. Advisors and compliance officers have, over time, become increasingly sensitive to the different application of fiduciary principles under each law, recognizing that the non-retirement brokerage account and the 401(k) account are subject to different rules. Often, the central value of an advisor is the ability to integrate both accounts into an overall retirement plan for the investor, providing a coordinated investment approach utilizing tax and contribution strategies that maximize savings and growth during employment, and limit exposure to losses and taxes during retirement.

Given the 34-year gap between passage of the Advisers Act and ERISA, and the rapid growth of self-directed retirement accounts in subsequent years, Congress would have indeed found the task of contemplating the practical consequences of its legislative work nearly impossible. As a result, securities and pension attorneys have long recognized that ERISA "imposes requirements, duties and liabilities that are often different from, and sometimes in conflict with, law that otherwise governs investment management."[3]

We would argue that difference is not necessarily bad, and—in this instance—reflects the distinct goals of the underlying statutes.

Different Legislative Purposes

The intent of the Advisers Act, according to its legislative history, "[was] to protect the public from the frauds and misrepresentations of unscrupulous tipsters and touts and to safeguard the honest investment adviser against the stigma of [these] activities."[4] The Advisers Act imposed broad regulation over the entire business of investment advisers, rather than focusing primarily on the nature of their duty to investors. ERISA, on the other hand, sought to protect employees "by establishing standards of conduct, responsibility and obligation for fiduciaries of employee benefit plans."[5]

The fiduciary standards under both laws are historically quite different in their purpose and application, resulting in significant challenges when attempting to harmonize rules that cover retirement planning activities under each law. As a consequence, today under the Advisers Act,

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[3] Harvey Bines and Steve Thel, *Investment Management Law and Regulation, 2nd ed.* (New York: Aspen Publishers, Inc., 2004), discussing employee benefit plans, at 59-60.

[4] H.R. Rep. No. 76-2639, 76th Cong., 3d Sess. (1940), 28.

[5] ERISA § 2(b).

whether the client's financial goal is saving patiently for the long-term to ensure financial security in retirement, or investing in penny stocks to get rich tomorrow, the fiduciary standard under the Advisers Act permits a large amount of discretion in an advisor's decision-making process to accommodate the client's objectives.

In fact, the Advisers Act contained no reference to a fiduciary duty when it was passed by Congress in 1940. According to the seminal Supreme Court decision in 1963 confirming the fiduciary standard under the Advisers Act, a fundamental purpose of the statute was to "substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus achieve a high standard of business ethics in the securities industry."[6] Under the Advisers Act, the Court reasoned that advisers must adhere to a strict fiduciary standard including a duty of "utmost" good faith, full and fair disclosure of all material facts, and an obligation to use reasonable care to avoid misleading clients.[7] As a result, in enforcing the Advisers Act, the SEC generally places great emphasis on disclosure as a remedy for conflicts of interest.

The application of a fiduciary standard under ERISA is far different, in that it imposes fiduciary duties in addition to any specified duties of disclosure. In fact, Congress replaced the Welfare and Pension Plans Disclosure Act of 1958 with ERISA because, among other reasons, it found that relying primarily on disclosures would not protect participants adequately. To strengthen participant protections, ERISA expressly imposes a prudent man rule of fiduciary standard tailored specifically for employee benefit plans. "Congress 'expect[ed] that the courts will interpret this prudent man rule (and the other fiduciary standards) *bearing in mind the special nature and purpose of employee benefit plans.*'"[8] ERISA also broadly prohibits transactions that may represent conflicts of interest (permitting certain limited transactions under exemptive regulations) and, reflecting some of the current debate over harmonization, attaches fiduciary status to significantly more services providers under ERISA than under the Advisers Act.

In contrast to the sparse legislative history of the Advisers Act addressing a fiduciary standard, the legislative history of ERISA is robust in regard to Congress' strong focus on imposing a strict fiduciary regimen.[9] ERISA's legislative intent plainly states that the fiduciary section of the law "in essence, codifies and makes applicable to these fiduciaries certain principles developed in the evolution of the law of trusts."[10]

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[6] *SEC v. Capital Gains Research Bureau*, *Inc.*, 375 U.S. 180, 186 (1963).

[7] *Id.* at 194 (describing fiduciary duty).

[8] *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996) (citing H.R. Conf. Rep. No. 93-1280, p. 302 (1974)) (emphasis added).

[9] ERISA §§ 404-406, 409.

[10] H.R. Rep. No. 93-533, p. 11 (1973).

The common law of trusts is generally considered one of the highest fiduciary standards in the law, having developed jurisprudence over two centuries of court opinions addressing legal disputes over property managed by others. There are essentially two related areas of fiduciary responsibility under ERISA that draw from this area of law. One is a series of general trust principles that reflect trust law at the time ERISA was written in 1974,[11] and the second is a list of proscriptive activities that fiduciaries must avoid, i.e. self-dealing, or prohibited transactions.[12] General trust principles require a fiduciary to administer a trust solely in the interest of the beneficiaries.[13]

ERISA's trust principles prescribe a more specific fiduciary standard for the investment advisor than under the Advisers Act, because its objective was limited to a defined set of investors, i.e., workers saving for retirement, that Congress determined should have strengthened protection. As such, the assets of employee benefit plans, such as 401(k) investment accounts, must be held in trust (other than insurance policies).[14] Consistent with a common law duty of prudence, Congress also expressed its expectations that an ERISA fiduciary would "have to diversify the investments, except in the case of profit sharing, stock bonus, or thrift and savings plans, so as to minimize the risk of large losses unless under the circumstances it is prudent not to do so."[15]

In contrast, investment directives are markedly absent in the framework of the Advisers Act. Although most assets advised under the Advisers Act are held in trust, and diversification is broadly used as a strategy to reduce risk, neither is required by statute. ERISA, on the other hand, anticipated by almost 20 years efforts of the legal bar to revise and update the Third Restatement of Trusts, which embraces Modern Portfolio Theory as a means of reducing risk through diversification of assets.[16] The absence of a similar mandate under the Advisers Act or its rules does not necessarily constitute a shortcoming of the Advisers Act, but rather is recognition that many investors do not require the strong protection that Congress deemed necessary for participants in employee benefit plans. For example, the Advisers Act contemplates that some customers independently select their own investments, seeking only recommendations from their advisors, while the primary ERISA plan fiduciary is generally responsible for both selecting and monitoring the investment options under a self-directed arrangement, such as a 401(k) plan.

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[11] ERISA § 402(a).

[12] *Id. at* § 406.

[13] Norman Stein, "ERISA and the Limits of Equity," *Law and Contemporary Problems* (Winter 1993), at 75.

[14] *Id. at* § 403(a).

[15] H.R. Rep. No. 93-533, *supra* n. 10, at 21; *see also* ERISA § 404(a)(1)(C).

[16] *See,* e.g. W. Brantley Phillips, Jr., "Chasing Down the Devil: Standards of Prudent Investment Under the Restatement (Third) of Trusts," 54 Wash. & Lee L. Rev. 335 (1997).

While both laws generally impose a fiduciary duty of loyalty and care on the investment advisor, ERISA's prohibited transaction rules and its exclusive purpose standard are far more stringent, and absolutely prohibit transactions between the plan and a plan fiduciary, as well as any party in interest.[17] Only within a handful of safe harbors promulgated by the Department are fiduciaries provided with regulatory relief from self-dealing.

Disclosure and consent is the traditional remedy for managing conflicts of interest under the Advisers Act. However, it is less common to rely on disclosure as a way to manage conflicts under ERISA. Instead, the Department may combine disclosure with other solutions under certain prohibited transaction exemptions, such as requiring level fees and having independent audits of advice arrangements. The so-called "exclusive purpose rule" of ERISA to which these restrictions attach is defined in the statute and not merely an interpretation by the Department. The statute requires plan fiduciaries to maintain an unyielding duty of loyalty to make decisions solely in the interest of employees and their beneficiaries,[18] and to defray reasonable expenses for administering a retirement plan.[19]

Moreover, in addition to any enforcement activity of the Department, ERISA's legislative history suggests an expectation "that courts will interpret the prudent man rule and other fiduciary standards" of the law,[20] adding additional recourse for fiduciary breaches. In contrast, the Advisers Act does not provide for a private right of action except for recovery of advisory fees.[21]

Conclusion

As a result, the fiduciary standard under each law is quite different in its practical application to investment advice. If the SEC and DoL were to truly harmonize their rules, then the agencies would be left with one of two stark choices: 1) require the SEC to impose a higher standard commensurate with ERISA standards, or 2) require the DoL to violate clear legislative requirements under ERISA and thereby weaken the strong fiduciary protections now afforded to retirement plan participants. Stated another way, it is our view that an act of Congress is necessary to clear up conflicting areas of the two laws and to provide both agencies with sufficient guidance to proceed if rules harmonization were the primary objective (which, by the way, we believe is neither wise nor consistent with long-standing public policies in this area of law).

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[17] A party in interest under ERISA include plan fiduciaries, employers, employees, unions, plan service providers such as investment advisors, officers, directors and 10% shareholders.

[18] ERISA § 404(a)(1).

[19] *Id. at* § 408(b)(2).

[20] H.R. Rep. No. 93-533, 93d Cong., 1st Sess.

[21] Arthur B. Laby, "Fiduciary Obligations of Broker-Dealers and Investment Advisers" (September 29, 2010), *Villanova Law Review,* Vol. 55, No. 3, at 701.

For a fiduciary to fulfill its obligations under any law, fi360 believes that the fiduciary must, at a minimum: (1) place the client's best interest first; and (2) act with the skill, care, diligence and good judgment of a professional. We urge Congress, as it seeks to encourage agencies to harmonize their rules, to first establish clear safeguards in the statutory frameworks of the two laws to preserve investor protection in areas where the rules may appear to conflict, as well as reaffirm traditional fiduciary concepts that provide an important foundation for the professional relationship

Thank you for the opportunity to provide feedback, and do not hesitate to contact us at (412) 221-0292 if you have any questions or comments.

Sincerely,

Blaine F. Aikin	Byron F. Bowman	Duane R. Thompson
CEO	General Counsel	Senior Policy Analyst

cc: The Honorable Hilda L. Solis, Secretary
The Honorable Phyllis C. Borzi, Assistant Secretary
The Honorable Michael L. Davis, Deputy Assistant Secretary
The Honorable Mary L. Schapiro, Chairman
The Honorable Elisse B. Walter, Commissioner
The Honorable Luis A. Aguilar, Commissioner
The Honorable Troy A. Paredes, Commissioner
The Honorable Daniel M. Gallagher, Commissioner
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