

August 1, 2017

By e-mail (EBSA.FiduciaryRuleExamination@dol.gov) and First Class Mail

Office of Exemption Determinations
Employee Benefits Security Administration
Attention: D-11933
United States Department of Labor
200 Constitution Avenue, NW, Suite 400
Washington, DC 20210

**Re: RIN 1210-AB82
(Request for Information Regarding Fiduciary Rule and Prohibited Transactions)**

Ladies and Gentlemen:

Promontory Interfinancial Network (“Promontory Network”)¹ is pleased to respond to the Department of Labor’s Request for Information Regarding the Fiduciary Rule and Prohibited Transactions, RIN 1210-AB82 (the “RFI”). The RFI was published in the *Federal Register* on July 6, 2017. In particular, we are responding to Question 15 of the RFI, which asks whether there should be an amendment to the fiduciary rule (29 C.F.R. § 2510.3-21) or a streamlined exemption for particular classes of investment transactions involving bank deposit products.

As detailed in this letter, we respectfully request a streamlined exemption for FDIC-insured cash sweep services.

The exemption should allow brokerage firms, third-party administrators, and other providers of IRAs and ERISA plan services (collectively “Plan Providers”) to recommend an FDIC-insured sweep program for short-term cash that is awaiting investment or withdrawal, and to administer the program as described in this letter. Details on what the exemption should cover and proposed conditions for the exemption are described below under “Proposed Exemption” (beginning on page 3).

For simplicity, this letter describes a proposal for a streamlined exemption. An alternative to a stand-alone exemption would be a safe harbor under the Best Interest Contract exemption (or another existing exemption).

As explained below under “Discussion” (beginning on page 6), we believe a streamlined exemption (or safe harbor) is necessary because the existing framework contemplates case-by-case analysis that is onerous and inefficient, and exposes advisers to the risk of second-guessing. The existing framework might encourage advisers focused on mitigating their own risk to steer

¹ Founded in 2002, Promontory Network provides services to the banking and brokerage industries. Promontory Network’s deposit allocation and sweep services include CDARS[®] (the Certificate of Deposit Account Registry Service[®]) for time deposits; ICS[®] (the Insured Cash Sweep[®] service) for non-time deposits; and IND[®] (the Insured Network Deposits[®] service) for non-time deposits swept to banks primarily by broker-dealers.

cash toward alternatives that are less favorable than an FDIC-insured sweep. In accordance with ERISA § 408(a), the proposed exemption is administratively feasible; in the interests of plans, participants, and beneficiaries; and protective of the rights of participants and beneficiaries.²

Promontory Network's Insured Network Deposits Service

Promontory Network administers an FDIC-insured deposit sweep program called "Insured Network Deposits" ("IND"), which enables brokerage firms and other qualified entities to provide a superior sweep alternative for their customers' cash balances. IND is designed to give customers an opportunity to have FDIC insurance on all cash in the customer's account, subject to certain limitations, even if the account holder's balance exceeds the FDIC's standard maximum deposit insurance amount (the "FDIC Limit"). This is accomplished by placing customer funds at multiple banks if the customer's cash balances are greater than the FDIC Limit. This service is popular among brokerage customers. The IND service currently covers millions of account holders and processes well over \$100 billion in cash per year.

The following is a brief summary of how IND works:

- Promontory Network engages banks to participate in the IND program through individually negotiated agreements with the banks. Each bank commits to accept deposits, subject to negotiated limits and other constraints, and to pay interest and fees on the deposits at specified rates. The rates are negotiated by each bank individually, taking into account factors like the bank's capacity and funding needs. The rates are typically tied to an index, such as LIBOR or a federal funds rate. The amount that each participating bank pays in respect of deposits placed at such bank is called the "total all-in cost of funds."
- Promontory Network enters into contracts with brokerage firms and other qualified entities which govern their participation in IND. Customer accounts that sweep cash through IND may include retail brokerage accounts, IRAs, and ERISA plan accounts.
- Promontory Network provides to each brokerage firm a list of banks where customer funds may be deposited. The lists vary geographically. Brokerage firm customers may opt out of any bank on the list. For example, a customer might opt out of a bank if it already has cash deposited there, to avoid going over the FDIC Limit with respect to that bank.
- The bank list provided by Promontory Network determines the "sequence" for allocating each day's cash among the participating banks. In general, the sequence starts with the bank that has the highest deposit appetite and works its way down; but other factors are also taken into account.
- If a customer has more cash than the FDIC Limit, the customer's cash would be deposited with the first bank on the list that has capacity, until the FDIC Limit (less

² Throughout this letter, the term "plan" includes IRAs and other accounts described in Internal Revenue Code § 4975(e)(1). For IRAs and other individual accounts, the term "participant" means the account holder.

an allowance for later crediting of interest) for that bank is reached. Any remaining cash would then be deposited with the second bank or additional banks as necessary to provide FDIC insurance on the entirety of the cash balances (subject to certain program maximums).

- Separately, each brokerage firm sets an interest rate for cash in its customers' accounts. The rate is disclosed to customers in advance. The ability to set the interest rate is an important aspect of the program, because the participating banks all pay different rates for their total all-in cost of funds. By setting a rate in advance, the brokerage firm ensures fairness (each customer gets the same rate without regard to the bank of deposit) and transparency (advance disclosure).
- The program is designed for Promontory Network to receive a level fee equal to a fixed percentage of cash in the program, without regard to which banks are selected. Under our proposal, the brokerage firm's fee would equal the total all-in cost of funds minus customer interest and Promontory Network's fee.

Proposed Exemption

We propose a streamlined exemption (or safe harbor under the Best Interest Contract exemption or another exemption) for FDIC-insured cash sweep programs. The exemption would cover:

- Recommending an FDIC-insured sweep program for short-term cash management, and designating the insured sweep as the default for short-term cash management;
- Setting the interest rate for participant accounts in the program;
- Advice (whether discretionary or non-discretionary) on allocating assets to cash pending investment (in accordance with an investment policy or strategy) or withdrawal; and
- Receiving compensation equal to the excess (if any) of the total all-in cost of funds paid by the banks over the interest credited to participant accounts and fees to the sweep administrator and other service providers (the "spread").

Modeled after the principles of ERISA § 408(b)(4) (exemption for bank deposits) and (6) (exemption for ancillary services), PTE 77-4 (exemption for investment in affiliated mutual funds), and Field Assistance Bulletin 2002-3 (obligations relating to "float"), we propose the following conditions for the exemption:

1. ***Participant Choice.*** Each participant must have a choice of at least three options for cash awaiting investment or withdrawal: (i) the FDIC-insured sweep, (ii) a money market fund, or (iii) idle cash. The provider agreement may designate the FDIC-insured sweep as the default option, subject to satisfying the disclosure, opt-out, and other requirements described below.
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2. ***FDIC Insurance.*** The sweep program must be designed to provide an opportunity to have FDIC insurance for all deposits, up to applicable program limits.
3. ***Ancillary to Investment Strategy.*** The insured sweep program is recommended only for unallocated cash that is awaiting investment or withdrawal. For example, the exemption would cover recommending an insured sweep program for new contributions that will be invested gradually (*e.g.*, dollar cost averaging) in accordance with an investment policy or strategy, or for proceeds from sale of an investment pending withdrawal or allocation to a new investment or investments.

In contrast, the exemption need not cover a recommendation to allocate part of a participant's portfolio to cash or cash equivalents as part of a long-term investment strategy. In that circumstance, advisers could be required to rely on the Best Interest Contract or another exemption.

4. ***Objective Interest Rate Formula.*** The interest rate credited to participants' accounts must be determined using an objective formula. The formula may be set by the Plan Provider and must be disclosed to the participant prior to initial participation in the sweep program; material changes to the formula would have to be disclosed at least 30 days before such changes go into effect. The formula must be tied to one or more external benchmarks, such as a federal funds rate, LIBOR, an appropriate rate from the Crane Brokerage Sweep index, or a similar index generally utilized by the financial services industry. The benchmark would have to be determined by the Plan provider and agreed to (affirmatively or by negative consent) by the participant.

As noted above, the objective formula disclosed in advance ensures ***transparency*** (to allow participants to compare rates under the sweep program to other alternatives) and ***fairness*** (ensuring that all participants receive the same rate of return without regard to where they land in the allocation among banks). The requirement to tie to an external benchmark prevents discretion to manipulate the rate out of self-interest.

5. ***Allocation of Cash Among Participating Banks is Determined by Sweep Administrator—Not Plan Provider.*** The sequence for allocating cash among participating banks (and selection of participating banks) must be determined by the sweep administrator, and not by the Plan Provider. The list of participating banks for each Plan Provider will be disclosed to the Plan Provider, who will be responsible for disclosing the list to participants, and the participants may opt out of participating banks. If a participant wishes to opt out of all of the participating banks (such that no banks are left on the list), the participant (or a fiduciary acting for the participant) would have to choose a different vehicle for his or her cash.
 6. ***Reasonable Compensation.*** The total compensation paid to the Plan Provider, sweep administrator, and other service providers must be reasonable for the services provided. Reasonableness would be determined in accordance with the requirements of ERISA § 408(b)(2) and Internal Revenue Code § 4975(d)(2). In addition:
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- Level Fee for Service Providers Other Than Provider. Fees for all service providers, other than the Plan Provider, must be level—*i.e.*, a fixed dollar amount or a fixed percentage of cash in the program, determined without regard to which banks are selected. The Plan Provider’s fee may be the excess of total all-in cost of funds paid by the banks over the interest credited to participant accounts and fees to the sweep administrator and other providers (the “spread”).

As noted above, the desire to provide consistent interest rates for all participants, and to disclose the rates in advance, necessitates that the spread between the total all-in cost of funds and interest paid to participants will vary depending on where the cash is deposited. Under our proposal, only the Plan Provider’s compensation would be affected by the allocation among banks. This protects against conflicts of interest, because the Plan Provider has no control over the bank lists. Determining the bank lists would be the responsibility of the sweep administrator, whose compensation will not be affected by which banks are selected for the bank lists or the sequence of the banks on the lists.

- No Duplication of Fees. Participants in the sweep program (or participating plans, as applicable) must not pay any fees with respect to cash in the sweep program, other than the cash management fee described in this condition #6, for the entire period in which cash is held in the sweep program. This requirement is intended to be analogous to section II(c) of PTE 77-4.

7. **Disclosure.** The Plan Provider must satisfy the following disclosure requirements:

- Advance Disclosure. Prior to initial participation in the sweep, the Plan Provider must disclose the current interest rate and formula, and a description of the Plan Provider’s compensation from the sweep program. Any material change to the interest rate formula or the Plan Provider’s compensation arrangement must be disclosed at least 30 days in advance.

Our proposal does not specify a minimum notice period before initial participation in the sweep. We recognize that this approach is different than the notice period required for a default investment under 29 C.F.R. § 2550.404c-5(c) (qualified default investment alternative). We believe more flexibility is appropriate for an FDIC-insured cash sweep because the program is designed for short-term cash, with very limited risk of loss and daily liquidity.³ Even if a participant opts out of the insured sweep program after the initial participation, he or she can transfer to another alternative without restriction or loss; and because the exemption is designed for short-term

³ Certain funds are placed in money market deposit accounts (an account that has the same characteristics as a savings account). Regulation D of the Board of Governors of the Federal Reserve System allows the depository institution for these accounts to require seven days’ prior written notice of intent to withdraw. As with other savings accounts, this right is rarely, if ever, exercised by banks.

allocations, variations in interest rate should not have a material effect on retirement savings. In contrast, a longer notice period could result in cash being idle and/or uninsured for a longer period.

- Statement of Interest and Fees. No less than quarterly, the Plan Provider must disclose to the participant the interest credited to the account and compensation received by the Plan Provider from the program. This information may be included in regular account statements. The compensation received by the Plan Provider may be presented as an average dollar amount per \$1,000 of cash across the Plan Provider's platform (in the case of individual accounts) or the plan (in the case of an ERISA plan).

This disclosure will provide further transparency to participants, and there will be no impediment to acting if the disclosure affects the participant's desire to participate in the insured sweep. Again, unlike other investments, there is virtually no risk of lost principal from transferring after cash has defaulted to the sweep; and the short periods contemplated by the exemption ensure that differences in return are not likely to have a significant impact on long-term savings.

Discussion

As explained below, we believe a streamlined exemption (or safe harbor) is necessary because the existing framework contemplates case-by-case analysis that is onerous and inefficient, and exposes advisers to the risk of second-guessing. For example, a well-intentioned Plan Provider who recommends an FDIC-insured cash sweep could be second-guessed (particularly in hindsight) for not recommending an uninsured alternative with a higher yield. The existing framework might encourage advisers focused on mitigating their own risk to leave cash idle or steer cash toward alternatives that are less safe than an insured sweep. In accordance with ERISA § 408(a), the proposed exemption is administratively feasible; in the interests of plans, participants, and beneficiaries; and protective of the rights of participants and beneficiaries.

A. A streamlined exemption is necessary because the existing framework is onerous and inefficient.

Under the fiduciary rule (unless it is changed), designating an insured cash sweep as the default for cash management might be treated as investment advice, even though the participant makes the ultimate decision whether to participate in the program. Accordingly, an exemption is needed to the extent that the allocation to the sweep affects the Plan Provider's compensation.

The Best Interest Contract exemption is not sufficient for this purpose, for three reasons:

1. The best interest determination is open-ended and contemplates analysis that is more onerous than practical for temporarily unallocated cash. In dollars, the differences in return among cash alternatives are relatively small for short-term cash holdings. We believe the benefits of FDIC insurance and liquidity outweigh the cost of evaluating
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small differences among competing products that are not FDIC-insured. Accordingly, the Department should at least add a safe harbor to the Best Interest Contract exemption for insured cash sweeps.

2. The Best Interest Contract exemption requirements that are scheduled to go into effect as of January 1, 2018, would be extremely costly to implement. We believe that many service providers will conclude the current form of that exemption is not worth the cost, which could effectively deprive plan participants of an attractive, safe alternative for cash.
3. The Best Interest Contract exemption is not available if the Plan Provider has discretionary control over investments. A streamlined exemption should expressly allow an insured sweep program to be designated as the default for cash awaiting investment or withdrawal, and to administer the program as described in this letter.

Moreover, the existing exemptions put Plan Providers that are not affiliated with banks at a competitive disadvantage. The exemptions for bank deposits and ancillary services under ERISA § 408(b)(4) and (6) make available to banks a sweep alternative that is not available to non-bank Plan Providers: they can either sweep cash to affiliated banks (and receive compensation as the bank of deposit) or design the sweep as an exempt ancillary service.⁴ These bank exemptions make available to Plan Providers that are affiliated with banks a revenue stream that can support lower cost products. The proposed exemption would level the playing field for non-bank Plan Providers, and it would provide greater protections than are currently provided under the bank exemptions.

B. The proposed exemption satisfies the requirements under ERISA § 408(a).

As discussed below, our proposed exemption satisfies the conditions for an exemption under ERISA § 408(a): the proposed exemption is (1) administratively feasible, (2) in the interests of plans, participants, and beneficiaries, and (3) protective of the rights of plan participants and beneficiaries.

1. ***Administratively feasible.*** The conditions for the proposed exemption are consistent with the conditions for a number of existing exemptions, including exemptions for bank deposits (ERISA § 408(b)(4)), ancillary services (ERISA § 408(b)(6)), affiliated mutual funds (PTE 77-4), and the Best Interest Contract exemption (PTE 2016-01). We believe the administrative burden of our proposed exemption is comparable to the burden of the other exemptions (and significantly *less* burdensome than the Best Interest Contract exemption), both in terms of workability for fiduciaries and other service providers and in terms of enforcement.

2. ***In the interests of plans, participants, and beneficiaries.*** As discussed above, we believe that the absence of an exemption or safe harbor for insured sweeps might lead to the service becoming unavailable for many participants. We are concerned that many providers will

⁴ See, e.g., Letter from Alan D. Lebowitz, Deputy Administrator for Program Operations, Department of Labor to Robert S. Plotkin, Assistant Director, Division of Banking Supervision and Regulation, Board of Governors of the Federal Reserve System (Aug. 1, 1986) (cited in ERISA Op. Ltr. 2001-10A).

conclude that they can minimize exposure to second-guessing by letting unallocated cash stay idle or by offering only alternatives that are not FDIC-insured, such as money market funds. In addition, advisers could be incentivized to rush into new investments (for example, forgo dollar cost averaging) rather than wait for the right opportunity. If this happens, participants would lose a valuable service.

The proposed exemption is designed to allow participants to select an alternative to the insured cash sweep by opting out. We recognize the Department's general hesitation to rely on consumers to review disclosures and make independent decisions. But the insured cash sweep is not a complicated long-term investment. There are only three considerations: safety, rate of return, and liquidity. For safety and liquidity, we believe an FDIC-insured sweep is the gold standard; and because the rate of return is disclosed in advance, it is easy to compare to other alternatives. In addition, because the sweep is designed for short-term investment, any difference between return from a higher yielding alternative (if there is one that is suitable) and the interest from the sweep is not likely to have a material effect on long-term retirement savings. In this circumstance, designating an insured sweep as the default is in the interests of plans, participants, and beneficiaries.

3. **Protects the rights of plan participants and beneficiaries.** The proposed exemption protects the rights of plan participants and beneficiaries by (i) protecting against conflicts of interest, (ii) offering transparency and flexibility, (iii) requiring that compensation be reasonable. The protections are greater than what is required under ERISA § 408(b)(4) (bank deposits) and (6) (ancillary service) and are aligned with the principles of PTE 77-4 (affiliated mutual funds) and Field Assistance Bulletin 2002-3 (obligations relating to "float").

i. Protects against conflicts of interest. The conditions for our proposed exemption protect against conflicts of interest in the following ways:

- The conditions protect against misuse or overuse. First, the exemption would be available only for cash awaiting investment or withdrawal (condition #3). Second, condition #6 prohibits duplication of fees: the only fee that the Plan Provider can receive with respect to cash in the sweep is the compensation from the sweep (described in condition #6).
 - The interest rate must be specified in advance, applying a formula that is tied to an external benchmark. This condition makes it easy to compare the interest available under the sweep program to interest available under other alternatives (all of which would almost assuredly have more risk than an FDIC insured sweep); the transparency will allow market forces to protect against conflicts of interest. Moreover, the requirement to specify a benchmark limits the Plan Provider's discretion to make changes. The benchmark provides more transparency and certainty than is available to consumers who are shopping for checking and other bank deposit accounts; and it provides more transparency and certainty than is available for deposits permitted by ERISA § 408(b)(4).
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- The party that determines the interest rate formula (the Plan Provider) has no control over the allocation of cash among participating banks. Accordingly, it is not possible to manipulate the allocation to increase the Plan Provider's fee.
- The party responsible for engaging banks and setting the sequence for allocation among the participating banks (the sweep administrator) receives a level fee that is not affected by which banks are used. Accordingly, it is not possible to manipulate the sequence to increase the sweep administrator's fee.

ii. Transparency and flexibility. As discussed above, the proposed conditions are designed to ensure transparency with respect to the interest rate formula and fees, and sufficient flexibility for the participant to make a change at any time. The material features of the sweep are disclosed in advance and easy to understand and compare to other alternatives (interest rate and FDIC insurance, and liquidity). Unlike with a long-term retirement investment, even a participant who does not read the initial disclosures can opt out later (for example, after receiving an account statement that shows actual interest credited and compensation from the sweep), without material harm. Transfers are permitted at any time and there is no risk of loss during the period from the first sweep until a change is requested; and because the exemption is designed for cash pending investment or withdrawal, the difference in return among competing products should not have a material impact on long-term savings.

iii. Reasonable compensation. Like ERISA § 408(b)(2) and the Best Interest Contract exemption, our proposal requires that the total compensation paid to service providers be reasonable (see condition #6). In addition, as discussed in paragraph 0, above, the proposed exemption requires specific safeguards against elevating the Plan Provider's potential compensation over participants' interests.

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We appreciate the opportunity to respond to the Department's RFI. We would welcome an opportunity to discuss our proposal in more detail and to work with the Department to address any concerns in a constructive way.

Sincerely,



Mark P. Jacobsen

