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VIA ELECTRONIC MAIL

August 7, 2017

Office of Exemption Determinations
Employee Benefits Security Administration
Attn: D-11933
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: Examination of Fiduciary Rule (RIN 1210-AB82)

Vanguard[1] appreciates the opportunity to respond to the Department of Labor's (the "Department") Request for Information ("RFI") Regarding the Fiduciary Rule and Prohibited Transaction Exemptions (the "Rule").[2] As outlined in our previous letters to the Department, Vanguard welcomes the Department's thoughtful reexamination of the Rule and encourages the Department to modify the scope of its definition of investment advice and certain operational aspects of the Rule in a way that will preserve important investor protections and protect investor access to high-quality investment advice, information and education.

Vanguard strongly believes that investors should always receive investment advice that is in their best interest, and that those who provide true investment advice should be held to a fiduciary standard. By adopting an updated Rule with the changes outlined below and in our prior comments, the Department will better promote quality investment advice and preserve access to critically important investment information and education in a cost-effective way.

Vanguard appreciates the Department's willingness to consider changes to the Rule and new exemptions because professional investment advice and education are essential components of retirement planning for many plans, participants and IRA investors (collectively, "Retirement

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[1] Vanguard is one of the world's leading asset managers, managing over $4 trillion for institutional and retail investors. Vanguard manages over $1 trillion in defined contribution and defined benefit plan assets and provides recordkeeping and administrative services for over 4 million participants in over 8,400 defined contribution plans. We also managed over $600 billion for over 6 million individual retirement account ("IRA") investors. We provide fiduciary investment advice to IRAs and other clients through Vanguard Personal Advisor Services, which currently has approximately $80 billion in assets under advisement across all client types. We also provide fiduciary investment management to retirement plan participants through the Vanguard Managed Account Program, an investment management service based on systems and methodology developed and maintained by Financial Engines Advisors, LLC. Vanguard Managed Account Program manages over $20 billion on a discretionary basis.

[2] 82 Fed. Reg. 31278 (July 6, 2017); 81 Fed. Reg. 20946 (Apr. 8, 2016).

Investors").[3] This review provides the Department an opportunity to revise the Rule to better promote investment advice and education and support future innovation in the market. As currently drafted, we are concerned that the Rule will reduce investor access to investment advice and education and will result in increased costs of service, ultimately reducing retirement wealth.

Accordingly, we encourage the Department to revise the Rule as described in our prior comments and as follows:

- ***The definition of investment advice should exclude recommendations to increase retirement savings and modify extreme allocations.*** As we have noted in prior comments, Retirement Investors benefit from simple and actionable educational messages to save more for retirement using balanced portfolios, and the Rule may undermine retirement security if it includes these communications in the scope of investment advice.
- ***The definition of investment advice should exclude communications between sophisticated counterparties, such as financial institutions.*** Requiring disclosures and disclaimers between financial institutions impedes the exchange of information about products and services and does not serve to protect or promote the interests of Retirement Investors.
- ***The Best Interest Contract ("BIC") Exemption should be significantly simplified by limiting it to the Impartial Conduct Standards, removing the Exemption's provisions encouraging litigation as a means of enforcement, and expanding the Exemption to cover more Retirement Investors and services.*** As we have described in prior comments, the Department can effectively address conflicts of interest and promote broader access to investment advice by limiting its conditions to the Impartial Conduct Standards[4] and eliminating an enforcement system that substitutes litigation for direct oversight by the Department, Internal Revenue Service and Securities and Exchange Commission ("SEC"). The BIC Exemption should also be expanded to cover services provided to large plan sponsor clients and robo-advice services provided to Retirement Investors. The

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[3] Our comments are intended not only to respond to certain of the Department's specific questions in the RFI but also to supplement our prior comments to the Department following the President's Memorandum directing the Department to prepare an updated economic and legal analysis considering whether, among other things:

(1) the Rule harms investors due to reduced access to retirement savings products, information or advice;

(2) the Rule has resulted in dislocation or disruptions within the retirement services industry that may adversely affect investors and retirees; and

(3) the Rule is likely to cause increased litigation and cost to investors to access retirement services.

If the record demonstrates that the Rule has caused any of these effects, the Department must issue a new proposal to revise or rescind the Rule. 82 Fed. Reg. 9675 (Feb. 7, 2017).

[4] Compliance with the Impartial Conduct Standards requires that the advisor:

(1) provide investment advice that is in the best interest of the Retirement Investor;

(2) charge no more than reasonable compensation; and

(3) not make any materially misleading statements about any matters relevant to a Retirement Investor.

distinctions in the BIC Exemption unduly complicate compliance and innovation in the delivery of investment advice – increasing cost and reducing access to services – and do not materially promote Retirement Investors' interests or meet their expectations.

- ***The Department should adopt a streamlined exemption providing flexible, principles-based conditions for arrangements that are designed to mitigate individual conflicts of interest and promote transparency.*** Streamlined exemptions should be based on principles that mitigate individual conflicts and increase transparency rather than particular product types (such as "clean shares" or "T shares"). By adopting a principles-based approach, the Department can foster continued innovation in the products and services provided to Retirement Investors while promoting approaches that reduce conflicts of interest and increase transparency.
- ***The Department should consider additional changes to the Rule and coordinate with the SEC as it reevaluates the standard of care for retail investors to better harmonize investor experience across different types of accounts.*** Vanguard welcomes SEC Chairman Jay Clayton's efforts to reconsider the standard of care applicable to broker-dealers and appreciates the Department's willingness to engage with other regulators to better harmonize investor experience in retirement and non-retirement accounts. As part of those efforts, the Department should consider ways to explicitly harmonize the Rule with a revised standard of care, including streamlined exemptive relief that would deem compliance with SEC standards as satisfaction of certain conditions of the Rule. Similar standards applied across retirement and non-retirement accounts will be easier for investors to understand and will ultimately better serve all investors' interests.

I. The Department should exclude recommendations to save more for retirement and investment communications between sophisticated entities from the definition of investment advice to reflect investor expectations

In prior comments, we asked the Department to revise the definition of investment advice to better reflect reasonable investor expectations. We continue to advocate for the more meaningful changes to the definition we have requested in the past. Specifically, we have proposed that a Retirement Investor's reasonable expectations should be a factor in defining whether communications are considered fiduciary investment advice. A service provider should not be a fiduciary unless the Retirement Investor reasonably believes that he or she is receiving investment advice. In this letter, however, we appreciate the opportunity to address two cases where the Department has requested specific comments: recommendations to Retirement Investors to save more for retirement and investment communications between sophisticated financial institutions.[5]

These cases illustrate the unintended consequences of an overly-broad definition of investment advice. As we describe in more detail below, at a minimum, the Department should exclude recommendations to save more for retirement or modify extreme asset allocations and

[5] *See* RFI questions 14 and 18.

communications between sophisticated parties from the definition of investment advice. These changes will help the Department more effectively regulate fiduciary investment advice while ensuring that Retirement Investors still have access to the investment education and advice that is critical to their investment success.

A. Recommendations to save more for retirement or modify extreme asset allocations should not be considered fiduciary investment advice

The majority of Retirement Investors rely on investment education, including nudges (described below), to help them overcome inertia and understand the importance of steady retirement savings.[6] Importantly, the Department has recognized the value of investment education by providing a specific carve-out for education including, among other things, specific plan information and guidance about the benefits of participating in a retirement plan. Subsequently, the Department provided interpretive guidance addressing whether recommendations to save more for retirement should be considered investment advice in the form of answers to multiple frequently asked questions.[7] We appreciate the Department's continued willingness to consider this question. We urge the Department to formalize the guidance by providing a definitive carve-out in the Rule for recommendations to enroll in a retirement plan, contribute more to a retirement account, or consider modifying extreme asset allocations by investing in a plan's qualified default investment alternative ("QDIA"). As discussed in more detail below, this carve-out is consistent with the structure and objectives of the Employee Retirement Income Security Act ("ERISA") and the Rule, will help Retirement Investors improve their retirement savings, and does not raise material conflict-of-interest concerns.

As we observed in earlier comments, for those participants who are not covered by default provisions and who do not use or have access to investment advice, simple and actionable educational messages to save more for retirement or modify extreme asset allocations are important tools to improve retirement outcomes. These "nudges" are most effective when they are clear, individually targeted and actionable. Guidance that limits recommendations to save

[6] *See* Vanguard's April 17, 2017 comment letter (the "April 17, 2017 Letter"), available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-AB79/01370.pdf, for specific examples and research regarding the value and necessity of investment education for Retirement Investors. *See also* Financial Advice Market Review Final Report (Mar. 2016) at p. 19, available at https://www.fca.org.uk/publication/corporate/famr-final-report.pdf (finding that the advice gap that followed investment advice reforms in the United Kingdom could be addressed by, among other things, encouraging the development of nudges).

[7] Conflict of Interest FAQs (Part II - Rule), Q&A-10 (Jan. 2017), available at https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-rules-and-exemptions-part-2.pdf; Conflict of Interest FAQs (Transition Period, Q&A-12 (May 2017) available at https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-transition-period-1.pdf.; Conflict of Interest FAQs (408B-2 Disclosure Transition Period, Recommendations to Increase Contributions and Plan Participation), Q&A-2 (Aug. 2017), available at https://www.dol.gov/sites/default/files/ebsa/about-ebsa/our-activities/resource-center/faqs/coi-transition-period-2.pdf.

more to particular circumstances will inhibit continued innovation that can promote greater financial awareness, engagement and retirement security among Retirement Investors.

In this regard, the Department issued additional guidance reviewing these kinds of actionable, targeted messages, clarifying that certain communications about the benefits of participating in a plan and increasing contributions are non-fiduciary investment education or general information. The Department's guidance to date, while providing certainty for some activity, has not provided a conclusive answer that recommendations to save more for retirement are excluded from the definition of investment advice.

While the guidance is very helpful, the question raised by the FAQs should be more definitively addressed by confirming in a revised rule or the preamble that recommendations to begin participating in a retirement plan or contribute more to a retirement account do not fall within the scope of the existing definition of investment advice. In the most recent FAQs, the Department provided additional clarity that such "save more" communications are not investment advice as long as no specific investments or investment strategies are mentioned. The Department appeared to base its position on the existing investment education carve-out under the Rule. Alternatively, the Department could reach this conclusion based on the current definition of investment advice, which limits covered advice to recommendations with respect to the management of a retirement account. Where a Retirement Investor has not started to participate in a plan, or is not contributing enough to that retirement account, recommendations to save more do not cover assets within a retirement account. Instead, those recommendations cover the Retirement Investor's decisions with respect to personal assets – how they choose to spend or save individual wages.

Similarly, in the context of investment allocations, the Department has confirmed that plans may default participants into a QDIA selected by the plan sponsor without any affirmative direction from the participant.[8] Nudges from the recordkeeper or other plan service provider to invest in the same QDIA selected by the plan sponsor can provide the same benefits and should be carved out from the definition of investment advice.[9] It is possible to invest participants' assets in a QDIA without affirmative participant direction; it should be possible to nudge participants to affirmatively decide to invest in a QDIA.

B. Interactions with sophisticated counterparties should not be considered fiduciary activity in the absence of a specific agreement

The Department should clarify that communications between sophisticated financial institutions should not be considered fiduciary activity unless the parties enter into a specific agreement to the contrary. The Department can accomplish this by expanding the carve-out for

[8] *See* 29 C.F.R. § 2550.404c-5; 72 Fed. Reg. 60452 (Oct. 24, 2007).

[9] Vanguard's research indicates that QDIA usage, particularly the use of target date funds, has significantly improved participant investment allocations compared with non-target date investors, who are much more likely to hold extreme portfolios that are either not invested in equities or invested entirely in equities. *How America Saves 2017*, pp. 71-74 (June 2017) available at https://institutional.vanguard.com/iam/pdf/HAS17.pdf.

communications to independent fiduciaries with financial expertise (the "Independent Fiduciary Exception" or "IFE") to broaden the scope of communications that will not be considered recommendations and eliminate unnecessary written disclaimers between sophisticated entities.

Currently, the IFE exempts communications to certain types of financial institutions, but it imposes a number of conditions, requiring a disclosure by the entity relying on the exception of their non-fiduciary status and confirmation that the recipient is (1) a fiduciary of the plan, (2) capable of evaluating risk, both in general and with respect to the specific transaction under consideration, and (3) responsible for exercising independent judgment in evaluating the transaction.[10] These conditions impede the beneficial flow of investment information between sophisticated investment providers and have created a flurry of disclosures and counter-disclosures between lawyers for these firms that does not inform or educate the Retirement Investors that the Rule was developed to protect.

More specifically, we do not believe it is helpful to require specific disclosures or representations between financial institutions or their representatives, whether or not they are serving as fiduciaries to any plan. These entities, by definition, are all financially sophisticated and should not need a specific disclosure to understand that an investment provider is not undertaking to provide impartial investment advice to another financial institution unless it has explicitly assumed fiduciary duties, such as through an investment advisory agreement. Similarly, investment providers should be presumed able to understand another investment provider's role as a counterparty in a transaction and to independently evaluate the investment risks of any proposed transaction. These changes will simplify compliance without reducing protections for Retirement Investors or changing the duties owed directly to them by their service providers.

II. The Department should simplify the BIC Exemption and make it broadly available to all Retirement Investors

The Department can effectively address conflicts of interest and promote broader availability of fiduciary advisory services by substantially simplifying the conditions of the BIC Exemption. As we have suggested in prior comments, the Department should limit the BIC Exemption's requirements to the Impartial Conduct Standards, removing the contract and warranty provisions that encourage enforcement through litigation. The existing regulatory enforcement mechanisms embodied in ERISA and the Internal Revenue Code (the "Code") are sufficient incentive for investment providers to comply with the Impartial Conduct Standards.

A revised BIC Exemption focused on the Impartial Conduct Standards would protect Retirement Investors while encouraging greater access to fiduciary investment advice. This simplified approach provides Retirement Investors substantially all of the economic protections of the Rule and can improve client experience by promoting consistent disclosures based on existing

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[10] Other than the $50 million minimum, the IFE imposes the same requirement for communications to a plan's professional advisers. *See* April 17, 2017 Letter regarding the $50 million distinction and specifically addressing a broader seller's carve-out.

disclosure requirements.[11] It would also give service providers a more workable compliance approach that would better reflect the Department's stated objective of adopting a principles-based exemption.[12] A principles-based approach would be more adaptable to new business models and advances in retirement products and services (such as clean shares), and would improve harmonization with other exemptions the Department has amended to include the Impartial Conduct Standards.[13]

Further, this approach would eliminate the Department's reliance on litigation as a primary means of enforcement by removing the contract and warranty requirements. As we have previously commented, the BIC Exemption's unprecedented requirement that IRA advisors seeking to rely on it agree to class-action litigation in state court to enforce the requirements of the Exemption is a significant deterrent to its use.[14] This condition is not found in any other prohibited transaction exemption, and the Department's rationale for its approach in the BIC Exemption is unconvincing. Under a revised BIC Exemption that is focused on the Impartial Conduct Standards, advisors would be required to act in the best interests of the Retirement Investor and refrain from providing any investment advice that would lead to the advisor, its affiliates and the financial institution receiving more than reasonable compensation. These conditions are sufficient to protect Retirement Investors.[15]

Financial institutions already expend significant resources on compliance with the Department's existing exemptions to avoid the serious consequences of a prohibited transaction. The prohibited transaction rules under ERISA, the severe tax penalties imposed under the Code for violations and the reputational consequences of prohibited transactions have long served as powerful incentives for financial institutions and their representatives to comply with applicable exemptions. A contract or warranty requirement is not necessary to promote compliance with a prohibited transaction exemption and will significantly limit use of the BIC Exemption to provide investment advice, ultimately reducing Retirement Investor access to those services.

Additionally, as we have previously commented, one of the more challenging aspects of the BIC Exemption is its inconsistent and inefficient approach to different types of clients and services. The exemption includes arbitrary restrictions on reliance that vary depending on the method used to deliver investment advice, subject of the recommendation and client size (generally prohibiting reliance with respect to robo-advice to participants and plan sponsor relationships that exceed $50 million in assets). As the Rule is drafted, advisors must design their advice programs to meet different conditions under different exemptions, requiring different disclosures at different points of engagement with the client, different contracts, and different oversight by

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[11] As noted in Vanguard's July 21, 2015 comment letter ("July 21, 2015 Letter") on the proposed BIC Exemption, available at https://www.dol.gov/sites/default/files/ebsa/laws-and-regulations/rules-and-regulations/public-comments/1210-ZA25/00149.pdf, any disclosure requirements under the BIC Exemption should leverage existing disclosure requirements under other regulations, such as plan sponsor and participant fee disclosures under ERISA or investor disclosures required under securities laws.
[12] *See, e.g,*, Preamble to the BIC Exemption, 81 Fed. Reg. at 21002-3.
[13] 81 Fed. Reg. at 21139 *et seq.*
[14] *See* July 21, 2015 Letter.
[15] *See* 82 Fed. Reg. 16902, 16906 (Apr. 7, 2017) (recognizing that these conditions provide substantial benefits to explain extension of the Rule's applicability date and phased implementation of the BIC Exemption's conditions).

internal or external parties. These arbitrary differences do not provide additional protections to Retirement Investors, and are likely to limit ongoing innovation in investment advisory services, ultimately limiting access to investment advice for some investors and increasing cost for others. While the Department did not request comment on this specific question in the RFI, we emphasize the need for these changes and encourage the Department to adopt them.

Large firms serve a wide spectrum of institutional and retail Retirement Investors with a wide range of preferences, from traditional in-person advice to online tools and recommendations, and naturally offer a range of investment advice programs to cater to these different preferences. A BIC Exemption that we could apply across our client base would simplify compliance efforts and benefit Retirement Investors through lower costs and a more consistent experience. Client characteristics, needs and preferences rarely remain static for the duration of a client relationship. The conditions that apply to define and permit investment advice to meet those changing characteristics and needs should be flexible enough to apply to a broad range of circumstances. The Department should encourage investment advice by allowing advisors to rely on the BIC Exemption to provide fiduciary investment advice to all types of Retirement Investors for the duration of their relationship with the service provider.[16]

III. The Department should consider flexible streamlined exemptions that encourage and support innovation

The changes we have requested to simplify the BIC Exemption would simplify compliance and expand the availability of investment advice to Retirement Investors. In the absence of these material changes to the BIC Exemption, we encourage the Department to develop new streamlined exemptions that will protect Retirement Investors from conflicts of interest and promote better understanding of retirement products and services, while fostering continued innovation and development in the investment marketplace.[17]

If the Department pursues this approach, it is imperative that streamlined exemptions be based on principles and general characteristics of products and services that protect Retirement Investors and promote innovation, rather than limiting available relief to particular types of products that exist, or are being contemplated, today.

In particular, we note that the Department identified product innovations such as clean shares and T-shares in its RFI. It is important to recognize that these products are still being refined and have not yet been implemented or adopted by the industry. Such product innovations are designed to mitigate the conflicts of interest individual investment advisors face when they receive compensation that varies based on the investments they recommend. While these products may be one helpful way to mitigate conflicts, the Department should not limit future streamlined exemptions to specific investment products.

[16] *See* April 17, 2017 Letter for more detail about the negative impacts created by the limitations of the BIC Exemption to individual Retirement Investors and plan sponsor fiduciaries controlling less than $50 million in assets.

[17] Our comments in this section are intended to respond to RFI Questions 7, 9, and 10.

The Department has long understood the danger of crafting class exemptions tailored to specific products or services that may be popular at a particular moment in time. This recognition of the need for principles-based relief has fostered extraordinary innovation leading to improved retirement outcomes for millions of Americans. Limiting streamlined exemptive relief to a particular product, rather than focusing on the characteristics of the product that mitigate particular conflicts, would deter continued innovation in products and services to the detriment of Retirement Investors. For example, an exemption that specifically references the recent SEC guidance on clean shares would exclude from relief advice with respect to investments not regulated by the SEC, such as collective trusts. Instead, we believe the Department should direct its streamlined relief to the characteristics that protect Retirement Investors – here, the elimination of compensation to the investment advisor that varies on the basis of the advisor's recommendations. By developing streamlined relief for a broader category of advisory arrangements structured to pay level compensation to the individual advisor, the Department will encourage continued innovation while simplifying compliance for the products that have developed to promote level compensation today. This approach is a more effective and flexible way to protect Retirement Investors as the market continues to evolve.

IV. The Department should consider additional changes to the Rule and coordinate with the SEC as it reevaluates the standard of care for retail investors to better harmonize investor experience across different types of accounts

Vanguard fully supports the Department's efforts to move forward with its examination of the Rule and to engage with other regulators to better harmonize the Rule's implementation and effects on investor experience in retirement and non-retirement accounts.[18] We encourage coordination between and among the Department, the SEC and FINRA as each moves forward with fiduciary guidance. In particular, we are encouraged by SEC Chairman Jay Clayton's efforts to reconsider the standard of care applicable to broker-dealers. We strongly encourage the Department to work closely with the SEC and to consider modifications to the Rule that reflect changes in SEC regulation to protect retail investors and Retirement Investors.

Because investors benefit from a consistent experience regardless of account type, each agency should strive to apply consistent principles wherever possible. SEC leaders have indicated they welcome joint agency efforts, noting the SEC itself needs to update its assessment of the current regulatory framework, the market for retail investment advice and market trends. Notably, SEC Chairman Clayton identified "clarity and consistency—and in areas overseen by more than one regulatory body, coordination" as key elements to effective oversight and regulation.[19] We urge the Department to embrace the SEC's invitation to coordinate. Such coordination will help align investor expectations and provide clarity and a consistent workable framework for advisers and Retirement Investors.

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[18] *See* RFI Question 11.

[19] Public Statement of SEC Chairman Jay Clayton, *Public Comments from Retail Investors and Other Interested Parties on Standards of Conduct for Investment Advisers and Broker-Dealers* (June 1, 2017) available at https://www.sec.gov/news/public-statement/statement-chairman-clayton-2017-05-31.

As part of that coordination, the Department should consider ways to explicitly harmonize the Rule with a revised standard of care, including streamlined exemptive relief that would deem compliance with SEC standards as satisfaction of certain conditions of the Rule. If an investment advisor, broker-dealer or representative is complying with SEC obligations requiring them to act in an investor's best interest by acting prudently, adhering to duties of loyalty and care, and providing clear disclosures of compensation and conflicts of interest, those advisors should be deemed to satisfy similar conditions the Department may impose as part of a streamlined BIC Exemption. We welcome additional opportunities to work with the Department and SEC as they continue to consider more coordinated requirements.

At the same time, we believe the Rule should not be delayed by the lack of consensus among other regulators about fiduciary status or who should act first, for which accounts and how. The Department should move forward with the Rule and remove unnecessary obstacles that complicate compliance and access to investment advice, education and information, as we have outlined in this letter and our prior letters to the Department. Without these changes, Retirement Investors will face reduced access to retirement products and services, and those that remain available will be costlier, more complex and more fragmented.

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Vanguard appreciates the opportunity to submit these comments and would welcome further discussion with the Department. If there you have any questions or wish to discuss in greater detail, please do not hesitate to contact Ann Combs at 610-503-6305 or Stephanie Napier at 610-503-1377.

Sincerely,

F. William McNabb III
Chairman and Chief Executive Officer
The Vanguard Group, Inc.