

Morgan Lewis

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Office of Exemption Determinations
Employee Benefits Security Administration
(Attention: D-11712, 11713, 11850)
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

Re: Proposed Extension of Transition Period and Delay of Applicability Dates for Prohibited Transaction Exemptions 2016-01, 2016-02, and 84-24; Contract Requirements and Brokerage Account Bulk Transfers

Ladies and Gentlemen:

Morgan, Lewis & Bockius LLP ("Morgan Lewis")¹ appreciates the opportunity to comment on behalf of some of its financial services clients ("Clients") on the Department of Labor ("Department") proposal to delay the applicability date of certain conditions of the Best Interest Contract Exemption and the Principal Transaction Exemption (collectively, the "exemptions"), including the requirement that financial institutions obtain customer signatures on contracts required under the exemptions.

Our Clients support the Department's proposal to delay the applicability date of the additional conditions of the exemptions to no earlier than July 1, 2019.² Further, our Clients are concerned that the customer signature requirement presents numerous operational issues while offering little added legal protection to retirement investors receiving advice pursuant to the exemptions.

Moreover, the customer signature requirement is, in the case of "bulk transfers" of brokerage accounts from one broker-dealer to another, in conflict with securities laws and regulations that permit customers to agree to such transfers by negative consent. For the reasons explained below, we urge the Department to amend the exemptions to eliminate the customer signature requirement and permit financial institutions to unilaterally agree to any contractual

¹ Morgan Lewis is an international law firm with extensive financial services, investment management, fiduciary and employee benefits practices. We assist service providers, including broker-dealers, investment advisers and consultants, banks and trust companies, recordkeepers, and third party administrators with ERISA and Internal Revenue Code compliance and reporting obligations. As such, many of our clients' service arrangements with retirement investors will face the issues raised in this letter.

² Morgan Lewis is filing a separate comment letter on its own behalf on the proposed delay.

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provisions required under the exemptions, or, at a minimum, to harmonize these requirements with the securities laws—particularly in the case of bulk transfers.

The Department should eliminate the customer signature requirement. Requiring customer signatures causes significant operational issues and expenses (*e.g.*, with respect to the timing of opening accounts, maintaining records of signed documents, and supervision and surveillance of the signature requirement), with little legal benefit. As the Department acknowledged in the release of the final exemptions, numerous commenters on the proposed exemptions advocated for permitting financial institutions to unilaterally agree to any required contract provision, or to permit customers to enter into such agreements by negative consent.³ We agree with these commenters.

Contracts entered into by negative consent are widely recognized as legally enforceable, thereby providing the protections that the Department is seeking to create under the exemptions.⁴ Moreover, because the exemptions require that each customer be provided with a copy of his or her contract, including on a website, customers will have evidence that the contract applies to them.⁵

At a minimum, the Department should amend the exemptions to harmonize the customer signature requirements with FINRA rules—particularly in the case of "bulk transfers." As the Department works to coordinate with other financial industry regulators on the standards that apply to investment services to retail investors, we urge the Department to seek to harmonize its rules with the securities and other laws applicable to financial institutions. As explained below, such harmonization would be particularly beneficial with respect to the contract requirements that apply to bulk transfers of customer brokerage accounts.

- ***What is a "bulk transfer" and what rules apply under FINRA's guidance?***
FINRA guidance permits broker-dealers to transfer customer accounts to another

³ Preamble to BIC Exemption, 81 Fed. Reg. 21,002, 21,025 (Apr. 8, 2016).

⁴ A negative consent process results in a unilateral contract. See RESTATEMENT (FIRST) OF CONTRACTS § 12 cmts. b-c (1932) ("In many cases... a promise becomes a contract even though no return promise is made by the promisee. In such cases the legal duty is unilateral, resting on the promisor alone. The correlative legal right is also unilateral, being possessed by the promisee alone."); Joseph M. Perillo, CORBIN ON CONTRACTS § 1.23 (2017) ("In the case of a unilateral contract, there is only one promisor. The legal result is that the promisor is the only party who is under an enforceable legal duty. The other party to this contract is the one to whom the promise is made, and this promisee is the only one in whom the contract creates an enforceable legal right."). As these sources describe, the promisor's promise becomes a binding and enforceable contract when the party receiving the promise – the promisee – takes an action that signifies its assent to the promise.

⁵ As the Department noted in discussing the negative consent approach for existing contracts under the exemptions, "this approach will still result in the Retirement Investor receiving clear evidence of the contract terms and their applicability to the Retirement Investor's own account or contract." 81 Fed. Reg. 21,002, 21,025.

broker-dealer in bulk without first obtaining affirmative consent from the customer in certain limited circumstances.

- FINRA established bulk transfer procedures in NASD Notice to Members 02-57 (the "Notice") to allow for the efficient transfer of customer accounts.
- Circumstances in which negative consent may be used to effect bulk transfers include where:
 - A firm becomes insolvent, or is experiencing other financial or operational difficulties and needs to transfer customer accounts to a new broker-dealer;
 - A firm goes out of business, or merges with, or is acquired by, another broker-dealer;
 - A bank changes its networking arrangement to a new broker-dealer; and
 - An introducing broker-dealer changes its clearing broker-dealer.
- FINRA's intention in adopting its bulk transfer guidance was to protect investors by:
 - Addressing potential risks and costs that could result if firms were required to solicit individual transfer instructions from each customer;
 - Minimizing interruptions to customer account access and the trading markets; and
 - Addressing the practical issues arising from the fact that the successor broker-dealer cannot generally solicit new documentation until the transfer date, because the account does not become a customer of the successor broker-dealer until such date.
- The Notice establishes procedures for customers to agree to the transfer of their accounts by negative consent:
 - The Notice recommends that firms provide customers with certain disclosures regarding the transfer of their accounts.
 - The Notice recommends that firms provide customers with sufficient advance notice so that customers can terminate their agreements and transfer accounts to another firm if they object to the transfer—at least 30 days prior to the transfer, absent exigent circumstances.
 - Typically, successor firms have the transferred customers execute the successor firm's own documents, rather than relying on the prior firm's

documents, within a relatively short time period after the bulk transfer, such as 90 days.

- ***The efficiencies and investor protections FINRA intended to provide for bulk transfers will be lost if firms are forced to obtain customer signatures in connection with the exemptions.*** If a firm desires to effect a bulk transfer following FINRA's procedures, which allow for negative consent, the firm would still need to obtain executed contracts from customers prior to providing investment advice and recommendations with respect to transferred retirement accounts under the current terms of the exemptions. This obviates the efficiencies and investor protections that FINRA provided by allowing bulk transfers under these procedures, potentially leaving investors without access to advice on their retirement assets after the transfer occurs and before signatures are obtained, and may also impede merger and acquisition activity in the financial services industry.⁶

For the reasons set forth above, the Department should amend the exemptions to eliminate the customer signature requirement and to allow for a negative consent notice with respect to any contract requirements.

Alternatively, a balanced approach to addressing the issues the exemptions raise with respect to bulk transfers would be to amend the exemptions to harmonize these requirements with the FINRA rules on bulk transfers.⁷ So long as firms otherwise comply with the other conditions of the exemptions (including the impartial conduct standards) when providing investment advice and recommendations to retirement investors, and follow FINRA's guidance on bulk transfers, retirement investors will have the legal protections the DOL intended to create under the exemptions.

⁶ We note that merger and acquisition activity in the financial services industry is expected to increase substantially, making this an issue that could negatively impact a large number of retirement investors by potentially depriving them of access to advice on their retirement assets. See Emily Zulz, Number of RIA Deals Could Reach Triple Digits in 2017: Schwab (Sept. 8, 2017), available at http://www.thinkadvisor.com/2017/09/08/number-of-ria-deals-could-reach-triple-digits-in-2?eNL=59b2e184150ba04d2df334ee&utm_source=TA_DailyWire&utm_medium=EMC-Email_editorial&utm_campaign=09082017.

⁷ We note that this approach would be consistent with the current requirements under the exemptions with respect to existing customers. Specifically, the exemptions permit contracts existing and in effect prior to January 1, 2018, to be amended by negative consent. The Department's stated rationale for allowing this negative consent process is "to avoid the burdens associated with signatures from a large number of already-existing clients." The same rationale would apply to "bulk transfer" situations, which also may affect all, or a significantly large number, of a financial institution's existing clients.

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Thank you for your consideration of this request. If you have any questions or require any additional information, please do not hesitate to contact us:

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Sincerely,



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cc: Daniel R. Kleinman
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