via electronic mail: e-ori@dol.gov

Friday, March 18, 2011

Office of Regulations and Interpretations
Employee Benefits Security Administration
Attn: Definition of Fiduciary Proposed Rule
Room N-5655
U.S. Department of Labor
200 Constitution Avenue, N.W.
Washington, D.C. 20210

RE: COMMENTS ON PROPOSED RULE
DEFINITION OF THE TERM "FIDUCIARY"
29 CFR PART 2510

Dear Sir or Madam:

I am the principal and chief investment officer of Chao & Company, Ltd., an SEC registered investment advisor. Chao & Company provides independent investment advice and discretionary investment management services to plan sponsors subject to the Employee Retirement Income Security Act of 1974 (ERISA), among other services. We serve in a fiduciary or co-fiduciary capacity in assisting our plan sponsor clients in meeting their respective investment fiduciary obligations and responsibilities on a one time or ongoing basis. Typically, Chao & Company is compensated directly by the plan sponsor client on a pre-negotiated fixed fee basis for the agreed to services. We understand and adhere to the duty of undivided loyalty, the duty to act for the exclusive purpose of the plan, and that the duty of care stems from the prudent man standard.

We believe that transparency and disclosures alone are insufficient to meet these duties imposed under ERISA. ERISA fiduciaries must adhere to the highest standard of care in meeting their solemn obligations owed to the plan participants and beneficiaries as so envisioned under ERISA. Further, we believe that by minimizing exceptions under the current fiduciary definition, ERISA plan participants and beneficiaries will benefit more from the regulatory protection.

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I am writing in support of the Department's proposed framework to reexamine the types of advisory relationships that should give rise to fiduciary duties on the part of those providing advisory services. This is a necessary and logical component to the Department's multi-year effort to establish uniform reporting and transparency standards. On a uniformed basis, service providers will be required to report data to all plan sponsors and plan sponsors in turn must disclose to plan participants and beneficiaries all relevant information, empowering plan sponsors to be more informed and better able to serve as ERISA fiduciaries. The proposed redefinition of "fiduciary" will attempt to close the door thereby disallowing individuals and entities to provide investment advice to plan assets while disclaiming the fiduciary status.

ERISA is designed to promote the interests of participants in employee benefit plans and their beneficiaries by establishing standards of conduct, responsibility, and obligation for fiduciaries of those plans. ERISA intends to protect the interests of plan participants and beneficiaries by holding those parties-in-interest responsible for their actions and inactions. The current regulation uses the five-part test to narrowly determine if a person should be deemed or included as an investment fiduciary under ERISA section 3(21)[A](ii):

Test 1 - Renders advice as to the value of securities or other property, or make recommendations as to the advisability of investing in, purchasing or selling securities or other property[i]
Test 2 - on a regular basis
Test 3 - pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary, that
Test 4 - the advice will serve as a primary basis for investment decisions with respect to plan assets, and that
Test 5 - the advice will be individualized based on the particular needs of the plan.

This means that a person would only be deemed an investment fiduciary if the person meets all five tests. This rule based approach in determining investment fiduciary status has created an environment that permits individuals and entities to cleverly avoid the application of any one of the five test to escape being labeled as an investment fiduciary and subject to the higher standard of care and ERISA's enforcement under Section 502. One such example would be an investment advisor who offers investment analysis to an ERISA plan sponsor on a one time or non regular basis, such as reviewing the investment options available under the 401(k) plan, and taking the position that such an analysis does not serve as a primary basis for investment decision by the plan sponsor client. The ability of this investment advisor to not adhere to the higher standard, that otherwise is required of a fiduciary, while delivering investment advice to an ERISA plan fiduciary regarding plan assets is a regulatory gap that needs to be closed.

Investment advice offered by an investment fiduciary on a regular or ongoing basis does not necessarily infer that each advice given at any one moment in time is materially different than the advice delivered by the same investment advisor who is hired to deliver investment advice on a one time or non-reoccurring basis. Regardless of the frequency of service engagement, the investment advisor should be held to the same standard. The investment advice must be delivered without any conflict of interest for the exclusive purpose of the plan in a disinterested manner and strictly meet the prudent man standard. The prudent process employed in deriving the investment or investment related decision should be based on the understanding of the plan sponsor, the participants' and beneficiaries' circumstances then prevailing among other pertinent factors. The fact that the investment advice only pertains to a specific issue or plan sponsor objective on a one time basis should not be the differentiator. The frequency of advice has no relevance to such advice meeting the prudent standards and being delivered in the sole and exclusive benefit of the plan.

The current regulation can be interpreted as giving a free pass to investment advisors who are hired on a project or short-term basis or in any way purposefully avoid meeting the five tests constructively. Excluding them from being an ERISA fiduciaries is construed as allowing such advisors to select a lower standard of care when advising plan sponsors regarding their plan assets. This unintended perversion promotes an uneven playing field and maintains a backdoor for those who can game the system at the expense of those the Department of Labor and ERISA intend to protect.

The services offered by bundled service providers should be clearly separated to minimize their exploitation of the current regulations. Since bundled service providers offer recordkeeping services alongside investment platforms (proprietary and non-proprietary investment options), their default position is to avoid being defined as a fiduciary. However, from a functional standpoint, they often take actions that can be considered offering investment advice.
For example, a bundled service provider is asked by the plan sponsor or by the investment intermediary to recommend, nominate, suggest, or otherwise make available one or more investment choices as a new option or a successor option to an existing investment. The bundled service provider typically conducts a search within its investment platform and prepares a report that nominates a number of investment choices. It is possible that the plan sponsor does not use or view the choices as the sole basis for investment decision, but since the investment universe is limited to the platform made available by the bundled service provider, the investment advice given by the bundled service provider in the form of investment alternatives outlined in the report will serve as "a primary basis for investment decisions with respect to plan assets". The fact that the bundled service provider is paid a fee or other compensation, direct or indirect, with respect to any moneys or other property of the plan makes this act an investment fiduciary act. If a bundled service provider wishes to hide behind a non-fiduciary curtain, then the same entity should not be permitted to

take on fiduciary acts at any time or from time to time and not be deemed a fiduciary under ERISA. Many bundled service providers take the fiduciary issue as a marketing advantage. Narrowly defining where and when they are fiduciaries as a way to exploit the current regulation and using such positions as a marketing tool often confuses the financial intermediaries and ultimately the plan sponsors.

Opponents of the proposed regulation suggest that the redefinition of "fiduciary" will 1) increase costs of delivering investment advice (for those advisors who are not currently delivering advice as an ERISA fiduciary), 2) reduce investment product choices to plan sponsors, 3) certainly dwindle down competition in the marketplace and 4) not necessarily improve outcome since the current scheme is working just fine. These consequences, opponents would suggest, are not in the benefit of the plan participants and beneficiaries. In actuality, the opponents are really suggesting that the advisors who can shield themselves, purposefully or otherwise, from being an ERISA advisor can cut corners and deliver investment advice without any regard to the fiduciary standard. This allows them to assess a lower fee or operate at a higher profit by arbitraging the current law. Conflicts of interest, imprudence, self dealing, suitability in lieu of sole benefit standard of care, and opaque compensation arrangements are thus acceptable business conduct for those who can advice a plan sponsor without meeting one of the five tests. This type of bifurcated standard will continue to confuse the plan sponsors and contribute to the possible failure of plan sponsors meeting their own fiduciary duties. Ultimately, and as is often the case, those whom the law intends to protect become the victims.

In the Department's proposed section (c)(2)(i) - Limitations, it states that a person shall not be considered to be an investment adviser fiduciary providing advice or making recommendations under section (c)(1)(ii)(A) if "such person can demonstrate that the recipient of the advice knows or, under the circumstances, reasonably should know, that the person is providing the advice or making recommendation in its capacity as a purchaser or seller of a security or other property, or as an agent of, or appraiser for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice." It is understandable that certain individuals have elected to sell investment products to ERISA plans and do not intend to offer any investment advice, such individuals should not inadvertently be defined as a fiduciary. However, we are troubled by two aspects of the proposed language. If the sales person can demonstrate that the plan sponsor or plan fiduciary who purchased the (1) "advice" knows, or, (2) "under the circumstances, reasonably should know," that the sales person has interests that are adverse to the interests of the plan or its participants or beneficiaries

(1) We are troubled by the word "advice" used in the proposed regulation. If the proposed regulation intends to accommodate financial product sales people in

selling their products and services, then they are not offering "advice" in the context of this section of the proposed regulation. Replacing the term "advice" with "financial products and non-advice services" would be less confusing.

(2) If we operate under the framework that the relevant sections of ERISA intend to minimize harm, intentional or otherwise, that could be brought on by fiduciaries and other parties in interest to an ERISA plan, we suggest that a clear and definitive standard be employed whenever possible. In the preamble of the proposed regulation, the Department noted that "recent Department enforcement initiatives indicate there are a variety of circumstances, outside those described in the current regulation, under which plan fiduciaries seek out impartial assistance and expertise of persons such as consultants, advisers and appraisers to advise them on investment-related matters. These persons significantly influence the decisions of plan fiduciaries, and have a considerable impact on plan investments." As such, we suggest that the lower standard suggested in the proposed language where a plan fiduciary "under the circumstances, reasonably should know, that the [sales] person has interests that are adverse to the interests of the plan or its participants or beneficiaries" should be raised. The plan fiduciary should not be expected to differentiate clear sales tactics from genuine responsible fiduciary advice. We suggest the use of a simple statement from the sales person that simply states that he or she is a financial product or services sales person and does not intend to be a fiduciary to the plan. Once this notice is mutually executed, the plan sponsor has a 48 hour cooling off period before meeting with the sales person regarding his or her products or services. If the statement has not been mutually executed, and services are rendered or products are sold by the sales person, the sales person would be considered an investment fiduciary.

Section 913 of Title IX of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act") requires the U.S. Securities and Exchange Commission (the "SEC") to conduct a study (the "Study") to evaluate:

- The effectiveness of existing legal or regulatory standards of care (imposed by the Commission, a national securities association, and other federal or state authorities) for providing personalized investment advice and recommendations about securities to retail customers; and

- Whether there are legal or regulatory gaps, shortcomings, or overlaps in legal or regulatory standards in the protection of retail customers relating to the standards of care for providing personalized investment advice about securities to retail customers that should be addressed by rule or statute.

On January 21, 2011, the SEC released the Study. It notes that "[t]he regulatory schemes for investment advisers and broker-dealers are designed to protect investors through different approaches. Investment advisers are fiduciaries to their clients, and the regulation under the Investment Advisers Act of 1940 (the "Advisers Act") generally is principles-based. The regulation of broker-dealers governs how broker-dealers operate, for the most part, through the Commission's antifraud authority in the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act"), specific Exchange Act rules, and SRO rules based on Exchange Act principles, including (among others) principles of fairness and transparency."

According to the Study, " Many retail investors and investor advocates submitted comments stating that retail investors do not understand the differences between investment advisers and broker-dealers or the standards of care applicable to broker-dealers and investment advisers. Many find the standards of care confusing, and are uncertain about the meaning of the various titles and designations used by investment advisers and broker-dealers. Many expect that both investment advisers and broker-dealers are obligated to act in the investors' best interests."

Consistent with Congress's grant of authority in Section 913, The Study recommends "the consideration of rulemakings that would apply expressly and uniformly to both broker-dealers and investment advisers, when providing personalized investment advice about securities to retail customers, a fiduciary standard no less stringent than currently applied to investment advisers under Advisers Act Sections 206(1) and (2)."

More specifically, the study recommends that the SEC exercise "its rulemaking authority under Dodd-Frank Act Section 913(g), which permits the [the SEC] to promulgate rules to provide that: the standard of conduct for all brokers, dealers, and investment advisers, when providing personalized investment advice about securities to retail customers (and such other customers as the [SEC] may by rule provide), shall be to act in the best interest of the customer without regard to the financial or other interest of the broker, dealer, or investment adviser providing the advice." The standard outlined here is referred to in the Study as the "uniform fiduciary standard." It is uncertain if the final regulation will adopt the recommendations stated in the Study and it is possible that the fiduciary standard under the Adviser's Act will be eliminated or morphed sufficiently that the harmonized standard weakens the protection afforded to retail investors under the Adviser's Act.

Under the Adviser's Act, "Investment adviser means any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities".[ii] The Study states that "[a]n investment adviser is a fiduciary whose duty is to serve the best interests of its clients, including an obligation not to subordinate clients' interests to its own. Included in the fiduciary standard are the duties of loyalty and care. An adviser that has a material conflict of interest must either eliminate that conflict or fully disclose to its clients all material facts relating to the conflict. In addition, the

Advisers Act expressly prohibits an adviser, acting as principal for its own account, from effecting any sale or purchase of any security for the account of a client, without disclosing certain information to the client in writing before the completion of the transaction and obtaining the client's consent."

In our opinion, the current fiduciary duties under ERISA are a higher standard (more protective to plan participants and beneficiaries) when compared to the standard promulgated under the Adviser's Act for the following reasons, among others:

1. The ERISA fiduciary is expected to operate for the sole and exclusive benefit of the plan which is a higher standard than an obligation not to subordinate clients' interests to the fiduciary's own.

2. An ERISA fiduciary cannot disclose away a conflict of interest unlike the lower standards where an adviser with a material conflict of interest must either eliminate that conflict or fully disclose to its clients all material facts relating to the conflict.

Protecting and applying the ERISA fiduciary standard of care is critical to safeguarding the retirement assets of millions of Americans. We applaud the Department of Labor in its effort to update the regulation since it was first written over thirty years ago. By eliminating inconsistencies and exceptions, the proposed regulation will strengthen investor protection and safeguard the private retirement system going forward.

We support the continuing application of a functional definition for "fiduciary". Thus we agree with a broad scope approach envisioned under the proposed rule. The intent should be to exclude from being considered as fiduciaries those parties that are strictly providing administrative and ministerial duties or offering basic investment information and education services while enveloping those that are delivering any kind of investment advice for a fee or other compensation. We urge the Department to minimize any opportunity for anyone to exploit the current definition for self gain or interest by redefining and delinking the five part test.

Thank you for the opportunity to offer comments regarding the proposed rule. We are available to answer any questions you may have.

Sincerely,
CHAO & COMPANY, LTD.

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Principal
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[i] In 1976, the Department of Labor issued Advisory Opinion 76-65A which excluded valuations of closely held employer securities that an employee stock ownership plan would rely on in purchasing the securities as being offering investment advice.)

[ii] "Investment adviser" definition excludes the following:

A. a bank, or any bank holding company as defined in the Bank Holding Company Act of 1956, which is not an investment company, except that the term "investment adviser" includes any bank or bank holding company to the extent that such bank or bank holding company serves or acts as an investment adviser to a registered investment company, but if, in the case of a bank, such services or actions are performed through a separately identifiable department or division, the department or division, and not the bank itself, shall be deemed to be the investment adviser;

B. any lawyer, accountant, engineer, or teacher whose performance of such services is solely incidental to the practice of his profession;

C. any broker or dealer whose performance of such services is solely incidental to the conduct of his business as a broker or dealer and who receives no special compensation therefore;

D. the publisher of any bona fide newspaper, news magazine or business or financial publication of general and regular circulation;

E. any person whose advice, analyses, or reports relate to no securities other than securities which are direct obligations of or obligations guaranteed as to principal or interest by the United States, or securities issued or guaranteed by corporations in which the United States has a direct or indirect interest which shall have been designated by the Secretary of the Treasury, pursuant to section 3(a)(12) of the Securities Exchange Act of 1934, as exempted securities for the purposes of that Act;

F. any nationally recognized statistical rating organization, as that term is defined in section 3(a)(62) of the Securities Exchange Act of 1934, unless such organization engages in issuing recommendations as to purchasing, selling, or holding securities or in managing assets, consisting in whole or in part of securities, on behalf of others; or

G. such other persons not within the intent of this paragraph, as the Commission may designate by rules and regulations or order.