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Submitted Electronically

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Office of Exemption Determinations, Employee Benefit Security Administration
U.S. Department of Labor
200 Constitution Avenue NW, Suite 400
Washington, D.C. 20210

RE: Z-RIN 1210-ZA29, Improving Investment Advice for Workers & Retirees

Ladies and Gentlemen:

Morningstar welcomes the opportunity to comment on the Proposed Rule "Improving Investment Advice for Workers & Retirees" (Proposed Rule).[1] Morningstar's mission is to help investors reach their financial goals. Because we offer an extensive line of products for individual investors, professional financial advisors, and institutional clients, we have a broad view on the Proposed Rule and its possible effect on the financial advice investors will receive. Specifically, relevant to the Proposed Rule and its impact on retirement investing, we collect data from the Form 5500 and Form 5500-Short Form to provide our clients with information on retirement plans, including identifying the underlying investments. Second, we offer 3(38) fiduciary services to plans through our investment management business.

This letter contains: 1) a summary of our views; and 2) detailed answers to selected questions posed in the preamble to the Proposed Rule.

I. Executive Summary

- We believe the Department of Labor (DOL) should revisit the "regular basis" prong of the five-part test to either eliminate this requirement or presume that it is satisfied in the context of a rollover. The fiduciary standards will not apply to advisors recommending rollovers or other transactions to many Americans who are seeking advice if the five-part test is retained as is. We believe that all advice on individual retirement account (IRA) rollovers should be subject to the proposed prohibited transaction exemption (PTE) and retaining this prong will undermine that goal, and ultimately retirement security, for many plan participants.

- The DOL is increasing confusion and inequity by requiring that investment advice fiduciaries disclose that they are Employee Retirement Income Security Act (ERISA) fiduciaries, without further explanation of what this means and without consideration that investment advice fiduciaries do not have to comply with all of the prohibitions of

[1] United States Department of Labor. 2020. "Improving Investment Advice for Workers and Retirees." https://www.govinfo.gov/content/pkg/FR-2020-07-07/pdf/2020-14261.pdf (Proposed Rule).

ERISA. We recommend that a more helpful disclosure – an expanded version of the Securities and Exchange Commission's (SEC) client relationship summary (CRS) – be provided to all individuals receiving advice on a rollover into an IRA or on an IRA account, and that this document explain an individual's rights and remedies under both SEC and DOL regulations.

- Regarding plan advice, we agree with the DOL that limited plan and IRA lineups, particularly those with options that are either proprietary or provide third-party fees, can present significant conflicts and may not be in the investor's best interest. We believe that the documentation requirements do not go far enough in mitigating this conflict, and the DOL could do more to encourage the use of independent fiduciaries in these cases.

- In addition to IRA rollovers, we think that it is useful for investors to obtain fiduciary advice on health savings accounts (HSAs), in which flows and a percentage of assets being invested have been increasing. Therefore, we believe the Proposed Rule should cover HSAs.

- The Proposed Rule leaves open major questions about enforcement. The DOL should clarify when it will take the lead on enforcement and when it will rely on the SEC to enforce regulations regarding IRA advice. Since the Proposed Rule does not create a private action, unlike the previous rule from 2016, it makes agency enforcement particularly important.

II. The Five-Part Test Should Be Revised to Capture All Rollover Advice

We recognize the importance of consistency and the need for the DOL to align with the SEC in order to promote investor understanding and avoid confusion, and we support the DOL's goal of protecting advice on IRA rollovers. We are glad that the DOL has updated its thinking around rollovers from that expressed in the Deseret letter,[2] where it previously determined that the five-part test would not apply to rollovers; however, we think the DOL could go further to protect all investors receiving rollover advice in a variety of contexts.

Under the Proposed Rule, if a broker is giving one-off advice on a rollover, then the broker does not meet the five-part test. The Proposed Rule should be amended to subject all financial professionals who advise on a rollover to be an investment advice fiduciary. This can be accomplished by removing the "regular basis" prong of the test or assuming that it has been met in the case of an IRA, because individuals and financial professionals often will not know at the time of the advice if the rollover marks the beginning of an ongoing relationship. A rollover is a significant event in the life of an investor and could well serve as the beginning of an advice relationship. Regardless of what the investor may anticipate or not at the time of the rollover, we think that the rollover event should be deemed the beginning of a (if not already part of an existing) relationship with an advice professional. The remaining four prongs are

[2] United States Department of Labor. 2005. "Advisory Opinion 2005-23A – Withdrawn as of 6/29/2020." https://www.dol.gov/agencies/ebsa/about-ebsa/our-activities/resource-center/advisory-opinions/2005-23a.

likely met in the case of rollovers. Disclaimers of "mutual agreement" or of "regular basis" should not be relied upon to take protections away from investors. To strengthen the impact of the proposed PTE, an update to the investment advice fiduciary standards which excludes the "regular basis" prong or presumes it to be true in the case of rollovers should be codified into the rule text. The standard also should be explicitly applied in the rule text to all financial professsionals, including brokers, SEC-registered investment advisors (RIAs), insurance agents, and any other financial professionals likely to interact with individuals regarding a rollover transaction.

The broader applicability of the standard in the Proposed Rule is necessary to prevent investors from receiving conflicted advice. Conflicted advice has been linked to millions of Americans rolling over low-cost 401(k) accounts into higher-cost IRAs and investing in funds with higher expense ratios and loads. We have found that the 2016 DOL rule, even though it never went fully into effect, was associated with a reduction of flows into funds with unusually high payments that created a conflict of interest, which improved outcomes for retirement investors.[3] Similar outcomes have been found for individuals rolling over into high-cost annuities.[4] Given opportunities for revenue-sharing, distribution fees, loads and commissions, and other payments between fund sponsors and distributors, the potential for conflicts, without stringent standards, are numerous and complex.[5] In order to have an impact for investors, this proposal should consistently subject all financial entities that provide advice on an IRA account, whether as a rollover or on a transaction in the account itself, to the proposed PTE.

Rollover advice is nuanced. A financial professional giving advice should consider not just the investor's current portfolio, but the best possible portfolio available to the investor in his or her 401(k) plan. This best option should be used as the benchmark against which to compare the benefits of rolling over to the IRA.[6] Focusing on just the participant's current portfolio may lead to a rollover when a participant is better served staying in the plan, but using a different set of investments.

Given these complexities, the proposed documentation requirements for this advice will be greatly beneficial to investors who are working with financial professionals on their IRA rollovers. We support the DOL's documentation requirements for rollovers and strongly urge the DOL to have robust documentation standards added to the rule text of the regulation that

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[3] Sethi, J., Spiegel, J., & Szapiro, A. 2019. "Conflicts of Interests in Mutual Fund Sales: *What Do the Data Tell Us?*" *Journal of Retirement,* Vol. 6, Issue 3, P. 48. https://jor.pm-research.com/content/6/3/46.

[4] Egan, M., Ge, S. & Tang, J. 2020. "Conflicting Interests and the Effect of Fiduciary Duty – Evidence from Variable Annuities." The National Bureau of Economic Research, Working Paper No. 27577. https://www.nber.org/papers/w27577.

[5] Mitchell, L., Sethi, J., & Szapiro, A. 2019. "Regulation Best Interest Meets Opaque Practices." Morningstar. https://www.morningstar.com/lp/regbi-opaque-practices-paper.

[6] Blanchett, D., & Kaplan, P. 2017. "To Roll or Not to Roll: A Framework for Assessing the Benefit of IRA Rollovers." *Journal of Retirement,* Vol. 4, Issue 4, P. 90. https://jor.pm-research.com/content/4/4/84 (IRA Rollovers).

requires brokers, advisors, insurance agents, and other persons recommending a rollover to analyze the following parameters, which the DOL discusses in the preamble:

- The retirement investor's alternatives to a rollover, including leaving the money in his or her current employer's plan, if permitted, and selecting different investment options.
- The fees and expenses associated with both the plan and the IRA.
- Whether the employer pays for some or all of the plan's administrative expenses.
- The different levels of services and investments available under the plan and the IRA.

Further, we want to ensure that it is clear, as it was in the 2016 proposal, that the advisors working on a rollover must make an effort to document the fees in a current 401(k) plan prior to a rollover. We think it is particularly important that the documentation analyze the value of financial planning and behavior management, as compared with the different levels of services and investments available under the plan and the IRA. These requirements are helpful to investors and will force the rollover decision to be justified. We think the rule text should explicitly include the requirement that firms must articulate a reason why the client is better off in the rollover than in an employer-sponsored (often low-cost) plan.

Our data demonstrates that average plan costs are low for many participants. For plans with assets under $10 million (which cover about 22% of participants), around 70% charge less than 125 basis points. For plans with assets over $10 million (which cover 78% of plan participants), more than 80% charge less than 100 basis points. In other words, in 2019, the average all-in cost of fees associated with an individual's 401(k) plan was less than 1% of their total invested assets. Thus, if an individual invested $103,700 into their plan, which is the average 401(k) balance among Americans, then the expected fee would be $467 a year.[7]

By contrast, there is no good way to estimate an all-in cost for IRAs. IRA costs can vary materially along several dimensions, including fees, quality and scope of investments, and quality and scope of services.[8] Given the nuances around comparing the value of the plan versus the IRA, the documentation requirements are critical to ensure that investors get the benefit of a rigorous analysis from the advice for which they are being charged.

Given the importance of advice, we agree with the DOL that compensation for such advice should be permitted and reasonable. We agree with the DOL in requiring "that compensation not be excessive, as measured by the market value of the particular services, rights, and benefits the Investment Professional and Financial Institution are delivering to the Retirement Investor."[9] Further, we agree with the DOL that no single factor is dispositive in determining

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[7] These expenses encompass expense ratios, plan administration fees, and individual service fees. Leonhardt, M. 2019. "Here's what the average American typically pays in 401(k) fees." CNBC. https://www.cnbc.com/2019/07/22/how-much-the-average-american-typically-pays-in-401k-fees.html.

[8] IRA Rollovers, P. 86.

[9] Proposed Rule, P. 40843.

whether compensation is reasonable, but rather "the essential question is whether the charges are reasonable in relation to what the investor receives."[10]

Consistent with this multifactored approach, we support the DOL in recommending that cost be a consideration but not determinative. In the preamble, the DOL states that financial institutions and investment professionals "would not have to recommend the transaction that is the lowest cost or that generates the lowest fees without regard to other relevant factors."[11] In fact, recommendations of the lowest-cost security or investment strategy, without consideration of other factors, could violate the exemption.[12] We think that the rule text should explicitly include that product cost is a factor, though it need not be the determinative factor, in the investment allocation decision.

III. The Proposed Disclosures Are Confusing to Investors and Should Be Harmonized with the SEC's CRS

Section II(3)(b) of the Proposed Rule requires: "Disclosure. Prior to engaging in a transaction pursuant to this exemption, the Financial Institution provides the following disclosure to the Retirement Investor: (1) A written acknowledgment that the Financial Institution and its Investment Professionals are fiduciaries under ERISA and the Code, as applicable, with respect to any fiduciary investment advice provided by the Financial Institution or Investment Professional to the Retirement Investor." We believe that this disclosure is confusing and problematic for several reasons.

First, the fiduciary duties under this Proposed Rule for investment advice fiduciaries are far less stringent than ERISA fiduciaries to 401(k) plans or those under the previous DOL rule. Telling investors that the entity is an ERISA fiduciary could provide a false sense of security and protection. The proposed PTE standards are aligned with Reg BI, which is not a fiduciary standard. While the PTE includes some fiduciary standards from ERISA,[13] it is unclear what rights and remedies such standards provide to investors. Most of the ERISA PTEs for 401(k) plans are from service providers to other fiduciaries, who in turn must still act in the best interests of their participants and cannot themselves engage in principal transactions or take prohibited compensation. Here, on the other hand, the investment advice fiduciary is permitted to receive compensation for advice, which is antithetical to much of ERISA.

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[10] Proposed Rule, P. 40843.
[11] Proposed Rule, P. 40843.
[12] Proposed Rule, P. 40843.
[13] The Proposed Rule defines best interest as "advice [that] reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims, based on the investment objectives, risk tolerance, financial circumstances, and needs of the Retirement Investor, and does not place the financial or other interests of the Investment Professional, Financial Institution or any affiliate, related entity, or other party ahead of the interests of the Retirement Investor, or subordinate the Retirement Investor's interests to their own." Proposed Rule, P. 40864.

Second, the investor, if working with a broker, will receive a CRS explaining how the services from the broker are different from those of a RIA and that the broker is not a fiduciary, but the RIA is. Thus, under the Proposed Rule, the client could be working with a broker who is not a fiduciary under the SEC's rules but is a fiduciary in some cases, depending on the significance of the "regular basis" prong in the final rule, under ERISA. The broker could also be an ERISA fiduciary on the rollover but not on other transactions in the IRA account, leading to more investor confusion. A more helpful disclosure would explain to customers their rights under both SEC rules and ERISA — such as where the financial professional is subject to ERISA fiduciary standards and Reg BI, but not RIA standards of conduct, and what this means for their rights and expectations. One possibility is to have an expanded version of the CRS for IRA accounts explaining how individuals are serviced by ERISA fiduciaries, brokers, and RIAs. As a result, these individuals would be able to clearly see that if the highest fiduciary standards are desired, then they are available for IRA accounts serviced by an SEC-registered RIA. Thus, an expanded CRS should make clear to the individual their choices, rights associated with each choice, and paths for recourse should misconduct occur.

IV. The DOL Does Not Go Far Enough to Prevent Conflicts in Plans with Limited Lineups

The DOL expresses concerns about limited plan or IRA product lineups regarding "proprietary products or investments that generate third party payments."[14] As the DOL itself has articulated, the interests of investors and those of professional financial advisors and institutions could be "misaligned" where limited menus "focus on proprietary products and products that generate third party payments, result[ing] in heightened conflicts of interest."[15] We agree with these concerns. We support the DOL's requirement to support limited plan or IRA lineups with rigorous documentation of "the specific reasons that any recommendation to roll over assets is in the best interest of the Retirement Investor."[16] In conjunction with a rigorous documentation requirement, the use of a 3(38) fiduciary should be encouraged in mitigating conflicts in these cases. The DOL could explicitly recognize the benefits of using a 3(38) fiduciary to mitigate such conflicts, indicating that such delegation would constitute sufficient mitigation from DOL's perspective. The benefits of 3(38) fiduciary services include personalized investments that are tailored to a retirement investor's circumstances as well as the reduction of the fiduciary liability of the employer sponsor. A 3(38) advisor is able to provide continuous portfolio management and investment oversight and can bridge the knowledge gap for employees in understanding the financial products available to them. We take fiduciary responsibility for selecting investment options in DC plans and monitoring them to ensure appropriate asset class coverage and that the fund managers are well-positioned to deliver strong risk adjusted returns to participants.

V. Investors Should Obtain Fiduciary Advice on Health Savings Accounts

[14] Proposed Rule, P. 40843.
[15] Proposed Rule, P. 40851.
[16] Proposed Rule, P. 40859.

The DOL asks if HSAs should fall under this proposal. Specifically, the DOL "requests comment on whether the definition of Financial Institution is sufficiently broad to cover firms that render advice with respect to investments in [HSAs], and about the extent to which Plan participants receive investment advice in connection with such accounts."[17]

We believe that individuals should receive advice on HSAs, as investments into these accounts have been increasing significantly over the last decade. "[HSAs] continue to offer better tax advantages than 401(k)s, individual retirement accounts, and 529s, making them a valuable tool to boost retirement savings."[18] As of 2019, the total amount of assets deposited in HSAs has exceeded $60 billion. Moreover, assets used for investments have grown at a faster rate than assets in plans used for checking accounts, from less than $1 billion recorded in 2006 to around $13 billion in 2019.[19] Individuals could greatly benefit from advice on these investments as an option to maximize their retirement savings.

VI. The DOL Should Provide Clarity on Enforcement

The DOL should clarify when it will take the lead on enforcement and when it will rely on the SEC. The lack of a private action in the Proposed Rule makes agency enforcement particularly important. It is unclear when the DOL or the SEC will bring actions against financial professionals. For instance, would the DOL rely on the SEC to examine and enforce Reg BI against brokers before bringing any actions of its own? Should individuals report misconduct relating to IRAs to one or both agencies? Clarity on these and related questions would be invaluable for investors.

VII. Conclusion

In summary, we believe the DOL does not go far enough in protecting individuals regarding advice relating to their IRA accounts. We ask the DOL to revisit the "regular basis" prong of the five-part test in order to subject all rollover advice to the PTE. We strongly encourage the DOL to provide more helpful disclosures to investors about their rights and remedies vis-à-vis the SEC and DOL regulations. We urge the DOL to strengthen the mitigation requirements to address conflicts for plans with limited lineups. In addition to IRA rollovers, we encourage the DOL to include financial institutions providing advice on HSAs within the definition of financial institution so that they are subject to the investment advice fiduciary standards. We urge the DOL to clarify the enforcement of the Proposed Rule, specifically because of the absence of a private action.

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[17] Proposed Rule, P. 40838.
[18] Acheson, L., & Pacholok, M. 2019. "2019 Health Savings Account Landscape." P. 4. Morningstar. https://www.morningstar.com/lp/hsa-landscape (HSA Landscape).
[19] HSA Landscape, P. 6.

We thank the DOL for the opportunity to comment on the Proposed Rule. Should you wish to discuss any of the comments in this letter, please do not hesitate to
contact either of us as indicated below:

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Sincerely,

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