



July 17, 2015

By Email and Courier

Office of Exemption Determinations  
Employee Benefits Security Administration  
Attention: D-11712  
U.S. Department of Labor  
122 C Street, NW  
Suite 400  
Washington DC 20001

and

Office of Regulations and Interpretations  
Employee Benefits Security Administration  
Attn: Conflict of Interest Rule and Related Exemptions  
Room N-5655  
U.S. Department of Labor  
200 Constitution Avenue, NW  
Washington, DC 20210

Re: Comments regarding ZRIN: 1210-ZA25 and RIN: 1210-AB32

Ladies and Gentlemen:

On behalf of the U.S. Securities Markets Coalition,<sup>1</sup> The Options Clearing Corporation (“OCC”) hereby submits these comments regarding two related proposals issued by the Department of Labor (the “Department”): “Definition of Term ‘Fiduciary’; Conflict of Interest Rule -- Retirement Investment Advice [RIN: 1210-AB32]” (the “Fiduciary Proposal”)<sup>2</sup> and “Proposed Best Interest Contract Exemption, Application No. D-11712 [ZRIN: 1210-ZA25]” (the “BIC Exemption Proposal”).<sup>3</sup>

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<sup>1</sup> The members of the Coalition (together with OCC) are BATS Options, BOX Options Exchange, Chicago Board Options Exchange, International Securities Exchange, NASDAQ Options Market, NASDAQ OMX PHLX, NYSE Arca, and NYSE Amex. All of these members are regulated by the Securities and Exchange Commission (“SEC”), and OCC is also regulated by the Commodity Futures Trading Commission and The Board of Governors of the Federal Reserve. NASDAQ Options Market and NASDAQ OMX PHLX are owned by the NASDAQ OMX Group, and NYSE Arca and NYSE Amex are owned by the IntercontinentalExchange Group.

<sup>2</sup> 80 Federal Register 21928 (Apr. 20, 2015).

<sup>3</sup> 80 Federal Register 21960 (Apr. 20, 2015).

In the Fiduciary Proposal, the Department issued a new proposed regulation that significantly expands the types of conduct that will cause a person or entity to be considered a “fiduciary” for purposes of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), and the prohibited transaction provisions of the Internal Revenue Code of 1986, as amended. This expansion goes far beyond the types of conduct that would cause a person to be considered a fiduciary under the Investment Advisers Act of 1940 and the guidance issued thereunder by the primary regulator for investment advisers, the SEC. In the BIC Exemption Proposal, the Department issued a new proposed prohibited transaction class exemption entitled the “Best Interest Contract Exemption” that is intended to permit certain transactions between a fiduciary and an ERISA plan or individual retirement account (an “IRA”).<sup>4</sup> While we are concerned about the overall direction of the entire proposal by the Department and particularly the concept of creating different standards for brokers with respect to retirement and non-retirement accounts, our greatest concern on behalf of the Coalition is that the Fiduciary and BIC Exemption Proposals would take away the current ability of investors to use exchange-traded (or listed) options in IRA accounts. Accordingly, OCC recommends a modification of a specific term of the BIC Exemption Proposal and recommends two clarifications to the terms of the Fiduciary Proposal.

1. Definition of “Assets” for Purposes of the BIC Exemption Proposal

- A. Summary

The BIC Exemption Proposal would permit certain “Advisers,” “Financial Institutions,” and their affiliates and related entities to receive compensation for services provided to “Retirement Investors” in connection with a purchase, sale or holding of an “Asset” by a Plan, participant or beneficiary account, or IRA, as a result of the Adviser’s and Financial Institution’s advice. For this purpose, “Asset” is defined as bank deposits, CDs, shares or interests in registered investment companies (mutual funds), bank collective funds, insurance company separate accounts, exchange-traded REITs, exchange-traded funds, corporate bonds offered pursuant to a registration statement under the Securities Act of 1933, agency debt securities, U.S. Treasury securities, insurance and annuity contracts (both securities and non-securities), guaranteed investment contracts, and exchange-traded equity securities.<sup>5</sup> The definition of “Asset” specifically excludes any equity security that is a put, call, straddle or other option to buy an equity security from or sell an equity security to another without being bound to do so.

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<sup>4</sup> The Department simultaneously issued another new proposed prohibited transaction class exemption intended to permit principal transactions in certain debt securities, and proposed amendments to and partial revocations of several existing exemptions currently used by ERISA plans and IRAs to engage in common securities trading transactions. These comments do not address such proposals.

<sup>5</sup> See Section VIII(c) of the Proposed Exemption.

## B. Recommendation

We recommend that the definition of “Asset” be revised in the final version of the BIC Exemption Proposal (the “Final Exemption”) to eliminate the inappropriate exclusion of exchange-traded options.

## C. Explanation

Equity options have been listed and traded on national securities exchanges (just like publicly traded stock) for over 40 years. U.S. options exchanges currently offer options on roughly 3,700 individual stocks, exchange-traded funds, and equity-related indices. In 2014, some 3.8 billion options contracts on individual equities were traded on U.S. options exchanges, with each contract typically covering 100 shares of the underlying stock. OCC is the central clearing agency for all such U.S. options exchanges, and was designated in July 2012 as a systemically important financial market utility by the Financial Stability Oversight Council.

Individual investors (including IRA account owners) are significant participants in the listed options markets. It has been estimated that almost 25 percent of volume (and perhaps even more) on U.S. options exchanges is attributable to individual investors. It is our understanding from brokers that cater to self-directed investors that IRA account owners are increasingly using listed options in their IRA accounts to manage the risk associated with owning stock, with the ultimate goal of increasing their retirement savings. In this respect, it has been estimated that approximately 15 percent of individual investor volume currently comes from IRA accounts. We understand that such firms, consistent with their interpretations of applicable regulatory requirements, limit the types of options strategies that IRA account owners can use to conservative strategies such as selling “covered” call options.<sup>6</sup> In fact, we understand that selling covered calls is the most popular options strategy employed in such accounts, and it is widely considered a conservative strategy to generate increased investment income from a stock position.<sup>7</sup>

We are concerned that many brokers and other service providers to ERISA plans and IRAs who are not fiduciaries under current law could be deemed to be fiduciaries under the Fiduciary Proposal. It also appears that many transactions relating to the trading of listed options by IRAs may become prohibited transactions for which the BIC

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<sup>6</sup> An exchange-traded call option is a standardized contract that gives the buyer of such option the right but not the obligation to buy 100 shares of the underlying stock at the price specified in the contract at any time before the expiration of the option. The call option is considered “covered” if the seller of the option owns the underlying shares referenced by the option. The seller of the option receives investment income in the form of the premium paid by the buyer for such option.

<sup>7</sup> See, e.g., Hemler & Miller, *The Performance of Options-Based Investment Strategies: Evidence for Individual Stocks During 2003-2013*, <http://www.optionseducation.org/content/dam/oic/documents/literature/files/perf-options-strategies.pdf> (“The findings suggest that options-based strategies can be useful in improving the risk-return characteristics of a long equity portfolio.”)

Exemption Proposal would be the only reasonably available exemption. The preamble to the BIC Exemption Proposal states that the exemption is intended to apply to “investments that are commonly purchased by plans, participant and beneficiary accounts, and IRAs.”<sup>8</sup> As described above, we believe that listed options are, in fact, investments that are commonly purchased by IRAs and can be used as part of a conservative strategy to generate increased investment income. Thus, we believe that the exemption should be made applicable to transactions relating to the trading of listed options. Accordingly, we recommend that exchange-traded options be included in -- rather than excluded from -- the definition of “Asset” in the Final Exemption.

2. Clarification of the Meaning of a Recommendation as to the Management of Plan Investments for Purposes of the Fiduciary Proposal

A. Summary

Under the Fiduciary Proposal, if an adviser or service provider to an ERISA plan or IRA makes recommendations as to the management of securities that constitute assets of an ERISA plan or IRA, and if certain other conditions are satisfied, the adviser or service provider will be considered a fiduciary with respect to such plan or IRA.<sup>9</sup> The preamble to the proposed regulation notes that, under this prong of the definition, fiduciary acts include individualized or specifically directed advice and recommendations on the exercise of proxy or other ownership rights. However, information (such as proxy guidelines) that is provided to a broad class of investors without regard to the investor’s individual interests or investment policy, and that is not directed or presented as a recommended policy for the plan or IRA to adopt, would not rise to the level of fiduciary investment advice for purposes of the Fiduciary Proposal.<sup>10</sup>

B. Recommendation

We recommend that the final version of the Fiduciary Proposal regulation (the “Final Regulation”) clarify that neither the screening by a broker of the owner of a self-directed IRA account nor the determination by a broker that engaging in listed option trading is appropriate for such account owner by itself constitutes a recommendation as to the management of plan investments.

C. Explanation

Under FINRA and options exchange rules, before approving a customer’s account for trading options, a broker must exercise due diligence to ascertain the essential facts relative to the customer, his/her financial situation and investment objectives as well as

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<sup>8</sup> See 80 Federal Register at 21967.

<sup>9</sup> See Proposed Section 2510.3-21(a)(1)(ii).

<sup>10</sup> See 80 Federal Register at 21939.

his/her investment experience and knowledge; and approval or disapproval of the account for options trading must be based upon such information.<sup>11</sup> If a broker determines to permit the customer to trade listed options, it typically uses “levels” to determine the types of options transactions in which the customer may engage. Level 1, the level at which customers new to options trading begin such activity, typically authorizes conservative options strategies such as writing covered calls. The requirement to conduct the screening is based on the rules of FINRA and the options exchanges, not on the customer’s individual interests or investment policy, and the determination that the customer is eligible for his account to be approved for listed option trading is not presented as a recommendation to engage in such trading. Thus, we do not believe that either conducting such a screening or determining that a customer’s account may be approved for listed option trading rises to the level of fiduciary conduct for purposes of the Fiduciary Proposal. Nevertheless, because the standard is broadly stated, it is possible that the proposal could be interpreted to provide that such conduct would result in fiduciary status. Accordingly, we recommend that the Final Regulation be clarified to provide that, absent other fiduciary conduct, neither the screening by a broker of the owner of an IRA account nor the determination by a broker that such an owner satisfies the requirements to engage in listed option trading constitutes a recommendation as to the management of plan assets.

We believe that it would be entirely inappropriate for compliance with a process that is intended to identify customers who have sufficient investment knowledge and experience to engage in options trading to result in a conclusion that the broker is a fiduciary with respect to that customer as if the broker were making investment decisions for the customer. And, assuming the BIC Exemption Proposal is adopted as proposed, the result of such a conclusion is that the exemption would be unavailable (because of the exclusion of put and call options from the definition of Asset), and even the most experienced investors would effectively be prohibited from engaging in transactions that they currently find beneficial in self-managing their investments.

### 3. Clarification of the Investment Education Carve-Out under the Fiduciary Proposal

#### A. Summary

Under the Fiduciary Proposal, certain conduct that otherwise might rise to the level of fiduciary status is specifically carved out from the definition of providing investment advice. One such exception applies to the providers of investment education to a plan, plan fiduciary, plan participant, IRA or IRA owner, provided that the education does not include recommendations with respect to specific investment products or recommendations on investment, management or the value of particular property.<sup>12</sup>

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<sup>11</sup> See, e.g., FINRA Rule 2360(b)(16)(B). The rules of FINRA and the options exchange are uniform in this respect.

<sup>12</sup> See Proposed Section 2510.3-21(b)(6).

B. Recommendation

We recommend that the Final Regulation clarify that the provision of instructional models, videos and interactive materials regarding listed option trading qualifies for the investment education carve-out to the definition of investment advice.

C. Explanation

The Fiduciary Proposal and preamble make clear that the provision of specified investment educational information and materials (such as investment allocation models and interactive plan materials) to a plan fiduciary or IRA owner will not constitute the rendering of investment advice if certain conditions are met, such as a requirement that the models and materials explain all material facts and assumptions on which such models and materials are based.<sup>13</sup> It is our understanding that many brokers catering to self-directed investors, and particularly on-line ones, frequently make available to the owners of options trading accounts instructional models, videos and interactive materials relating to such trading. We do not believe that merely making such information and materials available to account owners rises to the level of fiduciary conduct for purposes of the Fiduciary Proposal. In fact, we believe that the provision of such information is a valuable service to the account owners and is very comparable to the provision of asset allocation models and other interactive materials. Nevertheless, it is possible that the proposal could be interpreted to provide that such conduct would constitute investment advice. Accordingly, we recommend that the Final Regulation be clarified to state that the provision by a broker of instructional models, videos and interactive materials regarding listed option trading qualifies for the investment education carve-out to the definition of investment advice, so long as such information and materials do not include recommendations with respect to the trading of specific securities or recommendations on the investment in, or management or value of, specific securities.

Thank you for your consideration of this request. If you have any questions regarding these matters, please do not hesitate to contact me.

Respectfully submitted,



Craig S. Donohue  
Executive Chairman  
The Options Clearing Corporation

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<sup>13</sup> See 80 Federal Register at 21955.