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Before

The U.S. House of Representatives
Committee on Education and the Workforce
Subcommittee on Health, Employment, Labor and Pensions

Hearing on Principles for Ensuring Retirement Advice Serves the Best Interests of Working Families and Retirees

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Introduction:

Chairman Roe and Ranking Member Polis, thank you for the opportunity to testify today regarding the need to ensure access to quality, professional investment advice for retirement plan participants and Individual Retirement Account ("IRA") owners. I commend the Committee for holding this hearing, as American workers, retirees and their families need better tools and more assistance in achieving secure retirements.

My testimony today reflects my personal views, and not those of any client, of my firm, or of my colleagues. I am not testifying on behalf of any client or any other party.

I am encouraged that a group of bipartisan members of Congress, including the Chairman, recently released a set of principles to guide development of legislation to address this issue. These principles represent an important step forward in this debate, as they not only form a solid foundation for meaningful legislation, but highlight some of the very serious problems with the U.S. Department of Labor's (the "Department") sweeping regulatory package redefining fiduciary investment advice and proposing new and amended prohibited transaction class exemptions (the "Proposal").[1]

Though well intentioned, the Department's Proposal would not only fail to achieve its objectives, but would result in serious, unintended consequences harming retirement savers. It would make it more difficult for small businesses, workers and IRA owners to get the assistance they need. This is not just because the Proposal violates the common-sense principles the Chairman and his colleagues have outlined, but also because Congress, not a single Federal agency, is the proper institution to comprehensively address retirement advice and the wide array of Federal and State laws and regulations already in effect.

The Problem—Lack of Access to Advice Costs Retirement Savers More than $100 Billion Each Year

In 2011, the Department issued a final regulation implementing certain investment advice provisions of the Pension Protection Act of 2006 (the "PPA"). In the economic analysis related to the final rule, the Department identified one of the key problems facing retirement plan participants, the lack of access to professional investment advice. The

[1] 80 Fed. Reg. 21,927-22,042 (Apr. 20, 2015).

analysis quantified the losses resulting from a lack of advice at more than $100 billion per year, and determined that these losses were due, in part, to the prohibited transaction and fiduciary rules of the Employee Retirement Security Act of 1974 ("ERISA").[2] In describing these concerns, the Department wrote:

> "Unfortunately, there is evidence that many participants of these retirement accounts often make costly investment errors due to flawed information or reasoning…Financial losses (including foregone earnings) from such mistakes likely amounted to more than $114 billion in 2010…Such mistakes and consequent losses historically can be attributed at least in part to provisions of the Employee Retirement Income Security Act of 1974 that effectively preclude a variety of arrangements whereby financial professionals might otherwise provide retirement plan participants with expert investment advice."[3] [Emphasis added]

This finding by the Department that lack of access to advice hurts retirement savers is consistent with the intent of the bipartisan principles to expand access to advice. The principles call for public policies that "protect access to investment advice and education for low- and middle-income workers and retirees," and that ensure "small business owners should have access to the financial advice and products they need to establish and maintain retirement plans and help workers save for retirement."[4]

Unfortunately, the Department's Proposal does the opposite. Rather than mitigating the effects of the prohibited transaction rules in denying advice, the Department expands their scope on the basis that they prevent "conflicted" advice and will result in advice in the "best interest" of workers and IRA owners. In reality, however, the prohibited transaction rules have little to do with "best interest" and can, and in fact do, prevent ERISA retirement plan fiduciaries, plan participants, and IRA owners from receiving advice that is in their best interest.

Unlike the Bipartisan Principles, the Department's Proposal Is Not a "Best Interest" Standard—It Actually Could Prevent Advice That Is in Your Best Interest:

The bipartisan principles lay out some very important, common-sense requirements for legislation revising the standards applicable to financial advice. In addition to those principles discussed above, they would:

1. Require advisors to act in the best interest of their clients;
2. Require clear, simple and relevant disclosure of conflicts, compensation and all investment fees;

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[2] *See,* The Preamble to the final regulation implementing the Pension Protection Act investment advice provisions, 76 FR 66,151-66,153 (October 25, 2011).

[3] Preamble at 76 FR 66,151.

[4] "Bipartisan House Members Outline Legislative Principles to Ensure Retirement Advisors Protect Clients' Best Interests," November 5, 2015, U.S. House Committee on Education and the Workforce, http://edworkforce.house.gov/news/documentsingle.aspx?DocumentID=399747, last accessed on November 30, 2015 .

3. Preserve investor choice and consumer access to all investment services and products in a way that does not pick winners and losers; and

4. Never deny individuals the financial information they need to make informed decisions.[5]

Unfortunately, the Department's Proposal violates all of these principles. As I will explain in more detail below:

1. Best Interest: What the Department actually proposed is something very different than a "best interest" standard. It is a broader application of the ERISA fiduciary standard and the prohibited transaction rules. The prohibited transaction rules are not a proxy for the quality of advice—in fact, their application is effectively unrelated to the content of the advice. Instead, they broadly prohibit compensation arrangements based on cost differences or affiliated relationships. For example, a plan's investment advisor would not be able to advise a plan participant on a rollover, simply because of the structural reality that a typical IRA has to charge a higher investment advice fee than a typical institutionally-priced 401(k). The reality is that different investment products and services have different costs and prices for reasons unrelated to any conflict—the prohibited transaction rules do not take into account those realities and simply prohibit the advice, unless an exemption applies.

2. Clear and Simple Disclosures: The disclosures required by the Best Interest Contract Exemption (the "BIC Exemption") are anything but "clear and simple." They directly conflict with securities laws, and will result in a deluge of information of little value to participants and IRA owners. Further, disclosure alone is not sufficient under the Proposal or ERISA to address a prohibited transaction, no matter how minor or inconsequential the perceived "conflict" may be.

3. Preserve Choice and Access: The Proposal does not preserve investor choice and consumer access, it restricts choice and access. Plans sponsored by small businesses, for example, would not have access to the same advisors and investments as plans sponsored by large businesses. It may not be possible for some advisors to help participants because of proprietary products or similar relationships. The structure of the Proposal and the BIC Exemption will clearly result in "winners and losers" not just among advisors and financial institutions, but also between "big" plans and "small" plans, participants or IRA owners.

4. Do Not Deny Information: The Proposal would deny individuals information needed to make informed decisions. For example, the BIC Exemption is only available for advice regarding certain types of assets. If the exemption is needed for an advisor to provide advice, such as will likely be the case in many rollover transactions, then the advisor is prohibited from discussing assets not on the list, regardless of whether they are in the best interest of the client.

Congress, Rather Than a Single Federal Agency, Should Decide What Cross-cutting Standards Apply to Advice Affecting Nearly $16 trillion in Retirement Savings

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[5] Bipartisan Principles Press Release, November 5, 2015.

As the former head of the Employee Benefits Security Administration ("EBSA"), the Department agency promulgating this regulation, I am very familiar with the Department's responsibility under ERISA to regulate private-sector, employer-provided benefit plans. However, in this Proposal, the Department is attempting to position itself broadly as the primary regulator of compensation and conduct for all types of financial advisors—registered investment advisors, insurance agents, bank officials, registered representatives of broker dealers, consultants, etc.—not only to ERISA-covered employee benefit plans, but also to IRAs, and to rollovers and other distributions from ERISA plans and IRAs. This is a significant departure from the Department's traditional view of its authority regarding the application of the prohibited transaction rules to IRAs, in that it is attempting to leverage this authority to establish a fiduciary standard of care the statute does not provide.

The likely result will be significant unintended consequences, separate from and in addition to the broader policy issues. In my opinion, the controversy surrounding the Proposal, and the comments and testimony identifying a large number of significant technical problems with the Proposal, are a direct result of the Department's unfamiliarity with the IRA marketplace and with the role of other regulators in governing financial advice provided to IRAs. The Department is trying to force a square peg into a round hole by asserting that the ERISA fiduciary standards can and should apply to IRAs in addition to the existing regulatory regimes already in place.

- Lack of Coordination with Other Regulators Would Lead to Conflicting but Simultaneously Applicable Advisor Requirements

It is difficult to overstate how broad the Proposal's effects would be. ERISA plans and IRAs collectively hold approximately $16 trillion in assets on behalf of tens of millions of Americans.[6] The Proposal would impose new restrictions and compliance obligations on advisors to these plans and IRAs that apply in addition to the extensive State and Federal regulatory regimes already in place. The result is predictable—the Proposal and the existing regulations do not mesh. It is very clear that the Department did not coordinate its Proposal sufficiently with other financial regulators. The Financial Industry Regulatory Authority ("FINRA") offered 21 pages of formal comments to the Department identifying various problems, including direct conflicts with securities law and regulation, created by the Proposal.[7]

Another example is the likely effect of the Proposal on the types of fee arrangements used in IRAs and plans. While the Proposal does not directly prohibit commissions or transaction-based fees, the fee-leveling requirements associated with the new fiduciary status of advisors will put considerable pressure to transition many IRAs to fee-based accounts. This is a likely outcome due to the administrative complexity of levelizing commissions and transaction-based compensation. However, this will clearly increase costs for some workplace plans and IRAs that benefit from transaction-based pricing. The U.S. Securities and Exchange Commission ("SEC") has a targeted enforcement program directly addressing this so-called "reverse churning" in which fee-based accounts are used to make investors pay more for services than they would have paid in transaction-based accounts. The inappropriate use of fee-based accounts is an SEC examination priority for

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[6] *See,* "The U.S. Retirement Market, First Quarter 2015," the Investment Company Institute, June 24, 2015, available at https://www.ici.org/research/stats/retirement/ret_15_q1.

[7] *See,* Comment letter from Financial Industry Regulatory Authority ("FINRA"), July 17, 2015.

2015.[8] It is not clear how advisors pushed towards fee-based accounts by the Proposal would comply with the SEC standards.

- Congress is Best-Positioned to Address These Concerns

Congress is the institution best-positioned to improve access to quality investment advice because it has the authority to comprehensively review and modify the different bodies of law and regulation applicable to different types of financial advisors. The public input into the legislative process would also result in a more open and inclusive process incorporating all relevant viewpoints.

While I appreciate that the Department received extensive comments, and heard four days of testimony during administrative hearings on the Proposal, the comments and testimony served to highlight that this unusually broad and aggressive rule has an unusually large number of technical and policy problems. No matter how well-intentioned and hard-working the Department may be, retreating again behind closed doors to write a final rule will result in serious technical flaws at the very minimum.

In my opinion, Congress should "tap the brakes" on the Department's Proposal until it has had an opportunity to thoroughly review the issues and develop its own legislation. The bipartisan principles are an ideal starting point for this process.

Unlike the Bipartisan Principles, the Proposal Would Increase Costs and Reduce Access for Small Plans and Small-Account IRA Owners:

Small plans and small-account IRA owners may be most in need of basic investment advice, but they would be least likely to be served by the Proposal due to the increased compliance costs and increased legal liability risks it unnecessarily creates. The bipartisan principles properly focus on ensuring access to advice for these groups.

The Small Business Administration's ("SBA") Office of Advocacy expressed concerns in its formal comment letter to the Department, questioning the Department's economic analysis and criticizing the Department for not sufficiently taking into account the effects of the Proposal on small businesses. The conclusion from focus groups held by the SBA was that "the proposed rule would likely increase the [advisers'] costs and burdens associated with serving smaller plans…[and] could limit financial advisers' ability to offer savings and investment advice to clients…ultimately lead[ing] advisors to stop providing retirement services to small businesses."[9]

Strangely, the Department permits large plans with more than 100 participants or more than $100 million in assets to receive the full range of products and services currently available, but would deny the right to receive sales information on a non-fiduciary basis to small plans, and to all participants and IRA owners.

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[8] *See* "Examination Priorities for 2015--National Exam Program, Office of Compliance Inspections and Examinations," available at http://www.sec.gov/about/offices/ocie/national-examination-program-priorities-2015.pdf.

[9] Comment letter from the Small Business Administration's Office of Advocacy, July 17, 2015, at 5-6.

The Department's rationale that large plan fiduciaries are sophisticated investors who can distinguish between sales activity and impartial advice makes little sense on its face—there is no clear basis to believe that plan size is a proxy for financial sophistication, and no basis to treat every IRA owner as if she is incapable of making informed choices. With clear disclosure that the information being provided is not fiduciary advice but is sales activity for which the seller receives compensation, there is no reason to so narrowly restrict permissible activity by so broadly defining fiduciary advice.

The bipartisan principles would preserve access by small business and individuals to these services, but would ensure clear and relevant disclosure is provided to prevent confusion about the difference between sales and advice. This approach far better serves the interests of retirement savers than the Department's effort to change the entire regulatory structure governing retirement advice.

The BIC Exemption Does Not Cure the Proposal's Flaws—It Adds to Them

The BIC Exemption is the Department's attempt to permit some advice that the broad prohibited transaction rules otherwise forbid. Though portrayed as the solution to the Proposal's many practical problems, the proposed BIC Exemption actually creates more problems than it solves. The advisor and the participant or IRA owner would sign a contract enforceable in state court that must preserve the right to bring class action litigation. The contract must contain a long list of warranties and representations by the advisor and its financial institution, and would require very specific disclosures regarding fees and expenses. The advisor would also have to agree to a standard of conduct that is a slightly reworded version of the ERISA fiduciary standard.

As Proposed, the BIC Exemption would not be feasible for many advisors—the disclosure provision would require gathering and disclosing information to which some advisors would not have access (or only at great expense), and it is not clearly written to apply to many important transactions. For example, it would not apply to managed accounts, so a participant wanting to rollover from a 401(k) plan to a managed account in an IRA may not be able to find an advisor who could assist him.

The BIC Exemption essentially outsources enforcement of advice arrangements to private lawsuits. The class action requirement, combined with the subjective nature of many of the warranties and representations required to be in the contract, likely would result in excessive and unnecessary litigation. The lack of clear, objective criteria in the exemption and contract terms result in compliance uncertainty and greater risk of litigation.

- BIC Exemption Exceeds Regulatory Authority

It is my belief that the BIC Exemption exceeds the Department's legal authority to regulate in at least three areas.

First, by providing a new cause of action in state court, the BIC Exemption is attempting to create an alternative remedy to ERISA's exclusive remedies available to plan participants. The Department has no authority to create alternative remedies directly by regulation—it cannot, in my view, do as a condition of an exemption what it lacks the authority to do directly in a regulation.

Second, the contract creates a fiduciary conduct standard for advisors to IRAs. In 1974, when Congress passed ERISA and created IRAs, it expressly decided not to apply the ERISA fiduciary standard to IRAs. While the Department has authority over the prohibited transaction rules, the Department has no authority to directly establish a fiduciary standard of conduct for advisors to IRAs. As a result, while the Department can regulate how the advisor receives payment to ensure it is consistent with the prohibited transaction rules, the Department cannot regulate the legal standard for the advice that is provided. The Department cannot, in my view, create this standard as a condition in an exemption, when it could not do so directly.

Third, the requirement that the contract cannot limit access to class action litigation in state court impermissibly limits the right of private parties to agree to binding arbitration of disputes. The Federal Arbitration Act ("FAA") has been held to require a clear Congressional statement of intent to override the FAA's protection of arbitration clauses,[10] and ERISA does not have such a provision.

Finally, the IRS, not the Department, has the sole enforcement authority over prohibited transaction violations under Sec. 4975 of the Code according to Sec. 105 of Reorganization Plan No. 4 of 1978. This Executive Order provides the Department the interpretive authority over the prohibited transactions in Sec. 4975, but not enforcement authority.

Conclusion:

To be clear, my concern with the Proposal is not the Department's goals, but with the Department's execution in achieving those goals. As a former regulator, I understand the enforcement concerns that led the Department to begin this initiative. The current regulation does contain conditions that are worthy of review, such as the requirement that advice be provided on a "regular basis" in order to be fiduciary advice.[11]

However, I believe the approach the Department has taken in the Proposal will harm the people it is intended to protect, and that Congress is the proper institution for addressing these complex issues. The bipartisan principles are a bold step in the right direction.

Thank you Mr. Chairman and Mr. Polis for your commitment to the retirement security of America's workers. I appreciate the opportunity to discuss these issues with the Committee, and I would be happy to answer any questions you may have.

Thank you.

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[10] *See*, *CompuCredit Corp. v. Greenwood*, 132 S. Ct. 665, 669 (2012).

[11] *See*, 29 CFR 2510.3-21(c)(1)(ii)(B)