



April 12, 2011

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Submitted to: e-ORI@dol.gov

Jeffrey Turner  
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Office of Regulations and Interpretations  
Employee Benefits Security Administration  
U.S. Department of Labor  
200 Constitution Avenue NW  
FP Building, Room N-5655  
Washington, DC 20210

Re: Public Hearing on Definition of Fiduciary

Dear Mr. Canary and Mr. Turner:

AARP appreciates this opportunity to respond to the written comments and oral testimony previously provided to the Department of Labor concerning the definition of fiduciary. Although we certainly appreciate the additional tools that the proposed regulation provides to plan trustees and administrators, especially for small employer plans, AARP is most concerned about the impact of this rule on individual participants and beneficiaries.

**I. THE DEPARTMENT SHOULD SUBJECT ALL SERVICE PROVIDERS THAT OFFER INVESTMENT ADVICE TO ERISA PLANS AND PARTICIPANTS TO ERISA'S FIDUCIARY STANDARD.**

The distinction between broker-dealers and registered investment advisors is not well understood by average investors, especially individual plan participants. All investors believe that investment advice they receive should be in their best interest, and this expectation should be met in practice. AARP believes that imposition of ERISA's fiduciary status upon all financial services professionals who deal with retirement plans, plan assets and retirement plan participants and beneficiaries is the principal vehicle through which the

Department should foster the creation of a more investor-friendly financial services marketplace.

**II. THE DEPARTMENT OF LABOR SHOULD REJECT THE USE OF A DISCLOSURE-ONLY SCHEME FOR PROTECTING PLANS AND PARTICIPANTS FROM CONFLICTED INVESTMENT ADVICE.**

Some commenters have argued for a disclosure-only scheme regarding investment advisers especially for broker-dealers. AARP submits that the Department should reject such a scheme for four reasons.

**A. Participants View The Purchase Of Securities In A Retirement Plan Differently Than In The Open Market.**

Retirement plan participants engage in a different evaluative approach compared to individuals who independently purchase securities in the open market. Individuals purchasing securities in the open market do so with the knowledge that any transaction occurs at an arm's length. Accordingly they know they must actively protect their personal interests when choosing an investment. In contrast, rather than being on notice of the need to actively protect their interests, plan participants choose investments from a predetermined list of options the plan provides. Many individuals believe that because the plan or employer has selected these investments as options, the plan or the employer has certified these investments as being "good" investments, at least implicitly. Therefore, rather than choosing investments based solely on their own evaluation, plan participants certainly weigh, and likely solely rely upon, employers' endorsement of the plan options when making investment decisions. ERISA serves to protect plan participants as a result of participants' natural reliance on the employers' implicit endorsement of plans' investment options.

**B. The Department Should Ensure That Retirement Plans And Participants Are Protected From Conflicted Investment Advice To Ensure That Tax Expenditures Are Used For The Purposes For Which They Were Enacted.**

Congress has used tax incentives to encourage the offering and participation in retirement plans in order to achieve the goal of improved income security in retirement; in contrast, there are no similar tax incentives to purchase securities outside of a retirement plan. Employers and employees may deduct their contributions from their current year's income, while investment income accrues without any taxes. The amount of this income exclusion is estimated to total over \$515 billion in tax expenditures

for Fiscal Years 2010-2014.<sup>1</sup> See STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2010-2014 at 49 (Comm. Print JCS-3-10 2010). ERISA plays a crucial role in ensuring the protection of funds subsidized by taxpayers so that participants have money for a secure and adequate retirement.

Because the Department of Labor must ensure that tax expenditures are used to further the purposes for which they were granted, see subsection II.C., *infra*, service providers are not entitled to rules under ERISA that are necessarily the same as rules under the SEC or CFTC. Cf. *In re CMS Energy ERISA Litigation*, 312 F. Supp. 2d 898, 915 ((E.D. Mi. 2004), citing *In re Worldcom*, 2001 U.S. Dist. LEXIS 17450, 2002 WL 31640557 at \*4 (N. D. Cal. July 26, 2002)) (“existence of duties under one federal statute does not, absent express congressional intent to the contrary, preclude the imposition of overlapping duties under another federal statutory regime”); see *generally* EMPLOYEE BENEFITS LAW (2d ed.) – 2010 Cum. Supp. at 679-680 (2010). However, these service providers are entitled to rules that are not in conflict with each other. We commend the Department of Labor for its continued cooperation and coordination with the SEC and other agencies on these related but distinct issues.

**C. When It Enacted ERISA, Congress Rejected Using A Mere Disclosure Scheme Because Such A Scheme Under The WPPDA Had Failed To Protect Plans And Participants.**

Congress attempted to use disclosures to remedy the abuses in private pension plans by enacting the Welfare and Pension Plans Disclosure Act (“the WPPDA”). See P.L. 836, 85th Cong., 2d Sess. (Aug. 28, 1958). This statute required the plan administrator to file an annual plan description and financial report, but this information was only available to plan participants upon request. See *id.* When the WPPDA became law, it was widely recognized that the WPPDA would not have the corrective effect necessary in the private pension system. For instance, when signing the legislation, President Eisenhower remarked that “Congress has failed to respond effectively to the pleas for action in this field, and I am sure that the public is as disappointed with [the WPPDA] as I am.” James A. Wooten, THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974 49 (Univ. of Cal. Press 2004).

Fifteen years after its passage, Congress recognized that the WPPDA and its disclosure requirements failed to address the abuses in private pension plans. Congress explained that:

It was expected that the knowledge thus disseminated would enable participants to police their plans. . . . Experience in the decade . . . has demonstrated the inadequacy of the Welfare and Pension Plans Disclosure Act in regulating the private pension system for the purpose of

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<sup>1</sup> This figure takes into account the tax expenditures that exclude from income employee contributions to defined benefit and defined contribution plans. See Estimate of Tax Expenditures, *supra*, 49.

protecting rights and benefits due to workers. It is weak in its limited disclosure requirements and wholly lacking in substantive fiduciary standards. Its chief procedural weakness can be found in its reliance upon the initiative of the individual employee to police the management of his plan.

S. Rep. No. 93-127 (1973).

In response to the ongoing abuses in private pension plans, Congress enacted the Employee Retirement Income Security Act ("ERISA"). See S. Rep. No. 92-634 (1972). Congress recognized the chief weakness of the WPPDA was its reliance on individual plan participants to monitor the plan through disclosure. As a result, Congress changed the disclosure and oversight approach of the WPPDA. Congress added "a new section setting forth responsibilities and proscriptions applicable to persons occupying a fiduciary relationship to employee benefit plans, including a 'prudent man' standard for evaluating the conduct of all fiduciaries." See *id.* And, ERISA provides substantive rights to employees. See Wooten, *supra*, at 49; Title I of ERISA.

Clearly, the WPPDA revealed the insufficiency of disclosure-only requirements and the need for a strong fiduciary standard. Disclosure-only requirements concerning fiduciary duties would wholly fail to guarantee the stronger protections and substantive rights provided by ERISA. Consequently, arguments that the Department should adopt a disclosure-only scheme instead of substantive rules concerning fiduciaries fly in the face of Congress' findings and intent, and should be rejected as being inconsistent with the purposes of ERISA.

**D. Because Many Americans Have Low Financial Literacy Skills, Heightened Disclosure Requirements Alone, Without More, Are Not The Solution To The Financial Literacy Gap.**

As 401(k) plans became more predominant in the workplace, scholars began examining the impact of financial literacy on participants' saving and investing behavior. What they found was sobering. Early research warned of the lack of financial literacy among savers and investors and the implications for individuals' economic security. See Annamaria Lusardi, NBER Working Paper No. 13824, *Household Saving Behavior: The Role of Financial Literacy, Information and Financial Education Programs* at 7 (Feb. 2008), <http://www.nber.org/papers/w13824>. In response to these findings, financial education programs were developed and promoted. Matthew Martin, Federal Reserve Bank of Richmond Working Paper No. 07-3, *Literature Review on the Effectiveness of Financial Education* at 3 (June 2007), [http://www.richmondfed.org/publications/research/working\\_papers/2007/wp\\_07-3.cfm](http://www.richmondfed.org/publications/research/working_papers/2007/wp_07-3.cfm); Annamaria Lusardi, *Financial Literacy: An Essential Tool for Informed Consumer Choice?* at 10 (Jan. 2008), [www.dartmouth.edu/~alusardi/.../Lusardi\\_Informed\\_Consumer.pdf](http://www.dartmouth.edu/~alusardi/.../Lusardi_Informed_Consumer.pdf). Although there have been significant attempts to promote financial education, *id.* at 21, financial literacy remains low. See Financial

Industry Regulatory Authority Investor Education Foundation, *Financial Capability in the United States: National Survey—Full Report* (Dec. 2009), <http://www.finrafoundation.org/resources/research/p120478>.

In a recently completed study to evaluate financial knowledge, respondents were exposed to a battery of questions covering fundamental concepts of economics and finance impacting everyday life, such as calculations involving interest rates and inflation, principles relating to risk and diversification, the relationship between bond prices and interest rates and the impact that a shorter term can have on total interest payments over the life of a mortgage. While the correct response to any single question sometimes exceeded 60%, fewer than half of respondents (46%) correctly answered both a question about interest rates and a question about inflation. Less than one-third (30%) correctly answered those questions plus a question about risk and diversification correctly. And, fewer than 10% of respondents were able to answer all questions correctly. For example, less than two thirds of respondents (64%) were able to correctly identify that the money in an account earning 1% interest during a year with 2% inflation would be able to buy less than today. Only one in five respondents (21%) knew that if interest rates rise, bond prices will typically fall. See *id.* at 37-41.

A more disturbing finding is that a significant portion of defined contribution plan participants could not even describe how their retirement assets were invested. For example, 17% did not know whether the assets in their retirement plan were invested in stocks or stock mutual funds, and 37% did not know whether their assets were invested primarily in a life-cycle or target-date fund. See *id.* at 27-28. And of equal concern is the observation that plan participants demonstrate a woeful lack of understanding concerning fee structures in 401(k) plans. A substantial number of them actually believe that they are paying none. AARP, *401(k) Participants' Awareness and Understanding of Fees* (July 2007), [http://assets.aarp.org/rgcenter/econ/401k\\_fees.pdf](http://assets.aarp.org/rgcenter/econ/401k_fees.pdf).

Of particular import to AARP is a study of individuals over the age of 55 showing that they lacked even a rudimentary understanding of stock and bond prices, risk diversification, portfolio choice, and investment fees. Annamaria Lusardi, Olivia S. Mitchell, and Vilsa Curto, *Financial Literacy and Financial Sophistication Among Older Americans* (Nov. 2009), <http://www.nber.org/papers/w15469>.

Finally, in a 2008 GfK Roper Public Affairs Survey concerning whether individuals understood financial jargon well enough to explain it to a friend, less than one-third of individuals understood the concept of rebalancing, expense ratio or dollar cost averaging, less than one-quarter understood what an index fund was and less than twenty percent understood what a basis point meant. GfK Roper Public Affairs, *The Costs of Financial Jargon* (February 2008).

Because financial literacy is only achieved over time (as the financial literacy programs have demonstrated), and most participants currently possess poor financial

literacy, a disclosure-only scheme will not protect them. Instead, providing participants with non-conflicted, independent quality investment advice is crucial. ORC/Infogroup, *U.S. Investors & The Fiduciary Standard: A National Opinion Survey* (September 15, 2010), [http://www.cfp.net/downloads/ US Investors Opinion Survey 2010-09-16.pdf](http://www.cfp.net/downloads/US%20Investors%20Opinion%20Survey%202010-09-16.pdf).

### **III. AARP ALSO SUPPORTS COMPREHENSIVE DISCLOSURE REQUIREMENTS CONCERNING INVESTMENT ADVISORS TO AID PLAN SPONSORS AND ADMINISTRATORS IN THEIR CHOICE OF SERVICE PROVIDERS.**

The financial literacy gap does not pertain only to plan participants and beneficiaries. AARP believes that special care must be taken also to address the need for thoroughness and clarity in the financial service community's communications to plan sponsors and other plan fiduciaries, such as plan administrators and plan administrative committee members. This is especially important for small employers who may not have the resources to obtain independent advice on fiduciary and administrative issues. The Department has acknowledged the Government Accountability Office's (GAO) report which cites various conflicts of interest that may arise in the employee benefits area and recommending certain steps that the Department should take to mitigate such potential conflicts. See GAO, Report to Ranking Member, Committee on Education and the Workforce, House of Representatives, *401(k) Plans Improved Regulation Could Better Protect Participants from Conflicts of Interest* at 70-72 (GAO-11-219 Jan. 2011). Among those recommendations is GAO's suggestion that the Department change the definition of a fiduciary for purposes of investment advice. The upshot of that recommendation is that the pertinent regulation should require financial service providers' written disclosures to plan sponsors to specify, when appropriate, that the financial service provider is not undertaking to provide impartial investment advice. Comprehensive disclosure is necessary so that the plan sponsor is able to distinguish sales pitches from advice and to otherwise fulfill its fiduciary duties under ERISA. AARP heartily concurs in that approach to setting the standard for disclosures to plan sponsors, as we believe that it comports with a proper ERISA standard.

### **IV. AARP SUBMITS THAT INVESTMENT ADVICE TO PARTICIPANTS CONCERNING THE ROLLOVER OF PLAN ASSETS TO IRAS SHOULD BE CONSIDERED FIDUCIARY ACTION.**

AARP is particularly concerned with the Department's role in regulating financial service providers' practices involving plan distributions by way of transfers, rollovers, or purchases of financial products that are intended to land outside of a retirement plan upon completion of the transaction. It is AARP's position that to the extent that any such transaction is funded by retirement plan assets then the Department has both the authority and the interest in setting the applicable standard for the financial service professional's conduct. In this connection, AARP urges the Department to exercise its regulatory

expertise to protect plan participants by requiring financial service professionals to disclose in a consistent and prominent manner, prior to the point of sale, any financial incentive they may have in the outcomes of such transactions and, since disclosure itself is insufficient, to subject any such investment advice to ERISA fiduciary standards.

**V. AARP SUGGESTS THAT THE DEPARTMENT REVISE THE REGULATION TO MORE ACCURATELY REFLECT ITS INTENT.**

The Department's proposed interpretation of the definition of investment "fiduciary" has drawn many negative comments from those who have focused on the breadth of the proposed regulation. Certain of those commenters have posited interpretations of language in the proposed rule that appears to be beyond any of the Department's targeted conduct or intent. Based upon the written comments submitted prior to and following the March hearings on the proposed regulation, as well as exchanges during the hearings themselves, AARP recognizes that there remain several language revisions and refinements to be performed on the proposed regulation so as to cure potential misinterpretations and avoid unintended consequences. We also emphasize that we expect that the implementation of the regulation will engender further interpretive guidance from the Department through the initiation, development, and issuance of Technical Guidance such as Advisory Opinions, Exemptions, Field Assistance Bulletins (FAB), etc. This regulatory and guidance process is not new. Thus, the perceived lack of certainty as to how the Department will interpret and enforce the rule should not effectively stall a regulatory response where the Department has identified actual and potential abuses pertaining to retirement plan investment advice.

**VI. AARP SUBMITS THAT THE DEPARTMENT SHOULD REJECT CRITICISMS OF ITS ECONOMIC AND PAPERWORK REDUCTION ACT ANALYSIS BECAUSE THE UNDERLYING ASSUMPTIONS OF THESE CRITICS IGNORE POTENTIAL BENEFITS IN THEIR ANALYSIS.**

AARP is aware that in addition to its recently released fee regulations, the Department is currently assessing the advisability of requiring a consistent and summary format to be used by financial services providers to disclose to plans their direct and indirect compensation from plan investments and fiduciary status. See GAO, Report to Ranking Member, Committee on Education and the Workforce, House of Representatives, *401(k) Plans Improved Regulation Could Better Protect Participants from Conflicts of Interest* (GAO-11-219 Jan. 2011). AARP acknowledges that it is useful to weigh the anticipated costs with the benefits that may be anticipated from the requirement, to the extent that such costs may be predictable. Absent a compelling demonstration that the costs far outweigh the benefits, AARP favors the requirement for disclosure of information regarding compensation from all sources to fiduciaries in a format that is likely to be useful to plan sponsors and other parties responsible for plan administration. AARP believes that

contentions by certain financial service industry advocates that the costs far exceed the benefits may be overblown.

For example, the assumptions underlying the SIFMA cost study that was previously submitted to the SEC are debatable. The OW-SIFMA brief (which is a deck of slides) argues that even under conservative assumptions regarding the implications of a broader coverage of fiduciary duty, the costs that brokers pay to do business would increase significantly. The estimates this study derives are based on a sample of 17 firms with over 35 million clients.

The study assumes that the contemplated broadening of fiduciary coverage would result in increases in costs from two sources. First, the shift to fee-based compensation would increase charges, even without brokers taking any action to comply with the new law. Second, costs would increase because of the additional time and effort of account advisors to comply with the law.

The estimate of the first component of the projected increase in costs is taken from a comparison of charges of fee-based brokerage versus commission-based brokerage activities. For an investor with assets of \$500,000, the extra cost is estimated to be 37 basis points, or \$1,850 per year. This component of the increase does not assume any increase in brokers' costs. It results from a mechanical application of current pricing structures.

The second component of the increase in costs is derived in two steps. The first step is to calculate the hourly cost, including overhead, of investment advisor time. The estimated figure is about \$200 and is derived from estimates of median advisor compensation and the ratio of overhead to labor costs. By assuming that the new regulations would require two additional hours of advisor time per year, the cost of which would be passed on to the client, an investor with assets of \$500,000 is estimated to suffer an additional decline in his or her annual return of 8 basis points. Investors with larger portfolios would suffer less of a decline, and smaller investors a greater one.

The OW-SIFMA brief contends that the two-hour estimate for additional account advisor time is conservative. The broader fiduciary standard could require increases in a range of activities, including advisor training, production and mailing of disclosures, the preparation of an investment plan, documentation of discussions with the client, etc.

There are three basic problems with the brief's method of estimating the impact on net returns. The first is the assumption that fee-based charges—excluding the increase due to increased compliance efforts—would not change. If, however, the cost of servicing accounts with a commission-based charge is lower than the cost of servicing accounts with a fee-based charge, competitive pressures could be expected to lower fee-based charges to bring them into line with commission-based charges.



Second, the assumption that every account will require an average of two extra hours of an advisor's time takes no account of the possibility that compliance can be achieved in other ways: for example, by a safe harbor investment alternative as exists with 401(k) plans. (The assumption that the same amount of advice would be needed every year of the investing life cycle is also questionable.)

Finally, the approach attaches no value to the advice received. In effect, it assumes that the additional advice is only a costly legal formality. There are costs, but no benefits to the additional advice. This assumption cannot be correct. The benefit might take the form of a higher gross return, or of reduced risk for a given expected return. In more technical parlance, the additional advice should put the investor closer to his "risk-return frontier," or should position him at a spot on that frontier that he or she prefers. Sound advice would improve the individual investor's portfolio choices, and should be worth paying for.

In order to gain a working model for estimating the costs of the proposed action, AARP encourages the Department to undertake independent assessment of the cost factor.

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AARP appreciates this opportunity to provide its views on the proposed amendment to the regulation related to the definition of a fiduciary. If you have any questions, please do not hesitate to contact Jay Sushelsky at 202.434.2151 or Tom Nicholls at 202.434.3765.

Sincerely,



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Government Relations & Advocacy