COMMITTEE ON EDUCATION AND THE WORKFORCE
U.S. HOUSE OF REPRESENTATIVES
2181 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515–6100

July 21, 2015

<u>SUBMITTED VIA REGULATIONS.GOV</u>

The Honorable Thomas E. Perez
Secretary
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, D.C. 20210

<u>RE: Comments Regarding RIN 1210-AB32</u>

Dear Secretary Perez:

We write in opposition to the Department of Labor's (DOL) proposed rule amending the definition of "fiduciary" under the *Employee Retirement Income Security Act* (ERISA) and strongly urge the immediate withdrawal of this proposed rule.[1] DOL's initial attempt to regulate in this area in 2010 was roundly criticized by stakeholders and lawmakers on a bipartisan basis leading to its withdrawal.[2] Despite this failure, the administration refused to address the shortcomings embedded in its earlier proposal. Consequently, the proposed rulemaking currently under consideration suffers from many of the same fatal flaws as that discredited approach and should meet the same fate.

If adopted, the proposed regulation will reduce access to investment options and increase costs for retirement savers. Despite the administration's professions of concern about a "retirement crisis,"[3] this proposal would cut off vital financial advice for many low- and middle-income

---

[1] Definition of the Term "Fiduciary"; Conflict of Interest Rule – Retirement Investment Advice, 80 Fed. Reg. 21928-21960 (Apr. 20, 2015), *available at* http://www.gpo.gov/fdsys/pkg/FR-2015-04-20/pdf/2015-08831.pdf.
[2] 75 Fed. Reg. 65263 (Oct. 15, 2010). After receiving hundreds of comments, DOL announced it would repropose the regulation. "US Labor Department's EBSA to re-propose rule on definition of a fiduciary," Sept. 19, 2011, http://www.dol.gov/ebsa/newsroom/2011/11-1382-NAT.html.
[3] *Restricting Access to Financial Advice: Costs and Consequences for Working Families and Retirees: Hearing Before the House Committee on Education and the Workforce's Health, Employment, Labor, and Pensions Subcommittee* (June 17, 2015) (Statement of the Hon. Thomas E. Perez, Sec'y, Dep't of Labor) ("This Subcommittee knows too well that there is a retirement crisis in America and that not enough Americans are saving for retirement").

families and small business owners. For example, some of the most basic advice, such as assistance in rolling over funds from a 401(k) to an IRA or determining how funds are to be distributed upon retirement, would be prohibited. Additionally, small business owners will be denied assistance in selecting the right investment options for their employees, which means fewer small businesses will offer employees a retirement plan. Furthermore, low- and middle-income families with fewer resources to invest will lose access to advice or have to pay substantially higher fees in order to continue seeing their trusted advisors.

We also remain concerned this initiative could conflict with Securities and Exchange Commission (SEC) rulemakings authorized by the *Dodd-Frank Wall Street Reform and Consumer Protection Act*.[4] The Committee has repeatedly requested information that would allay these concerns.[5] Unfortunately, DOL has refused to provide an adequate response to these inquires.

Stakeholders and commenters also raised significant procedural objections, including a rushed process, which has led to an ill-considered regulatory proposal rife with unanswered questions and unintended consequences. For example, this proposal was in the Office of Management and Budget's formal review process for less than 60 days. According to some estimates, the average review of DOL proposals is nearly 120 days.[6] This shorter timeframe indicates the administration has not adequately considered stakeholder concerns.

Despite the agency's protestations of inclusivity and coordination, DOL's fiduciary rulemaking has been likened to a "runaway train."[7] The administration even refused to grant meaningful extensions of the public comment period, as requested by both Republican and Democrat lawmakers.[8] The rushed, uncoordinated process evident throughout the development of this

[4] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 913, 124 Stat. 1376, 1824 (2010).
[5] The committee has engaged in a line of oversight inquiries relating to the DOL's purported coordination with the SEC. *See* Letter from the Hon. John Kline, Chairman, H. Comm. on Education and the Workforce, and the Hon. Phil Roe, Chairman, H. Subcomm. on Health, Employment, Labor, and Pensions, to the Hon. Thomas E. Perez, Sec'y, Dep't of Labor (Mar. 4, 2015) , *available at* http://edworkforce.house.gov/UploadedFiles/3-4-15-Secretary_Perez-Fiduciary_Liability.pdf; Letter from the Hon. John Kline, Chairman, H. Comm. on Education and the Workforce, and the Hon. Phil Roe, Chairman, H. Subcomm. on Health, Employment, Labor, and Pensions, to the Hon. Thomas E. Perez, Sec'y, Dep't of Labor (Mar. 24, 2015) , *available at* http://edworkforce.house.gov/uploadedfiles/3-24-15-secretary_perez-fiduciary_letter_follow_up.pdf; Letter from the Hon. John Kline, Chairman, H. Comm. on Education and the Workforce, and the Hon. Phil Roe, Chairman, H. Subcomm. on Health, Employment, Labor, and Pensions, to the Hon. Thomas E. Perez, Sec'y, Dep't of Labor (June 2, 2015) , *available at* http://edworkforce.house.gov/uploadedfiles/fiduciary_rulemaking_to_dol.pdf
[6] Meagan Leonhardt, *DOL Fiduciary Rule Released Publicly,* http://wealthmanagement.com/industry/dol-fiduciary-rule-released-publicly (Apr. 13. 2015).
[7] Commissioner Daniel M. Gallagher, *Remarks at The SEC Speaks in 2015*, Feb. 20, 2015, http://www.sec.gov/news/speech/022015-spchcdmg.html ("...despite public reports of close coordination between the DOL and SEC staff, I believe this coordination has been nothing more than a "check the box" exercise by the DOL designed to legitimize the runaway train that is their fiduciary rulemaking").
[8] Letter from the Hon. Thomas E. Perez, Sec'y, Dep't of Labor, to the Hon. John Kline, Chairman, H. Comm. on Education and the Workforce (June 11, 2015) (on file with the Committee) (refusing request to extend comment period by 30 days, noting comment period had been extended by 15 days); *see also,* Letter from the Hon. John Kline, Chairman, H. Comm. on Education and the Workforce, *et al* to the Hon. Thomas E. Perez, Sec'y, Dep't of

proposal so troubled the House of Representatives that it passed legislation to ensure this rulemaking would not conflict with rulemakings under Dodd-Frank.[9] And yet DOL's steamrolling continues unabated and unconcerned with the very real objections lodged by stakeholders and investors.

DOL's obstinacy is all the more disappointing because a workable compromise updating the fiduciary rules could be reached. As the committee of primary jurisdiction in the United States House of Representatives, we have a long-standing interest in this rule and its consequences for individuals saving for retirement.[10] The Committee has long believed that financial advisors "should be well trained, committed to high ethical and professional standards, and devoted to the best interests" of those they are serving.[11] These shared values should have formed the basis of a consensus update to ERISA's fiduciary regulations. Sadly, we now fear DOL's approach is motivated by an insatiable desire to reengineer the retirement services industry and control the mode and manner that Americans save for retirement.

The dangers of DOL's approach were evident during the June 17, 2015, hearing before the Subcommittee on Health, Employment, Labor, and Pensions examining this proposal.[12] At this hearing, a number of witnesses raised grave concerns. We write to ensure their statements (attached to this letter) are included in the record. The following are among the most alarming comments from hearing witnesses:

- "The problem with the [department's] proposal is not the best interest standard; the problem is the 'prohibited transaction rules' that cut off low- and middle-income individuals and small businesses from access to personal investment assistance."[13]
- "Under the DOL proposal, access to affordable financial help will effectively be prohibited – even when it is in the investor's best interest .... Unfortunately, the DOL proposal would specifically prohibit service providers from assisting small businesses.

Labor (May 29, 2015) , *available at* http://edworkforce.house.gov/uploadedfiles/05-29-15-dol-fiduciary_comment_extension.pdf (requesting a 30-day extension of comment period); Letter from the Hon. Frederica S. Wilson, *et al* to the Hon. Thomas Perez, Sec'y, Dep't of Labor (May 6, 2015), *available at* http://www.naifa.org/NAIFA/media/Communications/NAIFA-Blog/house_democrats_letter_may_6_2015.pdf (requesting a 45-day extension of comment period).

[9] H.R. 2374, 113th Cong. §2 (as passed by the House, Oct. 29, 2013). The House passed the bill by a vote of 255-166, but the Senate did not consider it. On Feb. 25, 2015, Rep. Wagner reintroduced the bill. H.R. 1090, 114th Cong. (2015).

[10] *See, e.g.*, Letter from Rep. Kline, Rep. Camp, Sen. Enzi, and Sen. Hatch to Secretaries Solis and Geithner, and IRS Commissioner Shulman, April 14, 2011 (on file with the Committee).

[11] *Redefining 'Fiduciary': Assessing the Impact of the Labor Department's Proposal on Workers and Retirees: Hearing Before the House Committee on Education and the Workforce's Health, Employment, Labor, and Pensions Subcommittee* (July 26, 2011) (statement of the Hon. Phil Roe, Chairman, H. Subcomm. on Health, Employment, Labor, and Pensions).

[12] *Restricting Access to Financial Advice: Costs and Consequences for Working Families and Retirees: Hearing Before the House Committee on Education and the Workforce's Health, Employment, Labor, and Pensions Subcommittee* (June 17, 2015).

[13] *Id.* (Statement of Mr. Kent Mason, Partner, Davis & Harman, LLP, Washington, DC).

The result would have a devastating impact on retirement coverage and savings for millions of workers employed by small businesses across the country."[14]

- "[O]ur concern lies with all of the additional requirements contained in the proposal that would create serious disruptions to the retirement savings landscape and make the proposal unworkable for retirees, financial advisors, and financial institutions. These extra requirements will drive up costs and will make it more difficult for me, and countless other advisors, to provide retirement advice to the millions of Americans that have modest retirement savings accounts. Without access to these services, I fear that many Americans will delay investing for retirement, respond emotionally to fluctuations in the markets or cash out their retirement savings to satisfy short-term needs. Most especially, I fear for my own low net-worth clients who I could no longer service under the new requirements."[15]

- "[DOL's] proposed rule is hopelessly complex, confused, and, in its current form, unworkable. The DOL also chose to break away from a coordinated approach with the Securities and Exchange Commission (SEC), which itself is considering whether to impose harmonized fiduciary standards that would provide a single standard of care for all investors. If the DOL adopts its proposed rule, the result will be a regulatory hodgepodge that does not promote the best interests of retirement savers .... The economic analysis used to justify the DOL proposal is fatally flawed. It appears to be crafted solely to support the agenda of adopting the DOL's proposed rule—not to measure accurately the costs and benefits of the proposal. The Regulatory Impact Analysis does not properly analyze the impacts of the proposal. The DOL does not establish that the benefits of its rule justify its significant costs. In fact, the economic analysis raises the question of whether the DOL fully understands the market for investment advice"[16]

Our nation's workers, small business owners, and retirees deserve better than this proposal, which will result in less financial advice and higher costs for those saving for retirement. Like its flawed predecessor, this regulatory proposal should similarly be discarded. We urge you to withdraw this proposal and work with Congress to strengthen protections for investors and preserve robust access to financial advice.

[14] *Id.* (Statement of Mr. Jack Haley, Exec. Vice President, Fidelity Invs., Boston, MA).
[15] *Id.* (Statement of Mr. Dean Harman, Managing Dir., Harman Wealth Mgmt, The Woodlands, TX).
[16] *Id.* (Statement of Dr. Brian Reid, Chief Economist, Inv. Co. Inst., Washington, DC).

Sincerely,

John Kline

JOHN KLINE
Chairman
Committee on Education and the Workforce

David P Roe

PHIL ROE, M.D.
Chairman
Subcommittee on Health, Employment, Labor and Pensions

Joe Wilson

JOE WILSON
Member of Congress

Virginia Foxx

VIRGINIA FOXX
Member of Congress

DUNCAN HUNTER
Member of Congress

Glenn GT Thompson

GLENN THOMPSON
Member of Congress

Tim Walberg

TIM WALBERG
Member of Congress

MATT SALMON
Member of Congress

Brett Guthrie

BRETT GUTHRIE
Member of Congress

TODD ROKITA
Member of Congress

Lou Barletta

LOU BARLETTA
Member of Congress

Joe Heck

JOSEPH HECK
Member of Congress

LUKE MESSER
Member of Congress

BRADLEY BYRNE
Member of Congress

DAVE BRAT
Member of Congress

BUDDY CARTER
Member of Congress

MIKE BISHOP
Member of Congress

GLENN GROTHMAN
Member of Congress

CARLOS CURBELO
Member of Congress

ELISE STEFANIK
Member of Congress

RICK ALLEN
Member of Congress

STEVE RUSSELL
Member of Congress

CC: The Honorable Shaun Donovan, Director, Office of Management and Budget

TESTIMONY OF

KENT A. MASON

of

DAVIS & HARMAN LLP

before the

SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR AND PENSIONS

of the

HOUSE EDUCATION AND THE WORKFORCE COMMITTEE

for the hearing entitled

RESTRICTING ACCESS TO FINANCIAL ADVICE: EVALUATING THE COSTS AND CONSEQUENCES FOR WORKING FAMILIES AND RETIREES

June 17, 2015

My name is Kent Mason. I am a partner in the law firm of Davis & Harman LLP and I have worked in the retirement plan area for over 30 years. I am currently working with plan sponsors, plan sponsor trade associations, and a wide array of financial institutions on the concerns that have been raised with respect to the Department of Labor's proposed regulation modifying the definition of a fiduciary.

I want to thank you, Chairman Roe and Ranking Member Polis, for holding this hearing and for inviting me to testify. It is important that the critical issues raised by the proposed regulation be addressed in a robust public dialogue.

I am speaking today on my own behalf based on extensive discussions with plan sponsors, plan sponsor trade associations, and numerous financial institutions.

On April 14, the Department of Labor ("DOL") issued a re-proposed definition of a fiduciary applicable to retirement plans and IRAs, along with a set of proposed prohibited transaction exemptions.

In brief, I will make the following points:

- **Industry supports best interest standard.** Contrary to indications from the Administration and statements in the press, most of the industry is completely fine with a best interest standard. The problem with the DOL proposal is not the best interest standard; the problem is the "prohibited transaction rules" that cut off low and middle-income individuals and small businesses from access to personal investment assistance.
- **Small businesses will lose critically needed help in setting up retirement plans.** The seriousness of this problem is well illustrated by expressions of great concern from the U.S. Chamber of Commerce, NFIB, the U.S. Hispanic Chamber of Commerce, and the Small Business and Entrepreneurship Council.
- **Small accounts will lose all access to professional investment advice.** It is well documented that this occurred in the United Kingdom under a very similar rule.
- **Under the current timetable, the following message will be delivered to many millions of individual IRA investors with small accounts *in the fall of 2016:*** *neither their current advisor nor any other advisor can service their accounts because of new government rules.*
- **The DOL proposal would eliminate any meaningful assistance for employees terminating employment regarding their distribution and rollover options.** According to a comprehensive study by former government economists, this would result in $20 billion to $32 billion more in annual leakage from retirement plans.
- **The DOL proposal significantly reduces the scope of permissible investment education.** Even the 2010 DOL proposal did not do this.
- **The DOL proposal inadvertently applies to the simple marketing of health, life, and disability insurance to small businesses, making such marketing arguably impermissible.** This inadvertent error is more evidence that the adverse ramifications of the proposal have not been fully considered.
- **The 2015 proposal is far less workable than the 2010 proposal.**

- **<u>All of this can be solved by legislation establishing a best interest standard, with workable rules that maintain access to investment assistance for low and middle-income individuals and small businesses.</u>**
- **<u>In this context, we need bipartisan legislation.</u>** This proposal can fundamentally alter the private retirement savings system, and there are critically important disagreements about what those effects will be on the retirement security of low and middle-income individuals across the country. Fundamental policy decisions like this are the province of Congress, not the agencies charged with interpreting the law.

<u>INDUSTRY SUPPORT FOR A BEST INTEREST STANDARD</u>

Under the DOL rules, an advisor's treatment as a fiduciary has two main significances. First, a fiduciary is required to provide advice that is in the best interest of the fiduciary's customer. ***There has been a lot of confusion in public discussions and media reports that state that the industry opposes a best interest standard. That is not the case. The vast majority of the financial services industry is completely fine with being required to act in the best interest of their customers.*** Advisors know that if they do not act in their clients' best interest, they will not have those clients for long.

The public policy dialogue regarding the fiduciary issue over the last 4 ½ years has never been about the best interest standard. The real debate has been over DOL's "prohibited transaction rules," which under the DOL proposal would cut off access to investment and distribution assistance for low and middle-income individuals and small businesses. Under those rules, an advisor cannot provide any advice that could affect the advisor's compensation, in the absence of a prohibited transaction exemption (provided by DOL). Assume, for example, that an IRA owner calls a broker/dealer for advice regarding whether to buy a particular stock. The advisor responds by saying that that stock is regarded as a good value and could help the IRA owner's portfolio. The IRA owner buys the stock, which earns the broker/dealer a commission. Absent an exemption, if the broker/dealer is a fiduciary, the simple favorable statement about the stock purchase is a prohibited transaction under the DOL proposal, regardless of whether the statement is in the best interest of the IRA owner. That is because the broker/dealer earns a commission on the purchase; thus, the broker/dealer's favorable statement led to the broker/dealer earning a commission.

The Administration's doctor analogy is a perfect analogy. The Administration has said:

> When you go to a doctor, you expect that advice you get is in your best interest. If you have cancer, you don't want your doctor telling you what's suitable for you. Rather, you want your doctor telling you what's best for you, and what will maximize the chances of saving your life. But when it comes to financial advice, conflicts of interest can lead to bad advice and hidden fees that too often keep us from getting investment advice that's in our best interest.

The industry is completely fine being subject to a best interest standard like doctors. But to picture the unworkability of the prohibited transaction rules, just imagine if those rules applied to doctors:

- A patient goes to a doctor with ankle pain. The doctor recommends an X-ray – which they do at the doctor's office -- to determine if the ankle is broken. Under the DOL rules, the doctor would have committed a prohibited transaction because the advice to get an X-ray leads to the doctor earning more money attributable to providing X-ray services for a fee. The doctor would be required to send the patient to another doctor for an X-ray.
- ***A patient goes to a doctor with back pain. The doctor prescribes rest and anti-inflammatories, and recommends the patient come back in three weeks for a follow-up visit. The doctor would have committed a prohibited transaction by recommending a follow-up visit, which will earn the doctor more money. The doctor would be required to send the patient to another doctor for the follow-up visit.***

HIDDEN FEE REFERENCES ARE FICTION

In 2012, the DOL issued rules making hidden fees illegal with respect to retirement plans, which were the product of work by both Democratic and Republican Administrations. Thus, it is somewhat mystifying to hear DOL make reference to hidden fees in 2015. In the IRA market, Richard Ketchum, the CEO of FINRA (which oversees broker/dealers) has noted that FINRA's robust disclosure rules "require that principal trades, commissions, fees and expenses must be disclosed to the customer and . . . require that revenue sharing arrangements with mutual funds generally must be disclosed if they form a basis for the selection of funds that the broker-dealer recommends." Where are the hidden fees?

OVERALL STRUCTURE OF THE DOL PROPOSAL

The DOL proposal has three basic components:

- **Expansion of the basic definition of the term "fiduciary."** Under current law, a person is treated as a fiduciary if, for a fee, the person provides individualized advice regarding investments on a regular basis pursuant to a mutual understanding that the advice will be a primary basis for decision-making. In other words, there must be a mutual expectation of reliance on the advice.
  - Under the DOL proposal, a person is treated as a fiduciary if, for a fee, the person provides individualized recommendations regarding investments, rollovers, or distributions that could be considered in making decisions. Any recommendation that would be viewed as a "suggestion" that someone take an action – or not take an action – is sufficient. ***So any casual comment that could be considered would give rise to fiduciary status.***
- **Exceptions from the definition of a fiduciary.** The proposal includes exceptions from fiduciary status, i.e., persons covered by the general definition above are not fiduciaries if they fall within certain exceptions, such as an exception for investment education (narrower than under current law or under the 2010 DOL proposal) and an exception for recommendations provided as a seller (not as an advisor) to large plans.
- **Exemptions from the prohibited transaction rules.** For persons that are treated as fiduciaries, the proposal provides limited exemptions from the prohibited transaction rules. The main exemption is the Best Interest Contract Exemption (the "BIC

exemption"). For reasons discussed below, the conditions required to satisfy the BIC exemption are so extensive and onerous as to make it unusable. Effectively there is no exemption.

EFFECTS OF THE DOL PROPOSAL

The DOL proposal would have the following adverse effects.

In general. The framework set up by the DOL could work conceptually, but ***in its current form, it would, like the original 2010 proposal, cut off the option for low and middle-income individuals and small businesses to receive personalized investment assistance, even if that assistance is in the best interest of the recipient.*** This is the case because the BIC exemption is unusable.

Small businesses could not get help setting up a retirement plan. When a financial institution talks to a small business owner about possibly setting up a 401(k) plan, the small business owner naturally wants to know if the plan can be established simply and inexpensively, with the financial institution taking care of almost everything. Today, that works well. The financial institution can, for example, provide the plan document, agree to do all the plan administration, and agree to help with all employee communications.

One other key item is selecting the investment options for the plan to offer to employees. Typically, the financial institution has a large portfolio of possible investment options, such as, for example, 2,000 options, but the business likely may only want to offer, for example, 10 or 15 options to its employees. Accordingly, a critical step in setting up a plan is choosing the 10 or 15 out of the 2,000 that the plan will offer. Today, the financial institution can provide "education" to the business owner about which 10 to 15 to choose, without the financial institution becoming a fiduciary. For example, the financial institution could provide examples of investment options offered to employees by similar businesses, including sets of options that are conservative, moderate, and aggressive. The financial institution can explain the difference between the different sets of options and provide additional information that the owner needs to make the right decision for him. (The financial institution will be clear that it cannot make the decision for the business owner and cannot act as a fiduciary, but can provide information and education.)

Under the DOL proposal, the assistance described above regarding the selection of the 10 or 15 investment options would be treated as advice and thus make the financial institution a fiduciary. This would make the assistance a "prohibited transaction," subject to severe penalties. Fiduciary advice is a prohibited transaction if the advice affects how much compensation the fiduciary earns. In almost all cases, the financial institution will make different amounts of money based on which investment options are chosen by the business owner. Some options may be proprietary funds and some may not be. Generally, the non-proprietary funds will pay the financial institution a fee, but the fee varies from fund to fund. Proprietary funds also vary in the management fee charged because certain investment strategies are more expensive to manage than others.[1] So in short, even if the financial institution recommends the best possible funds for

[1] These fees are not hidden. The fees earned both for proprietary and non-proprietary funds **are fully disclosed before the business owner adopts the plan** under DOL's fee disclosure rules.

the business owner to offer to his employees, the advice is a prohibited transaction because the advice affects how much the financial institution earns.

So if the financial institution cannot help the business owner select the 10 or 15 investment options, the owner has two choices:

- Select the investment options himself without any assistance, subject to fiduciary liability. If the owner is not an expert on investments, this would subject the owner to liability, since ERISA holds fiduciaries to an expert standard. A fiduciary *must* seek help and guidance if the fiduciary is not an expert.
- Conduct a diligent search, subject to fiduciary liability, for a qualified independent third party to do the selection ***for an additional fee.***

Neither of the above choices is really viable in most cases, so that there would be far fewer small business plans established. The adverse effects of the original proposal would continue to apply, since the 2015 proposal is, with respect to the small business issue, effectively identical to the original proposal. The adverse effects were powerfully demonstrated by the results of a 2014 survey of small businesses by Greenwald & Associates (which our firm co-sponsored, along with the U.S. Hispanic Chamber of Commerce). For example, the survey found that:

- Almost 30% of small businesses with a plan indicate that it is at least somewhat likely that they would drop their plan if this regulation were to go into effect.
- Close to 50% of small businesses without a plan state that the regulation would reduce the likelihood of them offering a plan, with 36% saying it would reduce the likelihood greatly.

Small accounts will lose all access to an investment professional. There are two main ways that an IRA owner can get access to an investment professional: the brokerage model and the advisory model. Under the brokerage model, the amount of the payments to the advisor – such as commissions and payments from a mutual fund (e.g., marketing, recordkeeping, and shareholder servicing fees) – varies based on the investment made. Thus, any advice made under the brokerage model violates the prohibited transaction rules unless an exemption applies. Because the BIC exemption is unusable, the brokerage model is effectively illegal with respect to IRAs and retirement plans under the DOL proposal.

This means that the only source of personal investment assistance for an IRA owner is through an advisory account. However, advisory accounts are not available to small accounts. Under an advisory account, typically, the advisor takes full responsibility for managing the investments on an around the clock basis in exchange for a fee based on the amount of assets, such as a 1% of assets fee. Small accounts are not eligible for advisory accounts in part because the economics cannot work. An advisor cannot accept around the clock liability for $4,000 IRA for an annual fee of $40. Moreover, under the securities laws, an advisory account may not be suitable for a small account (or even a large account) under which the IRA owner simply buys and holds securities. It is not in the best interest of a IRA owner to pay a 1% a year on a security that will likely be held until retirement; it is much less expensive to pay a single commission when the security is purchased.

So small IRA accounts would be entirely cut off from personal investment assistance. This could have devastating effects, since it is advisors who encourage individuals to save, explain how IRAs work, explain how to open and maintain an IRA, explain investment diversification, and encourage individuals to stay in the market during down times and avoid the urge to sell low. In 2011, Oliver Wyman performed an extensive study of 40% of the IRA market, measuring the effect of the 2010 DOL proposal, which would have had the exact same effect as the 2015 DOL proposal. Oliver Wyman found that:

- Over 7 million IRAs could lose access to an investment professional (just within the study sample, which, as noted, was approximately 40% of the IRA market) because the brokerage model, which serves 98% of IRAs under $25,000, would become unworkable with respect to IRAs.
- As many as 360,000 fewer IRAs could be opened every year.

Lessons from the United Kingdom. The defenders of the DOL proposal maintain that the industry would never walk away from servicing small accounts because there is too much money to be made. The response is that somehow the industry will figure this out. That is a frightening basis on which to risk the retirement security of low and middle-income individuals: "if the brokerage model becomes illegal, industry will figure out some other way to service small accounts – we don't know what it is, but they will figure it out."

That is effectively what the regulators in the U.K. said before new rules took effect as of January 1, 2013 that have an effect almost identical to the effect of DOL's prohibited transaction rules – making payments from mutual funds illegal. Instead, advisors ceased servicing small accounts in droves, as shown below. Some of these practices were implemented before the U.K. rule went into effect but clearly in anticipation of the rule, as recognized by a study commissioned by the U.K. regulator itself.

- **U.K.'s "big four" banks (an important source of investment advice in the U.K.)**
    - **HSBC:** provided investment advice only for customers with at least $80,000 in total assets or $160,000 of annual income.
    - **Lloyds:** provided face-to-face investment advice only for customers with at least $160,000 in assets.
    - **Royal Bank of Scotland:** charged $800 to set up a financial plan, and made changes to gear investment advice services to high net-worth clients.
    - **Barclays:** provides investment advice only for customers with at least $800,000 in assets.

      These banks previously had entire business arms or strategies providing investment advice to investors with less assets, but just prior to the U.K.'s implementation of its new rule, HSBC, Lloyds, and Barclays completely pulled out of offering investment advice to such investors, and, as noted, Royal Bank of Scotland overhauled its offerings to target high net-worth clients. For example, Barclays closed Barclays Financial Planning, leaving only Barclays Wealth to offer financial advice to individuals with at least $800,000 in assets.

- **<u>Examples of other actions taken.</u>**
  - **Aviva:** ceased offering face-to-face investment advice.
  - **AXA:** ceased offering face-to-face investment advice.
  - **Advisor firm AWD Chase de Vere:** stopped accepting clients with $80,000 or less in assets.
  - **Advisor firm Towry:** stopped accepting clients with less than $160,000 in assets.

- **<u>Millions of small investors will be told in the fall of 2016 that they will no longer be permitted to talk to their advisor.</u>** The Oliver Wyman study lines up exactly with the experience in the United Kingdom and leaves us with a clear picture of the future under the DOL proposal. Based on DOL's time line, the applicability date for the new rules will be some time around January 1, 2017 or slightly earlier. That means that in the fall of 2016 financial institutions will need to deliver the message to millions of small investors that they will no longer be permitted to consult with their advisor for assistance.

<u>Meaningful assistance regarding rollover and distribution options would be prohibited.</u> Under the DOL proposal, financial institutions would be prohibited from providing any specific assistance to individuals seeking help with the rollover and distribution process. This is the case in large part because any financial institution providing IRA services would have a conflict of interest with respect to advice regarding the rollover decision, thus creating a prohibited transaction. Most read the BIC exemption in the re-proposal as not covering this type of assistance, thus rendering the assistance categorically prohibited. Others read the BIC exemption as technically applicable to this assistance, but effectively unavailable because of the exemption's unworkable conditions. Either interpretation denies assistance to many in need of help in navigating the retirement savings options that exist after termination of employment. Among many unfortunate consequences, this would cause a drastic curtailment of call center, brokerage, and other assistance to those terminating employment, leading to greatly increased leakage of assets from the retirement system.

A study conducted by Quantria Strategies LLC found that this could increase annual cash-outs of retirement savings for employees terminating employment by $20 billion to $32 billion. These withdrawals could reduce the accumulated retirement savings of affected employees by 20% to 40%.

<u>Elimination of the ability of financial professionals to continue to provide meaningful investment education.</u> The DOL proposal would significantly restrict the type of investment education that can be provided without triggering fiduciary status and the prohibited transaction rules. Under current law, education includes (1) guidance on the extent to which an individual should invest in different asset classes (such as large and small cap equity funds, and long and short-term bond funds) based on her age and other factors, and (2) examples of investments that fit within such asset classes. This definition of education has worked very well for nearly 20 years, ensuring that a basic level of needed assistance was widely available to retirement investors often with no cost; moreover, this definition was explicitly preserved under DOL's 2010 proposal. Under the 2015 proposal, providing examples of investments that fit within asset classes would be fiduciary advice, not education. Thus, education would be limited to hypothetical and abstract conversations about investment theory that will simply be of little use to most retirement savers. As a result, we will have less informed plan participants who will be less able to put investment education to practical use and will be much less able to make informed decisions about investing their 401(k) account assets.

Prohibition on promoting your own products, services, or yourself. With respect to individuals and small businesses, there is no seller's exception from the fiduciary definition, unlike the 2010 DOL proposal. So individualized marketing to individuals and small businesses would be treated as fiduciary advice. DOL's rationale for this is the following: "Most retail investors and many small plan sponsors are not financial experts, are unaware of the magnitude and impact of conflicts of interest, and are unable effectively to assess the quality of the advice they receive." This position is directly contrary to the structure of ERISA and to DOL enforcement positions which place a fiduciary duty on small employers to make prudent fiduciary decisions. It is also cutting off marketing to individuals. The DOL's view seems to be that individuals are unable to process marketing. But if individuals are unable to process marketing, how are they expected to make decisions?

- **Effect of absence of seller's exception.** Let's translate the lack of a seller's exception into real terms with a few examples. One could argue that these results were not intended, but after a four and a half year debate about the need for a seller's exception, and the nature of any such exception, concern levels are high.
  - **Prohibition on promoting a company's own products or services**. A company should be permitted to market its own products and services if it is made completely clear that the company is not providing advice but is selling a product or a service. Unfortunately, such promotion is prohibited with respect to individuals and small plans. Almost any discussion of a company's own products or services with any individual or small business plan is a fiduciary discussion. The result is that companies would be prohibited from, for example, promoting their own services, such as rollover services or managed account services.
  - **Interviews to be hired.** Assume that a broker is interviewing with a prospective customer and asking that she be hired to help with the customer's IRA. She talks about her firm and her hard work and her dedication to her customers. She does not make any investment recommendations. Under the proposal, the broker is acting as a fiduciary. In fact, the individual would actually be committing a prohibited transaction by recommending that she be chosen. Obviously, that is an absurd result, but the fact that this result is inherent in the structure of the proposal says a lot about how the proposal is structured far too broadly.
  - **How do we know the difference between the absurd results that are not intended and the very strange results that may be intended?** It is not enough to say that the above examples were not intended and cannot be the law. There is no hint in the proposal regarding what promotion by a financial services provider is permissible and what promotion is prohibited, leaving all of us to make guesses. Unfortunately, this lack of clarity is built into the structure of the proposal.

ADDITIONAL ANALYSIS AND CONCERNS

The BIC exemption is unusable. Initially, there was hope that the BIC exemption would address many of the concerns that had been raised with respect to the original proposal. For many reasons, however, as noted above, the BIC exemption is unusable. For example:

- **The BIC exemption does not even apply to advice provided to small businesses.** With rare exceptions, small business 401(k) plans permit employees to direct the investment of their own account. The BIC exemption does not apply to advice provided with respect to any such plan.
- **The BIC exemption only applies if a contract is entered into before discussions begin.** So an individual who wants to interview different advisors, the individual would have to enter into contracts with all those advisors before talking to them, which simply would not happen.
- **The BIC exemption only applies to individual advisors who sign a contract.** So if an individual advisor is on vacation or leaves her employer, a new contract would be needed.
- **The BIC exemption requires disclosure of an unimaginable amount of detailed information.** The advisor's company must maintain a webpage with detailed information – updated at least quarterly -- about all direct and indirect compensation payable to the adviser, his company, and all company affiliates with respect to ***every single asset*** purchased, sold, or held by a retirement customer during the last 365 days (excluding only certain assets not commonly purchased). In addition, the webpage must include the same information about ***all assets that a retirement customer could possibly purchase (subject to the same exclusion).*** It is hard to imagine that almost anyone would be able to process this staggering amount of data, which would be extremely costly to provide.
- **Inconsistent with existing DOL rules.** Every year, the advisor must provide information to the customer about that year's transactions, including the total dollar amount of all indirect compensation received by the adviser and his company during the year attributable to the customer. We understand that systems do not exist that could produce this data. Also, this data is very different from existing DOL requirements about disclosing indirect compensation.
- **Predictions of future investment performance required.** Before a recommended purchase of an asset is made, the advisor must provide a chart to the customer with the "Total Cost" of the asset over 1, 5, and 10 year periods, as a dollar amount, ***which requires the advisor to make assumptions about future investment performance.***

.

There is no way to comply with the applicability date. The proposal provides eight months to analyze and understand lengthy final regulations and exemptions that we have not yet seen, make business decisions that affect the entire retirement business, restructure that business, revise compensation packages and structures for advisors, renegotiate fee arrangements, design and implement company policies and procedures, create and modify systems to produce an unprecedented amount of new data, draft contracts for IRA owners across the country, and enter into contracts with tens of millions of existing customers. That will take a minimum of two years; eight months is simply not realistic.

- **<u>Feasibility of entering into contracts with all existing customers.</u>** A financial institution has no way to compel existing customers who are not actively using their services to enter into any contract. So not only is the applicability date unrealistic, the entire contract requirement is problematic as a transition matter.
- **<u>Transition rule inadequate.</u>** The proposed transition rule protects assets purchased by the applicability date but does not protect (1) assets purchased after the applicability date pursuant to advice given before the applicability date, or (2) advice provided after the applicability date that was paid for before the applicability date.

<u>None of the above issues, which have been raised for four and a half years, received the attention they deserved at OMB.</u> OMB's 50-day review of the re-proposal was startlingly brief:

- The review period *was almost a month shorter* than the next shortest review period for any significant retirement regulatory proposal in the last 10 years.
- It was less than half the average review period of other significant retirement regulatory proposals in the last 10 years (which was 109 days).
- Equally startling is that the review period after OMB received significant public input was actually just a few days. For example, a critical meeting to discuss new information was held on April 9, 2015, and the DOL proposal was issued on April 14, 2015, a mere five days later.

<u>Insurer promotion of its own health, life, and disability products</u>. The proposal would convert the promotion by an insurer (or its agent) of the insurer's own group health,[2] life, and disability insurance products to small businesses (or their fiduciary, such as a broker) or employees (of employers of any size) into fiduciary acts even in circumstances where no plan assets are held in trust. In other words, an insurer would be treated as a fiduciary with respect to certain welfare benefit plans simply by reason of promoting its own products.

If the promotion of these insurance products to small businesses (or their broker/fiduciary) or employees does become a fiduciary act, (1) the insurer would be vulnerable to a lawsuit simply for selling its own product without sufficiently considering the advantages of competitors' products, and (2) it is unclear whether a prohibited transaction exemption would be available to permit the continued sale by an insurer of its own insurance products to small businesses.

This result might seem counterintuitive, especially because DOL did not, in the preamble to the proposal, address this issue or provide any analysis of the economic effects of this aspect

[2] All references herein to health insurance also include dental, vision, and other similar forms of health-related insurance coverage.

of the proposal. Nonetheless, DOL's proposal applies to the sale of common employment-based insurance. There are several steps in the analysis of this issue.

- **The ERISA definition of "fiduciary" applies by its terms to both retirement plans and welfare benefit plans.** Under ERISA, the term "fiduciary" applies by its terms to all types of plans, including both retirement plans and welfare plans. Moreover, the DOL proposal explicitly defines a "plan" covered by the fiduciary proposal as including both retirement plans and welfare benefit plans. See § 2510.3-21(f)(2)(i).
- **The DOL proposal applies to any "recommendation as to the advisability of acquiring . . . securities or other property."** Under the proposal and generally, it is clear that insurance contracts are "property." For example, the DOL proposal uses the term "Asset" to refer to a specific subset of property both covered by the new definition and eligible for an exemption. The term "Asset" is defined to include insurance contracts. See Section VIII(c) of the Proposed Best Interest Contract Exemption.
- **The DOL proposal only applies to advice regarding the property of a plan or IRA; this requirement is satisfied too.** Under longstanding DOL rules, if employees contribute toward the cost of benefits, such as health, life, or disability insurance, the employee contributions are considered property of a welfare benefit plan, even if the contributions are not held in trust. See 29 C.F.R. § 2510.3-102; DOL Advisory Opinion 96-12A. Thus, in every case where employees contribute to the cost of a plan, advice regarding the insurance products is advice regarding the property of a plan.
- **The advice is rendered for a fee.** Under the definition of fiduciary investment advice, the advice must be rendered for a fee or other compensation, direct or indirect. The DOL has long taken the position that this does not require a separate fee for the advice; on the contrary, it is sufficient for the advisor to receive compensation in connection with the recommended transaction, as clearly occurs when an insurer receives premiums for health, life, or disability insurance. If this were not the rule, financial institutions would, for example, be able to give free advice to purchase their own proprietary investment products and thus avoid fiduciary status.
- **The DOL proposal specifically treats individualized marketing to small plans and individuals as fiduciary advice, not as marketing.** Under the proposal, individualized marketing to large plans can be selling, not advising; individualized marketing to small plans and individuals cannot be selling, but rather is treated as investment advice. See § 2510.3-21(b)(1). DOL explains this rule in the preamble to the proposal: "in this retail market [for small plans and individuals], a seller's carve-out would run the risk of creating a loophole that would result in the rule failing to improve consumer protections. . . ." It is this dramatic change in position, from both current law and the 2010 DOL proposal, that causes this issue to arise.

Let's put the above points together in the context of a simple example. An insurer markets its group-term life insurance product to employees of any size employer in a situation where employees are required to contribute toward the cost of the plan. The insurer, as expected, promotes the virtues of its product, as compared to its competitors' products. Under the DOL proposal, this promotion is fiduciary advice because:

- Individualized marketing to an employee is advice under the proposal.

- The advice is for a fee, i.e., the premium that would be paid for the insurance.
- The advice relates to the acquisition of property, i.e., the insurance contract.
- The advice relates to the use of plan property, i.e., the employee contributions.
- The advice is specifically directed to the employee for her consideration.
- The advice relates to an ERISA plan, i.e., a group-term life insurance plan.

DOL informally indicates that the above result was not intended. But the above result very clearly flows from the actual language of the proposal and is further evidence that the full adverse ramifications of the proposal are not fully understood.

THERE IS A VERY STRAIGHTFORWARD SOLUTION

After 4 ½ years and massive input, the DOL proposal got much worse between 2010 and 2015.

- The 2010 proposal preserved investment education; the 2015 proposal significantly restricted such education.
- The 2010 proposal permitted financial institutions to do direct marketing of their products to individuals and small businesses; the 2015 proposal does not.
- The 2010 proposal permitted financial institutions to provide meaningful distribution and rollover assistance; the 2015 proposal does not.
- The 2010 proposal did not provide any prohibited transaction relief; the 2015 proposal provides unusable relief.
- There are very small improvements in the 2015 proposal, mostly addressing glaring glitches in the 2010 proposal, such as clarifying that ads on television are not fiduciary advice.

We need legislation establishing a best interest standard with workable rules that preserve access to investment assistance for low and middle-income individuals and small businesses. The industry is completely fine with a best interest standard and is ready to support legislation that would establish a best interest standard with workable rules that preserve consumer choice and access to information.

Bipartisan legislation is the right answer. The DOL proposal can fundamentally alter the private retirement savings system, and there are critically important disagreements about what those effects will be on the retirement security of low and middle-income individuals across the country. Fundamental policy decisions like this are the province of Congress, not the agencies charged with interpreting the law.

Testimony

of

John F. "Jack" Haley, Jr.

Executive Vice President, Fidelity Investments

Before a hearing of the

House Committee on Education and the Workforce

Subcommittee on Health, Education, Labor, and Pensions

June 17, 2015

Chairman Roe, Ranking Member Polis, and members of the subcommittee, good morning, and thank you for this opportunity to testify.

My name is Jack Haley and I am an Executive Vice President at Fidelity Investments. I oversee a team of investment professionals dedicated to helping our employer clients and their workers have access to a wide array of high quality investment products and services to meet their investing needs.

At Fidelity, we have the privilege of helping more than 25 million people save for their financial goals and serving more than 14,000 workplace clients, close to 8,000 of which are small businesses[1] who offer retirement savings benefits to their workers.

From our roots as a small mutual fund company, Fidelity has grown into a diversified financial services leader. We are a premier asset manager; the nation's retirement leader in 401(k)s and IRAs; an award winning discount broker; and we provide clearing, custody, and practice management solutions to thousands of leading financial services firms as they help people and institutions invest for the future.

We offer the nation's largest mutual fund supermarket. With close to 700 fund families on our platform, we are at the leading edge of ensuring customers have the choice they desire when making investment decisions. For example, it may surprise you to hear that Fidelity is actually the largest distributor of PIMCO mutual funds. The team I lead sits at the nexus of investment products and our customers' saving vehicles, such as 401(k)s and IRAs.

Fidelity takes very seriously the responsibility of helping employers set up and offer robust and competitive retirement savings plans. I appreciate the opportunity to share with you our experiences helping small businesses provide retirement savings opportunities for their workers and to voice our

[1] Plans under 100 employees and under $100million in assets

concerns about the impacts of the Department of Labor's proposed rule on our ability to continue helping small businesses and their workers.

First, however, I want to answer a call from the Department of Labor, by stating directly, up front: Fidelity acts in the best interest of its clients and investors and we support a best interest fiduciary standard. We are proud of the services, products, and choices we provide to help customers achieve a secure retirement. Our data clearly show that access to financial guidance helps customers achieve better retirement outcomes. We fear the Department of Labor's proposed regulation will severely restrict our ability to continue providing this assistance to small businesses and workers in 401(k) plans.

We support a best interest fiduciary standard, but the details matter. A best interest standard must allow individual retirement savers and businesses offering retirement plans to have choice and access to the products and services that help them achieve a secure retirement. While the framework of the Department's proposed rule would theoretically preserve different service models when acting in the customer's best interest, the proposed Best Interest Contract (BIC) Exemption contains so many problematic conditions that the rule is unworkable as drafted and will have the effect of banning many well-established service models. Under the DOL proposal, access to affordable financial help will effectively be prohibited – *even when it is in the investor's best interest.* Small businesses and lower- and middle-income investors will be harmed the most.

We believe there is a balanced approach where savers can be protected by a best interest standard <u>and</u> continue to have access and choice in their retirement products, services, and providers. We look forward to continuing to work with Members of Congress and the Administration to ensure this balance is reached.

I. Impact on small businesses

Small business remains the lifeblood of our economy. According to the Small Business Administration, 99 percent of U.S. employers are small businesses. These companies produce 63 percent of all new private-sector jobs and include everything from your family doctor and local construction companies to entrepreneurs who may be the large employers of the future. Ten years ago, Facebook had only 15 employees. Today, it has grown to more than 9,000.

At Fidelity, small businesses make up close to 60 percent of our workplace clients for whom we help create, manage, and maintain retirement savings plans. These hardworking entrepreneurs and businesspeople bring significant expertise and passion to their work. We see a very strong desire from these employers to offer competitive, high-quality retirement savings benefits to attract and keep a highly-skilled workforce. Not surprisingly, with all they have to do to manage their businesses, there is little time, expertise, or desire to manage their retirement savings plans.

That is why small businesses turn to us. Every day we provide a range of critical services to ensure these employers and their workers have access to retirement savings plans. We help these companies understand and select the right savings vehicle -- whether it is a 401(k), SEP, or IRA -- and provide all of the critical functions to keep a plan running smoothly including:

- trustee and custodial support;
- recordkeeping;
- compliance testing and reporting;
- assist in selection of investment offerings;
- ongoing monitoring of investments; and,
- perhaps most importantly, participant education and guidance services.

Fidelity provides comprehensive, end-to-end investment services for new and existing clients. From the beginning of the relationship, a prospective client is given key insights for developing and designing an optimal plan line up for its employees. This includes a framework on how to design a plan for different levels of employee engagement, the number and types of investments to include, and how these should be structured in the plan investment lineup. For example, best practices suggest Target Date funds as the default option and starting place for most investors.

Next, Fidelity's research team provides a curated list of funds ("Funds for Discussion"), which helps the employer narrow from hundreds of funds available to a short list from which to select. This scalable process allows small plan sponsors access to quality information otherwise only affordable to larger employers.

Once an employer becomes a client, they continue to have access to Fidelity's research, investment consulting, thought leadership and best practices. For example, Fidelity produces over 14,000 client-specific Investment Reviews per year.

These reviews ensure the employer has the best high-quality investment products to meet their investment policy statement requirements and that their employees are well positioned to invest for their futures. If changes are required, Fidelity would provide the information needed to help the employer meet their fiduciary duties.

Every year, Fidelity receives an additional 1,500 new requests for help from small businesses who want to offer a plan.

Additionally, on a day-to-day basis, Fidelity offers best in class operational support, including contribution calculations, participant notifications, plan testing and reporting, as well as assistance with plan amendments. Employees receive employee education and financial planning advice through a variety of channels including Net Benefits, employee meetings, digital and mobile access, and one-on-one assistance with guidance representatives skilled in the client's specific plan design.

Unfortunately, the Department of Labor's proposal would put a stop to these offerings. The Labor proposal would classify the assistance we provide to small businesses (which today is education) as fiduciary investment advice.

Curiously, the rule's BIC Exemption, which is intended to preserve different service models, does not apply to assistance provided to small business plans (defined as plans with less than 100 employees or less than $100 million in assets.) In other words, the proposed DOL rule specifically prohibits service providers from assisting small businesses. The result would have a devastating impact on retirement coverage and savings for millions of workers employed by small businesses across the country. This, at a time when policymakers on both sides of the aisle are looking for opportunities to provide American workers with access to retirement savings plans.

To reiterate, we support a best interest fiduciary standard. But without exemptive relief from ERISA's strict rules, Fidelity would be prohibited from providing these critical services to our small business clients – even when the help we provide them is in their best interest.

II. Why guidance matters

Just as important as the services we provide to small businesses is the critical education and guidance we provide to their employees every day. Let me tell you a personal story which underscores the universal need for this kind of education.

I began my career here in Washington as a research analyst at the Government Finance Research Center where I had a retirement account with TIAA-CREF. At 26, I accepted a job at Fidelity, and what did I do with my retirement savings? I did the worst thing someone could do – I cashed out.

I might not have made that decision had I talked to a financial professional who would have explained the negative consequences of cashing out – such as taxes, penalties, and a smaller retirement nest egg.

At Fidelity, standing up for the best interests of our customers means more than just meeting a legal standard. It includes encouraging workers to keep their savings in-plan when we know their investment options are better and providing a human experience – from ushering new workers into our community of retirement savers to helping a new widow decide her next steps in protecting her own future.

Some have suggested that technological developments have negated the need for the personalized support we provide to employers and their workers. We wholly support innovation, but I can assure you, a robo-advisor will not have a discussion with you about the perils of cashing out. And our representatives know acting in a client's best interest means being able to help workers plan for the long-term when they are facing important decisions today.

Today, the average worker has more than 11 employers over the course of his or her career. With job mobility on the rise, education and guidance at the time of job transitions is more critical than ever to protect the retirement security of these workers. The importance of this education is underscored by a recent study from the Boston College Center for Retirement Research, which found that individuals prematurely withdraw nearly $200 billion annually from their retirement savings[2]. Without access to critical assistance at the time of a career transition, this number would be even higher.

Under the proposed rule, many of these ordinary conversations could now be considered personalized investment advice, even if the conversation is merely educational and there is no discussion of investments or advice given. A best interest standard must ensure job changers are not disadvantaged at these critical transition periods in their lives.

III. Contract requirement

[2] The Impact of Leakages from 401(k)s and IRAs, BC Center for Retirement Research, February 2015

Our assistance to small businesses and their employees also includes basic everyday assistance to ensure workers are on the right path to a secure retirement. Today, we are able to help these workers by discussing *potential* product and service offerings with them. The proposed DOL exemption would require a signed contract *before* a conversation could even occur. And since our customers speak to different phone reps each time they call, the rule would require *each of our customers* to have a signed contract with *each of our phone reps* in order to get answers to these basic questions. For Fidelity, requiring our nearly 25 million customers to sign contracts before we can continue to service them would be a significant impediment to ongoing engagement with them, potentially suppressing their savings levels and retirement security.

IV. Unworkable disclosures

Not only are the logistics of entering into a contract with all plan participants and IRA holders unworkable, but the proposal is also unworkable because it requires an unreasonable amount of confusing disclosures. The proposal requires three separate types of disclosures: (1) a point of sale disclosure of the total cost of each recommended investment projected over one-, five-, and ten-year periods; (2) an annual disclosure of the compensation payable to the advisor in dollar amounts for the preceding year; and (3) maintenance of a publicly available website showing information about compensation payable to the advisor with respect to all assets that can be purchased by a plan, participant, or IRA investor.

These disclosure requirements, some of which conflict with existing FINRA requirements, are completely unworkable, would confuse workers, and do nothing to help them better understand potential conflicts. We believe a single disclosure of material conflicts of the advisor, including compensation payable to the advisor in connection with the recommended transactions, will best support the purpose of a best interest standard.

The contract and disclosure requirements are clearly not in a workers' best interest.

Closing

These are just a few of the examples of the critical services we provide to small businesses and their employees and the real concerns we have with parts of the proposal which would harm the very people the rule intends to protect. There is a much longer list of additional issues which will be outlined in more detail next month when we file official comments with the Department on its proposal.

Fidelity feels strongly that a balanced approach which provides investors with fiduciary best interest protections but retains existing service models critical to ensuring retirement preparedness is achievable. This is the commitment the Administration gave earlier this year when the President announced his support for the proposal. Unfortunately, the DOL proposal does not deliver on this commitment. We look forward to working with you in the coming months to ensure that a best interest standard preserves financial assistance and choice for individual retirement savers and businesses offering retirement plans.

Let me close by stating unequivocally that we support a best interest fiduciary standard but it must be crafted in a way that allows workers to the choice and access to the services they need and desire.

FINANCIAL SERVICES INSTITUTE

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS

AND INDEPENDENT FINANCIAL ADVISORS

Testimony of
Dean Harman
Founder and Managing Director
Harman Wealth Management, Inc.
and
Member, Board of Directors
Financial Services Institute

Before the
United States House of Representatives Committee on Education & the Workforce
Subcommittee on Health, Employment, Labor, and Pensions

On

"Restricting Access to Financial Advice:
Evaluating the Costs and Consequences for Working Families and Retirees"

June 17, 2015

Introduction

Good morning, Mr. Chairman, Ranking Member Polis, and members of the Subcommittee. I am Dean Harman, Founder and Managing Director of Harman Wealth Management in The Woodlands, Texas. I am a CERTIFIED FINANCIAL PLANNER™ with over 20 years of experience in the financial services industry. I am here representing the Financial Services Institute (FSI). FSI is the only organization advocating solely on behalf of independent financial advisors[1] and independent financial services firms. Since 2004, through advocacy, education and public awareness, FSI has successfully promoted a more responsible regulatory environment for more than 37,000 independent financial advisors, and more than 100 independent financial services firms who represent upwards of 160,000 affiliated financial advisors. We effect change through involvement in FINRA governance as well as constructive engagement in the federal and state regulatory and legislative processes, working to create a healthier regulatory environment for our members so they can provide affordable, objective advice to hard-working Main Street Americans.

Independent financial advisors, such as me, are in the business of helping hard-working Americans achieve their financial goals. This entails helping our clients plan for a dignified retirement, pay for their children's education, support loved ones in old age, deal with healthcare issues, and the many other life situations that require financial resources. In my practice, approximately 60% of the accounts that I service are retirement accounts. Furthermore, approximately 90% of the accounts that I service are under a fee-based advisory model. The other 10% are accounts that I service under a commission-based model. These commission-based accounts belong to smaller investors, including the elderly and many young adults who are just starting their careers, who need the advice, products and services I can provide.

As our retirement system has moved towards a defined-contribution model and traditional pensions are becoming a thing of the past, it is critical that these lower net-worth investors be able to obtain professional guidance as they prepare for retirement. It is because of this that I am here today. I want to ensure that any rule written by the Department of Labor (DOL), or any

[1] The term "financial advisor" is used to denote registered representatives of broker-dealers, investment adviser representatives of investment advisers, and persons who are dually registered in both capacities.

other regulator in the retirement savings sphere, will make it easier, not harder for investors to receive high-quality, retirement services from a trusted financial advisor.

My testimony will touch on three main points. First, FSI and many independent financial advisors support a uniform fiduciary standard. Second, the current DOL proposal regarding the definition of the term "fiduciary" for purposes of the Employee Retirement Income Security Act of 1974 (ERISA) is based on flawed assumptions that lead it to be too complex, too cumbersome, and too costly. Finally, because of these shortcomings, FSI and I believe that the DOL's proposal will result in small- and mid-sized investors losing access to the retirement advice and products that they need to secure a high-quality of life in their retirement years.

DOL's Proposed Rule Creates Vast, Sweeping Changes to the Retirement Savings Landscape

On April 20, 2015, the DOL published its proposed rule on conflicts of interest and the definition of the term fiduciary under ERISA. The DOL previously attempted to pass a similar regulation in 2010. Because of concerns expressed by the industry and Congress, DOL withdrew its previous proposal on September 19, 2011. However, they promised to issue another proposal. To their credit, the DOL took its time and attempted to address the concerns with the 2010 proposal raised by the industry and Congress. Unfortunately, while the proposal being discussed today is one that looks and functions very differently from the 2010 proposal, it delivers virtually the same results – an unworkable, complex and costly rewrite of ERISA and IRS regulations that will harm retirement investors more than it helps them.

DOL's proposal would institute a broad new definition of the term "fiduciary" for the purposes of ERISA. Under this new proposed definition, an individual who provides investment advice or recommendations to an employee benefit plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner would be treated as a fiduciary in a wider array of advice relationships than under current requirements. Under this much more expansive definition, more advisors will be considered fiduciaries when providing services to retirement savers. This is an extremely important change because fiduciary status brings with it prohibitions and limitations on compensation and other arrangements that are essential to those who service retirement accounts.

Under current laws and regulations that have been in place since 1975, a person who does not have discretionary authority or control with respect to the assets of a plan will not be treated as a fiduciary by virtue of providing investment advice unless:

1) Such person renders advice as to the value of securities or other property, or makes recommendations as to the advisability of investing in, purchasing or selling securities or other property;
2) On a regular basis;
3) Pursuant to a mutual agreement, arrangement or understanding, with the plan or a plan fiduciary;
4) That the advice will serve as a primary basis for investment decisions with respect to plan assets; and
5) The advice will be individualized based on the particular needs of the plan.

The DOL proposal would eliminate this current five-part fiduciary test. In its place, the proposal would institute a vastly expanded fiduciary definition. Under this proposed rule, an advisor would be deemed a fiduciary if two different conditions are met.

First, the individual receives a direct or indirect fee for providing directly to a plan, plan fiduciary, plan participant or beneficiary, IRA, or IRA owner any one of the following:

- A recommendation as to the advisability of a plan investment holding or transaction, including a recommendation to take a distribution or as to the investment of a rollover of that distribution;
- A recommendation as to the management of securities or other property;
- A verbal or written appraisal, fairness opinion, or similar statement concerning the value of securities or other property in connection with a specific transaction; or
- A recommendation of a person to provide, for a fee, any of the above three services.

Second, the individual directly or indirectly represents or acknowledges that he/she is acting as a fiduciary, or he/she renders the advice pursuant to a written or verbal agreement, arrangement, or understanding that the advice is either individualized or specifically directed to the recipient for consideration in making investment or management decisions with respect to plan or IRA securities or property.

Not only does this new definition expand the activities that would render an individual a fiduciary, but it also expands the universe of accounts that are covered by the regulation to include IRAs and other accounts such as HSAs that were previously not considered to be under ERISA's umbrella. The proposal does provide eight narrow carve-outs to the above definition. Unfortunately, these carve-outs tend to be so narrowly tailored that they are of little to no help to most financial advisors.

Because of the expansive definition and the narrow nature of the carve-outs, the vast majority of interactions that a financial advisor, whether registered with a broker-dealer or investment adviser firm, will have with plans, plan fiduciaries, plan participants or beneficiaries, IRAs, or IRA owners would fall under the new fiduciary definition.

As ERISA fiduciaries, financial advisors are prohibited from receiving variable compensation or commissions unless an exemption applies. Under the proposal, a fiduciary advisor may still receive these types of compensation if the advisor's activities fall under one of the Prohibited Transaction Exemptions (PTEs) like the newly proposed Best Interest Contract Exemption (BICE).

The DOL has stated its intention is for BICE be the primary method by which advisors and firms would be able to receive otherwise prohibited compensation for services provided in connection with the purchase, sale, or holding of an asset subject to the proposed fiduciary standard. BICE would require that both the financial advisor and the firm enter into a pre-advice, pre-point-of-sale contract with a potential investor. In this contract, the financial advisor and the firm would have to make various warranties and acknowledgements to consumers that amongst other things include: acknowledging their fiduciary status; agreeing to provide advice that is in the best interest of the investor; agreeing to not recommend assets when compensation for those assets would exceed "reasonable compensation;" and disclosing any conflicts of interest.[2]

[2] The full contract requirements are as follows: the advisor and the firm acknowledge that they are fiduciaries; the advisor and the firm agree to provide advice that is in the best interest of the investor and will not recommend an asset if the total compensation would exceed "reasonable" compensation for the total services provided; the advisor and the firm agree to not make misleading statements regarding the asset, fees, conflicts of interest, and any other matters related to investment decisions; the advisor and the firm warrant that they will comply with all applicable federal and state laws, the firm has adopted written policies and procedures to mitigate conflicts of interest, the firm has identified all potential conflicts of interest and has adopted measures to prevent the conflicts from impeding the advisor and the firm from providing advice that is in the best interest of the investor, and the firm and its affiliates (to the firm's knowledge) do not engage in practices that encourage advisors to not provide advice that is in the best interest of the investor; any conflicts of interest have been identified and disclosed; the investor be advised of the

Furthermore, while the contract may call for arbitration of individual claims, it may not contain any provision disclaiming liability from a violation of any contractual term or any waiver or qualification of the investor's ability to enter into a class action suit against the financial advisor or the firm for any violation of the contract's terms.

Along with the contract briefly summarized above, BICE also contains various onerous disclosure, website, and recordkeeping requirements, as well as a list of approved investments that may be sold to retirement accounts. In a later section, I will dive further into these requirements and explain various troublesome aspects of BICE and its multitude of costly requirements.

I wish to emphasize that my concern, and the concern of FSI members, is not that DOL's proposal would expand the universe of retirement advice interactions that would be held to a fiduciary standard of care. Both FSI and I believe that a carefully-crafted, uniform fiduciary standard of care would be beneficial for investors, so long as it preserves the business and fee models that make it possible for all Americans to receive affordable retirement and other financial advice. Instead, our concern lies with all of the additional requirements contained in the proposal that would create serious disruptions to the retirement savings landscape and make the proposal unworkable for retirees, financial advisors, and financial institutions. These extra requirements will drive up costs and will make it more difficult for me, and countless other advisors, to provide retirement advice to the millions of Americans that have modest retirement savings accounts. Without access to these services, I fear that many Americans will delay investing for retirement, respond emotionally to fluctuations in the markets or cash out their retirement savings to satisfy short-term needs. Most especially, I fear for my own low net-worth clients who I could no longer service under the new requirements.

FSI Supports a Uniform Fiduciary Standard

Since 2009, FSI has publicly supported a carefully-crafted, uniform fiduciary standard of care applicable to all professionals providing personalized investment advice to retail clients.

---

right to complete information regarding all fees associated with the asset; and there be a disclosure as to whether the firm offers proprietary products or receives indirect compensation, and directs the investor to a publically-available website where the information can be viewed.

While our industry is already held to high standards of care and there is a robust enforcement regime to ensure that we are working properly on behalf of our clients, there is a lack of uniformity with regards to the standard of care that different advisors must adhere to when advising clients. Because of this, FSI supports the creation of a uniform fiduciary standard of care that would be applicable to all advisors and all asset classes.

Advisors all over this country have worked hard to grow their businesses and help their clients. We are in a business that is built on a foundation of trust. Our clients trust us to help them reach their life goals and help them weather the difficult moments in their lives. We are in a service profession and we take immense pride in being entrusted to help our families, our friends, our neighbors, our colleagues, and other members of our communities. Having these people's financial hopes and dreams placed in our hands also gives us a deep sense of responsibility. It is because of this pride and responsibility that we hold ourselves up to high standards and we would welcome further codifying our commitment to our clients through a uniform fiduciary standard of conduct. This uniform standard of conduct should consist of the following:

- A professional should act in the best interest of the customer;
- A professional should provide advice with skill, care, and diligence based upon information that is known, about the customer's investment objectives, risk tolerance, financial situation, and other needs;[3] and
- A professional should disclose material conflicts of interest, avoid them when possible, and obtain informed customer consent to act when such conflicts cannot be reasonably avoided.

The standard of care described above is designed to address the same investor protection goals that have motivated the DOL to release the proposal that the Subcommittee is analyzing today and it goes a step further by making this the standard for advice regarding all investment products, not just retirement savings. There are two other key differences between this uniform fiduciary standard of care and the DOL proposal – (1) this uniform fiduciary standard of care would not create the same disruption to the current retirement savings marketplace, and (2) it

[3] FSI believes that a financial advisor should use reasonable diligence to obtain the necessary information to provide advice.

would give advisors and firms the necessary flexibility to make the proper decisions regarding what investments and payment models are in the best interest of each individual client.

What I have outlined is truly a principles-based approach to investor protection, whereas the DOL proposal is one that is overly-prescriptive in its approach. Advisors need the flexibility to treat each client as an individual and tailor investment strategies that meet a client's specific circumstances. Flexibility in investment strategies and compensation structures allows me to develop unique investment plans for each and every one my clients. Should the DOL proposal be implemented, as currently proposed, I fear that much of this flexibility will be gone and I will be unable to provide retirement advice to all of my clients, especially those with lower balances in their retirement accounts.

The DOL has premised its proposal on flawed assumptions made about financial advisors, the financial services industry, and retirement savings products

In crafting its proposal, the DOL has made several flawed assumptions regarding our industry and the retirement savings products commonly used by investors. These assumptions cause the proposal to include additional requirements that I believe will prove to be too complex, too cumbersome and costly. These extra requirements will drive up costs and will make it more difficult for me, and countless other advisors, to provide retirement advice to the millions of Americans that have modest retirement savings accounts. I want to highlight three of the most troublesome misunderstandings that have colored the DOL proposal.

First, the proposal is premised on a belief that retirement investors are unprotected by the current regulatory system. This is simply not true. My business is heavily regulated by the Securities and Exchange Commission (SEC), the Financial Industry Regulatory Authority (FINRA), and 50 state securities regulators. Furthermore, my broker-dealer also routinely monitors my activities and examines my business to ensure that I am in compliance with the many rules and regulations that I am subject to as a financial advisor. Adding new levels of regulatory requirements and legal burdens on to this structure, as this proposal does, will not further protect investors. Instead, it will drive up compliance costs on financial advisors and, ultimately, drive up the costs of retirement advice for investors.

Second, the DOL has stated that "conflicted advice" causes consumers to lose approximately $17 billion on an annual basis. In reaching this conclusion, the DOL relies on an unreliable figure from a report published by the White House Council of Economic Advisers.[4] The figure is an estimate that is not directly found in any academic research and is an estimate calculated by the authors of the report. In arriving at this estimate, the authors of the report make largely unsupported generalizations and extrapolations. Their calculation is a simplistic one where they take the total value of load mutual funds in IRAs and the total value of annuities in IRAs, and multiplying that number by their estimated losses to consumers of 1% per year due to "conflicted advice."

This approach is flawed in the following ways: (1) academic literature suggests a more nuanced and complex set of findings than the simplistic claim of 1% in annual losses; (2) the academic studies that the report's authors rely upon only look at the first year of a fund's performance, when costs are highest; and (3) the report ignores the value to consumers added by brokers in the form of customer service, broader diversification, risk reduction, and other intangible benefits. Furthermore, the figure does not provide a true cost-benefit analysis because it only looks at the supposed costs to consumers of "conflicted advice." The study's authors did not take into account what would happen to the retirement savings marketplace if the DOL proposal is put into place. Therefore, the DOL is unable to quantify what positive and/or negative effects will result from the rule proposal.[5] By using such an unreliable figure to justify the need for the proposal, the DOL is doing a disservice to investors, especially those of modest means who will benefit from professional advice when planning for retirement.

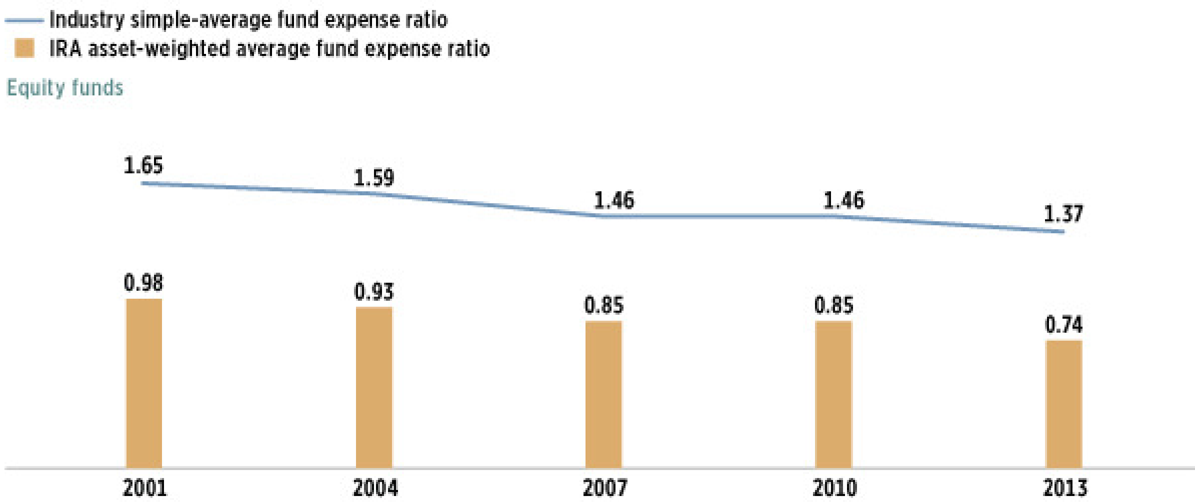
Third, the DOL proposal assumes that financial advisors direct their clients to the highest priced investment options to line their pockets to the detriment of their clients. As a financial advisor, I can tell you that isn't how my practice, or those of my fellow financial advisors, operates. But you don't have to take my word for it. Investment Company Institute research demonstrates that the opposite is true. Financial advisors tend to lead investors to funds whose

---

[4] Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings* (February 2015), *available at* https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

[5] For a more detailed analysis of the shortcomings Council of Economic Advisors' report, *See*, Berkowitz, Jeremy, et. al., *Review of the White House Report Titled "The Effects of Conflicted Investment Advice on Retirement Savings,"* NERA Economic Consulting (March 2015), *available at* http://www.nera.com/content/dam/nera/publications/2015/PUB_WH_Report_Conflicted_Advice_Retirement_Savings_0315.pdf.

expense ratios are far lower than the average expense ratio for all funds.[6] The following chart demonstrates the point:



Unfortunately, these and other flawed assumptions cause the DOL to offer a proposal that is poorly designed for investors and unduly burdensome for financial advisors and financial institutions. The result is that the proposal will drive up costs putting retirement advice out of the reach of many investors.

The DOL Proposal Will Inhibit Financial Advisors' Ability to Provide High-Quality, Individualized Retirement Advice

When looking at implementing any potential final rule in this space, it is imperative that the DOL ensure that all investors maintain affordable access to the significant benefits that financial advisors provide. Investors working with a financial advisor to save money for retirement are better positioned to reach their goals than investors that choose to forge their own investment path. This is because advisors are able to focus investors on their long term goals and help them navigate the many different and complex ways by which investors can save for both long- and short-term goals. This focus helps investors weather the ups and downs that accompany

[6] Letter from David Abbey and Brian Reid, Investment Company Institute, to Howard Shelanski, Administrator, Office of Information and Regulatory Affairs, Office of Management and Budget (April 7, 2015), *available at* http://www.ici.org/pdf/15_ici_omb_data.pdf.

our financial markets, thus preventing investors from chasing returns, buying high and selling low, and making rash emotional decisions during both bear and bull markets. Financial advisors also assist investors in resisting the temptation to cash out their retirement accounts to meet short-term needs.

There have been many studies conducted that demonstrate the positive impact of financial advisors working with investors, especially with regards to building retirement savings. Here is a small sampling of these studies:

- According to a 2012 study by the Investment Funds Institute of Canada[7] and a 2010 survey by the ING Retirement Research Institute,[8] individuals who spent at least some time working with a financial advisor had saved, on average, more than twice the amount for retirement than those that had not worked with an advisor.
- An April 2014 study by Quantria Strategies found that retirement savings balances are 33% higher for individuals who have access to financial advice; employees are less likely to take cash withdrawals out of their retirement savings if they discuss their distribution options with an advisor; and limiting access to this assistance could increase annual cash outs of retirement savings for employees leaving a job by $20-32 billion, thus reducing the accumulated retirement savings of affected employees by 20-40%.[9]
- A 2012 survey conducted by LIMRA found that investors working with an advisor are more likely to be saving for retirement at higher rates (defined as contributing more than 7% of their salary to a retirement plan) with 61% of investors who worked with an advisor saving at the higher rates compared to 36% of investors that were not working with an advisor.[10]

---

[7] Cockerline, Jon, *New Evidence on the Value of Financial Advice*, The Investment Funds Institute of Canada, 2012, *available at* https://www.ific.ca/wp-content/uploads/2013/08/New-Evidence-on-the-Value-of-Financial-Advice-November-2012.pdf/1653/.
[8] ING Retirement Research Institute, *Working with an Advisor, Improved Retirement Savings, Financial Knowledge and Retirement Confidence!*, 2010, p. 6, *available at* http://voyacdn.com/file_repository/5151/help_wanted_wp.pdf.
[9] Quantria Strategies, *Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings*, April 2014, *available at* http://quantria.com/DistributionStudy_Quantria_4-1-14_final_pm.pdf.
[10] LIMRA, *Advisors Positively Influence Consumers' Behavior and Sentiment Toward Preparing for Retirement*, July 2012, *available at* http://www.limra.com/Posts/PR/News_Releases/LIMRA__Advisors_Positively_Influence_Consumers__Behavior_and_Sentiment_Toward_Preparing_for_Retirement.aspx.

- A 2010 study by Prudential found that African Americans with a financial advisor were significantly more likely to participate in employer sponsored retirement plans, have a savings account, life insurance, long-term care insurance, annuities, and mutual funds. That same study also found that African Americans who worked with a financial advisor were more financially confident than those who did not.[11]
- A 2013 Morningstar study found that by working with a financial advisor, a retiree can be expected to generate 22.6% more certainty-equivalent[12] income. This has the same impact on expected utility as an annual return increase of 1.59%, which represents a significant improvement in portfolio efficiency for a retiree.[13]
- A 2012 study conducted by the Investment Funds Institute of Canada found that households working with an advisor have substantially higher investible assets than non-advised households, regardless of household income level, because advisors helped investors choose the right plans and asset mix to fit their individual circumstances, objectives, and risk tolerance.[14]

Unfortunately, the DOL appears to have been unaware of these positive effects or the importance of ensuring that all investors, regardless of their wealth, retain access to professional retirement advice.

I do not question the DOL's intentions. Protecting investors is a laudable goal and one that FSI and I share, but no matter how well-intentioned the DOL is in this matter, their proposal has severely missed the mark and it will lead to millions of Americans losing access to retirement advice. FSI does not want to see this happen, which is why we have been involved in constructive dialogue with the DOL to try and improve their proposal so that it achieves their investor protection goals in a manner that is truly workable for all parties.

[11] Prudential, *The African American Financial Experience* (2014), *available at* http://www.prudential.com/media/managed/aa/AAStudy.pdf.
[12] Certainty-equivalent is defined as a guaranteed return that an investor would accept, rather than taking a chance on a higher, but uncertain, return.
[13] Blanchett, David and Kaplan, Paul, *Alpha, Beta, and Now…Gamma*, Morningstar Investment Management, August 2013, p. 16, *available at* http://corporate.morningstar.com/ib/documents/PublishedResearch/AlphaBetaandNowGamma.pdf.
[14] The Investment Funds Institute of Canada, *The Value of Advice Report*, 2012, *available at* https://www.ific.ca/wp-content/uploads/2013/02/IFIC-Value-of-Advice-Report-2012.pdf/1650/.

The following are our biggest concerns with the proposal – the areas where we feel the proposal will do the most harm to investors and their access to retirement advice, products, and services. These are areas that must absolutely be fixed if this proposal is going to work as we believe the DOL intends it to work.

The proposal is too restrictive with regards to what activities are permissible "investor education" activities.

One of the most important aspects of my job as an independent financial advisor is improving the financial literacy of my clients and those in the community that I serve. For people to make educated decisions regarding their financial futures, it is imperative that they are given a solid foundation of understanding. Too many individuals do not have this foundation. Many do not know the difference between a growth and a fixed income mutual fund or do not understand the need to diversify their portfolio to reduce risk. Sadly, there are many people in this country that have never been taught the basics of investing.

There are few places where the effects of a lack of financial education can be more harmful than in the retirement savings sphere. For decades, large sections of our nation's workforce did not need to be concerned with how they would fund their retirement years. The twin pillars of the pension and Social Security systems provided millions of Americans piece of mind. They knew that if they worked hard, then they would be able to enjoy their retirement years. All of that has changed in today's world. The pension system now represents a small fraction of the retirement model for the American workforce. It has been replaced by a defined-contribution model where individuals now bear a greater responsibility for funding their retirements. Furthermore, as Americans are living longer lives, it takes more money to live comfortably in retirement. This means that, now more than ever, it is critical that Americans are given the proper tools and information to make informed decisions. Therefore, any regulation in the retirement savings sphere must make it easier for individuals to receive vital education regarding their investments and retirement savings.

In some ways the DOL's proposal achieves this goal. Under current regulations, as stated in DOL Interpretive Bulletin 96-1,[15] advisors have a hard time being able to clearly illustrate longevity risks and the effects of "decumulation" on retirement savings. In this instance, the DOL

[15] *Interpretive bulletin relating to participant investment education*, 25 C.F.R. § 2509.96-1.

listened to feedback from advisors and other industry representatives regarding the 2010 proposal. It is great to see that the DOL made a positive improvement from its prior proposal and have made it clear in this version that educational materials regarding longevity risks and the effects of "decumulation" are allowable as "investor education" pieces.

Unfortunately, not all of the DOL's proposed changes to the "investor education" carve out are positive. One of the most significant negative changes to "investor education" lies in the proposal's prohibition on referencing specific investment products in educational pieces. This change will lead to investors having less knowledge regarding their investment options. In my practice, I use asset allocation models and other similar illustrations to show plan participants, current, and potential clients how they can diversify their portfolios to manage risk. To a great extent, investor comprehension is contingent upon being able to identify what funds or other investment options available to them align with a category of investment. By removing the ability for me and other advisors to provide the proper context on these education materials, the DOL will be curtailing the effectiveness of these important educational resources. Sadly, this will likely lead to confusion among investors and a decrease in the overall financial knowledge of individuals when making important decisions regarding their retirement investments.

BICE is rife with problems and will not serve its intended purpose unless it is substantially altered.

Beyond the problems with "investor education," the DOL proposal has fundamental flaws at its core that make it currently unworkable for advisors, such as me, and the rest of the financial services industry. I want to focus in on the BICE, which the DOL has crafted with the intention of preserving compensation models, such as commissions, that many advisors and firms rely upon when providing retirement advice to small accounts.

First, let me give a brief explanation of why it is important that these compensation models be preserved. In my practice, I currently advise 618 clients whose accounts have a total of approximately $200 million in assets. Of those total assets, approximately $10 million are held in 331 different accounts that have an average of around $30,211.[16] These typically are the accounts that benefit from a commission-based account. For these accounts, it makes no sense for me to be paid under an advisory fee model because the asset management fee would be

[16] Nearly 40% of IRAs in a 2010 survey conducted by Oliver Wyman had less than $10,000. *See*, Oliver Wyman, *Assessment of the impact of the Department of Labor's proposed "fiduciary" definition rule on IRA consumers*, April 2011, *available at* https://www.dol.gov/ebsa/pdf/WymanStudy041211.pdf.

cost-prohibitive for the client. Because these accounts are mainly owned by lower net-worth clients, young professionals just beginning their careers, and the elderly, these individuals cannot afford to come out-of-pocket to pay up-front financial planning fees for my advice. A commission-based model eliminates, or significantly reduces, these issues, thus providing a way for small to mid-size investors to pay for the advice, products, and services they need in a way that makes economic sense for these individuals. Because of this, I, and countless other advisors, recommend commission-based accounts for many younger or lower net-worth investors.[17]

In 2010, the DOL proposed a complete ban on commission payments on retirement accounts. Thanks to their willingness to listen to the many concerns regarding that approach, the DOL's current proposal does not repeat that mistake. The DOL has created a new exemption, BICE, with the intention that it be the primary method by which advisors and firms would be able to receive commission payments, 12b-1 fees, revenue sharing, marketing allowances and other variable forms of compensation. Unfortunately, BICE has missed the mark and, as currently proposed, would lead to the same unwanted consequence as the 2010 proposal – an effective ban on commission payments, 12b-1 fees, and other variable forms of compensation – by hugely increasing the burdens on financial advisors and financial institutions.

Problems with the Pre-Advice Contract:

BICE would require that both the financial advisor and the firm enter into a pre-advice, pre-point-of-sale contract with a potential investor. It is here that we encounter the first problem with BICE. As written, BICE would require a financial advisor to have a potential client sign a contract prior to any meaningful conversation about their financial situation in order to ensure they do not inadvertently offer retirement advice. As currently written, this contract would be presented to a potential client at a stage in the engagement process when I am not making any recommendation. At this early stage, I am just outlining the different things that the individual can do with his or her assets. I want to ensure that the individual fully understands all of the available options, feels comfortable with me as a person, and has some time to digest the information presented before I ever make a recommendation regarding how the individual should be

[17] Of all the IRAs in existence in year-end 2010, 99% of those with less than $10,000 in assets were held in commission-based accounts, over 90% with assets between $10,000 and $25,000 were in commission-based accounts, and over 80% with assets between $25,000 and $50,000 were in commission-based accounts. *See*, Oliver Wyman, *Assessment of the impact of the Department of Labor's proposed "fiduciary" definition rule on IRA consumers*, April 2011, *available at* https://www.dol.gov/ebsa/pdf/WymanStudy041211.pdf.

investing his or her retirement assets. Requiring me to put a contract in front of an individual I have just met and having to tell him or her that I cannot provide even basic information regarding retirement savings options is counterproductive. In my experience, individuals who are interviewing financial advisors would not be willing to sign a contract with a financial advisor they have just met and haven't decided to do business with yet. As a result, I believe this "pre-engagement" contract will create an unnecessary hurdle to individuals engaging financial advisors to help them prepare for retirement and other financial goals.

Problems with BICE's "Approved Assets" List:

Another requirement of the BICE is that in order to qualify for its protections, an advisor may only provide retirement advice regarding investments that are contained within BICE's list of approved investment options available to plans and IRAs.[18] Among the products that are not included in the list of approved investments are non-traded Real Estate Investment Trusts (non-traded REITs), and Business Development Companies (BDCs), and other non-exchange listed equity securities and commodities futures. By creating a limited universe of investments that an advisor can recommend with regards to retirement accounts, the DOL has taken a cookie-cutter approach that assumes that products excluded from the "approved list" would never be in the best interest of an investor.

Financial advisors are in the best position to work with their clients to understand their clients' unique retirement savings needs and recommend investments that best match the goals, risks, and circumstances of each individual investor. Furthermore, I not only help my clients save for their retirement, but I also advise them on the benefits of receiving some of their savings in the form of lifetime income. Individuals nearing retirement need to consider supplementing their Social Security with an additional level of guarantee, so that they won't outlive their savings. Unfortunately, this proposal has the impact of preventing me from advising those near retirees on the benefits of annuities and assisting them with product selection, putting that individual at risk of

[18] As per the proposal, the approved list of assets "includes only the following products: bank deposits, certificates of deposit (CDs), shares or interests in registered investment companies, 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 as defined in FINRA Rule 6710(l) or its successor, U.S. Treasury securities as defined in FINRA Rule 6710(p) or its successor, insurance and annuity contracts, guaranteed investment contracts, and equity securities within the meaning of 17 CFR 230.405 that are exchange traded securities within the meaning of 17 CFR 242.600." The proposal also specifically excludes "any equity security that is a security future or a put, call, straddle, or other option or privilege of buying an equity security from or selling an equity security to another without being bound to do so."

running out of their savings in their older years when they can least afford it. The approach taken by the DOL in the BICE prevents advisors from having a full range of investments options and will prevent advisors from recommending products that very well may be in the best interest of an investor. Ultimately, these decisions are best made by investors working in collaboration with a financial advisor, not by officials at the DOL who don't understand the individual investor's needs.

Problems with the Mandated Point of Sale and Annual Disclosures:

Yet another concern with BICE comes in the form of its mandated disclosures. BICE requires that, prior to the execution of an asset purchase, an investor be provided an individualized chart that projects the total costs (in dollars) of the investment for one-, five-, and ten-year periods. In addition to this initial disclosure, BICE also requires that an annual disclosure be provided to the investor. The annual disclosure must list: (1) each asset purchased or sold during the previous year with the corresponding transaction price; (2) the total amount of fees and expenses with respect to each asset; and (3) the total amount of all direct and indirect compensation received by the advisor and the firm as a result of each asset.

The annual disclosure will increase compliance burdens on financial advisors. Financial advisors will have to ensure that their systems and reports are reprogrammed so that they capture the information being requested by the DOL. It will take a healthy amount of time and resources to ensure full compliance with such a disclosure. The same is true for the proposed initial disclosure, but the initial disclosure comes with an extra concern. In order to be able to provide an investor with the estimated costs (in dollars) of the investment for the one-, five-, and ten-year periods mandated by BICE, an advisor would have to make performance projections for the investment in order to make a projection of the costs. This very well could put advisors in direct conflict with SEC and FINRA rules that prohibit performance projections. Furthermore, such projections may create expectations by investors that their investments will achieve such performances, which could lead to hazardous and unreasonable investor expectations. Both the initial and annual disclosure requirements need to be reconsidered so that they provide investors with useful information in a concise manner that does not conflict with regulations already on the books.

Problems with Internet Disclosures:

Another problematic section of BICE revolves around the massive and overly-burdensome Internet disclosures. BICE requires that firms maintain a publically-accessible website that is updated on at least a quarterly basis. This website must be in machine-readable format, and include: (1) the direct and indirect compensation payable to the firm, each individual advisor, and each individual affiliate of the firm for each asset available within the last year; and (2) the source of any and all compensation and its variations among assets. It is clear to me that the DOL underestimates the complex nature of these disclosures. In the independent model, financial advisors have access to a wide variety of investment products which they offer to their clients. Each of these investment products has unique pricing structures and compensation models. For example, when factoring in the various share classes available, a single mutual fund family may offer 500 or more versions of their funds. As a result, compiling, presenting and maintaining the required Internet disclosure for each financial advisor affiliated with a financial institution will be a massive undertaking with significant costs to my clients. In addition, the scope, breadth and complexity of the project will lead to inadvertent errors which may confuse investors or expose financial advisors and financial institutions to unreasonable litigation.

Problems with Data Retention and Production Requirements:

Firms must also retain all records relating to BICE for six years and provide unconditional access to such records during normal business hours to DOL, the IRS, plan participants, and IRA owners (or their representatives). Furthermore, on request from DOL, a firm must produce massive amounts of information for each asset, by quarter, within six months of any data request. The data that may be requested includes the aggregate shares/units bought, the aggregate purchase price and investor costs of those purchases, the revenue received by the firm and its affiliates along with the identity of each revenue source, and comparable information for all sales and all holdings. Firms would also have to produce the following information with regards to their advisors: (1) the identity of each advisor; (2) quarterly return information for each advisor's clients' portfolios; and (3) external cash flows in and out of each portfolio by date. The proposal gives the DOL the right to publicly disclose any and all of the information obtained during the data requests without any identifiable financial information.

As can be seen from the above summary of the data retention and production request requirements, this will not be an easy task for the industry to undertake. I am no expert regarding the logistical, technical, and financial resources that would be required in order to put the proper systems in place to manage these requirements, so I will leave that to others to expound upon. That being said, I have no doubt that this will be a huge undertaking that will come at great costs to the industry. These new compliance burdens will come with astronomical costs that will inevitably be passed down to financial advisors and impact the consumer. For BICE to be a workable exemption, these requirements must be greatly scaled back so that the costs of compliance are reasonable.

Problems with "Levelizing" Compensation:

BICE requires the advisor to avoid recommending an asset if the total compensation would exceed "reasonable" compensation for the total services provided. The DOL provides very little information regarding what would be considered "reasonable" compensation and what types of variable compensation models would meet the requirements of BICE.

The DOL does discuss the need for firms to go through a rigorous process of proving that a variable compensation model meets the requirements set forth in BICE and also states that compensation models based on flat fees would meet the requirements. The combination of these two factors serves as a quasi-endorsement of level compensation models, and will likely push firms in the direction of "levelizing" compensation models. As the compensation models become "levelized," I believe they will no longer be reflective of the services that I and other financial advisors provide. This will likely have the effect of financial advisors instituting, or raising, account minimums on retirement accounts, thus making it more difficult for investors of moderate means to gain access to valuable retirement advice and products. I do not want to be in a position where I have to turn away a potential client who needs my advice because his or her account would cause my business to incur losses, but the DOL proposal's push towards "levelized" compensation would have that consequence for my practice and the individuals I serve.

Problems with a New Private Right of Action:

The last concern with BICE that I will cover is its creation of a new private right of action that was never authorized by ERISA or any other related statute. This new private right of action would stem from the contract that a financial advisor and a firm have to enter into with a client. BICE prohibits the inclusion of a provision disclaiming liability from a violation of any contractual term or any waiver or qualification of the investor's ability to enter into a class action suit against the advisor or the firm for any violation of the contract's terms. That being said, the contract may allow for arbitration of individual investor claims.

In creating this new private right of action, the DOL has failed to recognize that ours is an industry that is already heavily regulated and has an extremely low incidence of unethical behavior. Out of the over 637,000 individuals regulated by FINRA in 2014, approximately 0.2% had disciplinary actions filed against them.[19] This is largely attributable to the fact that, as I stated earlier, a financial advisor's business is built on trust and reputation. If we break that trust with our clients, then we are out of business. It's that simple.

Beyond the basic principles of trust and ethical conduct to which I and virtually every other advisor adhere, there are already effective federal and state remedies that are available to consumers who feel that they have been harmed by a broker-dealer and other advisors, including the FINRA arbitration and mediation processes. Because of the effective set of remedies already in place to help potentially aggrieved investors, the new private right of action created by BICE is wholly unnecessary. Perhaps the biggest impact of this private right of action will be an increase in error and omission insurance premiums. These increased costs will be borne by financial advisors and ultimately impact the consumer. This may further establish retirement advice as cost prohibitive for investors of modest means. Furthermore, because of the complexities of the proposal, it is conceivable that firms and advisors will make inadvertent errors that do not materially harm consumers, but give rise to suits against firms and advisors. All of this will be a boon to lawyers, while harming investors and small businesses across the country. Therefore, any final rule should do away with the proposed private right of action, thus allowing the current effective network of federal and state remedies to handle alleged instances of misconduct.

Even though each of the above requirements of BICE presents problems, the biggest concern is the cumulative effect of all of these issues. If the DOL moves forward with a largely unchanged rule, financial advisors will be faced with a mountain of regulatory burdens to overcome. This will place serious financial, compliance, liability and administrative strains on the many small businesses across this country run by financial advisors. Unfortunately, the costs associated with implementation will also be felt by the clients that we serve and it may lead many to not seek or be able to afford critical retirement advice. Because of this, it is absolutely vital

[19] http://www.finra.org/newsroom/statistics.

that the DOL make substantial changes to its proposal to ensure that there is a workable path forward for all parties.

There are Better and Less Disruptive Alternatives to the DOL's Proposal

While FSI is committed to working constructively with the DOL to improve the current proposal, we believe there are better ways to achieve the goals of investor protection that guide the DOL in this effort, and guide our industry and the various federal and state regulatory entities that supervise our industry.

As I stated earlier in this testimony, FSI strongly supports a carefully-crafted, uniform fiduciary standard of care applicable to all professionals providing personalized investment advice to retail clients. The idea of a uniform fiduciary standard of care is not an idea that is solely championed by FSI. Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Section 913) instructed the SEC to evaluate the effectiveness of existing standards of care for financial advisors. The SEC is specifically charged with evaluating how the current standards of care affect the ability of advisors to provide personalized investment advice to retail customers, and identify any places for improvement in these standards. In order to accomplish this mission, Section 913 gave the SEC the authority to adopt a uniform fiduciary standard of conduct for financial advisors. Earlier this year, SEC Chair Mary Jo White announced her support for SEC rulemaking adopting a uniform fiduciary duty of care.[20] FSI has a strong preference for the SEC to take the lead or, in the alternative, conduct a joint rulemaking with the DOL so as to reduce inconsistent standards that would likely create compliance burdens for advisors and increase costs for investors.

Beyond the uniform fiduciary standard of care, improved disclosures would address many of DOL's concerns that have led to the proposal. Investors can make better choices when they are properly informed of the differences between the advice and services being offered. In order to provide investors with the information that they need, investors should receive concise, consolidated disclosure documents written in plain English. This course of action is beneficial on three fronts. First, it helps to increase the knowledge base of investors because they are able to

---

[20] *See*, Lynch, Sarah, *White says SEC should act on fiduciary rule for brokers, advisers*, Reuters, *available at* http://www.reuters.com/article/2015/03/17/sec-fiduciary-white-idUSL2N0WJ1E920150317.

better understand information related to their retirement savings. Investors would have access to important information in language that is easy to understand and not full of "legalese." Second, improved disclosures would not upend the retirement savings landscape. It would require that disclosures be rewritten, but, unlike DOL's current proposal, it would not entail the financial services industry completely overhauling business models in order to achieve compliance. Third, and most importantly, this course of action would preserve access to retirement advice, products, and services for small- and mid-sized investors.

As a way to illustrate how reworked disclosures could work and start a conversation regarding this approach, FSI suggests the following two-tiered approach that would be beneficial to investors:

1) A short-form document focused on the issues that are of greatest importance to investors provided at the point of engagement.[21] The document would include:
    - The standard of care owed by the financial institution and financial advisor to each client;
    - The nature and scope of the business relationship between the parties, the services to be provided, and the duration of the engagement;
    - A general description of any material conflicts of interest that may exist between the financial institution, the financial advisor and the investor;
    - An explanation of the investor's obligation to provide the financial institution and financial advisor with information regarding the investor's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose;
    - An explanation of the investor's obligation to inform the financial institution or financial advisor of any changes in the above information;
    - A phone number and/or e-mail address the investor can use to contact the financial institution regarding any concerns about the advice or service they have received; and

[21] The disclosure could be provided in paper or electronic format.

- A description of the means by which a customer can obtain more detailed information regarding these issues free of charge.

2) An expanded disclosure that would provide investors with access to full details via the financial institution's website or brochures to be provided free of cost. The short-form disclosure form above would have information on how to access this expanded disclosure. Utilizing hyperlinks and other internet functionality, investors would be able to access the following information in areas where they desire additional detail:
    - A detailed schedule of typical fees and service charges;
    - The specific details of all arrangements in which the firm receives an economic benefit for providing a particular product, investment strategy, or service to a customer; and
    - Other information necessary to disclose material conflicts of interest.

This is just one alternative to the current DOL proposal that could achieve the DOL's goals. There may be other, better alternatives out there that should be discussed and analyzed. Both FSI and I are ready and willing to engage in the development of disclosures, standards of care, or other mechanisms that would effectively protect investors and preserve access to retirement advice and products for all investors.

Conclusion

I thank Chairman Roe, Ranking Member Polis, and the rest of the Subcommittee for allowing me to share my thoughts on this very important issue. Should the Subcommittee need anything further from FSI or from me, we would be glad to provide the requested information.

FSI and I want to ensure that Americans are well-prepared to make decisions regarding their retirement savings. This will require that our retirement savings landscape continue to evolve so that it is easier for investors to receive high-quality, individualized investment advice from a trusted advisor. As a result, we support the adoption of a carefully-crafted, uniform fiduciary standard of care applicable to all professionals providing personalized investment advice to retail clients. Unfortunately, while well-intentioned, the current DOL proposal will make it harder for all Americans to receive such retirement advice. This is because it is based on flawed assumptions that lead it to be too complex, too cumbersome, and too costly, thus resulting in a proposal that will leave small- and mid-sized investors without affordable access to much-needed retirement advice and products. FSI believes that there are alternatives to the current DOL proposal, including a uniform fiduciary standard and better, more concise disclosures. We stand ready to continue our engagement with the DOL and any other interested parties to try and develop a final rule or other proposal that will protect investors and ensure that all Americans have access to the retirement advice, products, and services that will help them achieve the dignified retirement that they deserve.

About Dean Harman, CFP ®

Dean Harman, CFP ® has been practicing in the financial services industry since 1994. He operates Harman Wealth Management, LLC in The Woodlands, Texas. Harman Wealth Management, LLC specializes in working with clients who are business owners, executives and sports coaches.

In 2006 Dean purchased Estate Resources, a financial planning, RIA and asset management firm in Houston, Texas, which he merged into Harman Wealth Management, LLC In 2010 he purchased ETF Plan, Inc., and asset management, RIA firm which also merged into Harman Wealth Management, LLC He serves on the Advisory Boards of Genworth Financial, Sagepoint Financial, The Financial Services Institute, and The College of Business and Behavioral Sciences at Clemson University.

Dean is regularly quoted in the media and has been featured in: The Wall Street Journal, the New York Times, Newsweek, Kiplinger's, Smart Money, CBS Market Watch, Men's Health, Yahoo Finance, Google Financial News, Retire Smart, The Players Club, The Journal of Financial Planning, Investment News, Investment Advisor, H-Texas and local media. He also had an appearance in the movie Tin Cup.

He is a graduate of Clemson University where he played football from 1987-1991. Following college he had a brief stint with the Tampa Bay Buccaneers in 1992 and 1993 before starting his career in financial planning.

Background on Independent Broker-Dealers, Independent Financial Advisors and FSI

For more than 40 years, independent broker-dealers and independent financial advisors have brought Wall Street to Main Street, offering comprehensive financial planning services and unbiased, affordable investment advice to millions of individuals, families and businesses large and small. The approximately 167,000 independent financial advisors make up nearly 60% of all practicing financial advisors nationwide, offering services that include financial education, planning, implementation and investment monitoring. While we serve a broad cross-section of clients, our members' typical clients are middle class, Main Street investors – those investing tens or hundreds of thousands of dollars, not millions.

Independent broker-dealers and independent financial advisors also share a number of other business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. The independent business model allows our members to tailor their products and services to support both the small investors opening their first IRAs and the more affluent clients who need more complex wealth management services.

These financial advisors operate as self-employed independent contractors, not as employees of their affiliated broker-dealer firms. They are small business owners with strong ties to their communities. In fact, their standing in their communities is critical to their success, as word-of-mouth and reputation are their primary sources of new clients. Independent financial advisors generally meet their clients in person and provide their services face-to-face or over the telephone, forming personal, trust-based relationships. Thus, independent financial advisors have a powerful incentive to pursue their clients' investment goals with integrity and transparency, and every reason to want to make sure their clients receive personalized investment advice that is in their best interest.

Since 2004, the Financial Services Institute (FSI) has represented the interests of independent financial service firms and independent financial advisors. Through FSI, these financial professionals work together to promote the independent business model and a regulatory environment that serves all its constituents effectively.

Independent broker-dealers and independent financial advisors formed the Financial Services Institute not only to serve as an advocacy organization, but also to be a forum for improving compliance efforts and promoting our business model. FSI is committed to preserving the crucial role of independent broker-dealers and independent financial advisors in helping Main Street Americans plan for their futures and meet their long-term financial goals. As part of this mission, FSI conducts industry surveys and research, and provides a forum for members to share their best practices in compliance, operations, and marketing. FSI also serves as an advocate in Washington, using the information it collects to help shape a regulatory environment that is fair and balanced and serves all its constituents.

Statement of the Investment Company Institute

Brian Reid, Chief Economist

Hearing on "Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees"

Subcommittee on Health, Employment, Labor, and Pensions

Committee on Education and the Workforce

United States House of Representatives

June 17, 2015

The Investment Company Institute[1] is pleased to provide this statement regarding the U.S. Department of Labor's fiduciary proposal for the hearing in the Subcommittee on Health, Employment, Labor, and Pensions of the U.S. House of Representative's Education and the Workforce Committee. We thank Subcommittee Chairman Roe and Ranking Member Polis for the opportunity to testify, and Chairman Kline for the committee's continued bipartisan attention to an issue so critical to American retirement savers.

The mutual fund industry is especially attuned to the needs of retirement savers because mutual funds hold half of retirement assets in defined contribution (DC) plans and individual retirement accounts (IRAs).[2] The DOL's proposal would have a dramatic impact on the ability of those retirement savers to obtain the guidance, products, and services they need to meet their retirement goals.

ICI supports the principle at the heart of the DOL's proposal—that financial advisors should act in the best interests of their clients when they offer personalized investment advice. Unfortunately, the DOL did not stay true to the meaning of that principle. As a result, its proposed rule is hopelessly complex, confused, and, in its current form, unworkable. The DOL also chose to break away from a coordinated approach with the Securities and Exchange Commission (SEC), which itself is considering whether to impose harmonized fiduciary standards that would provide a single standard of care for all investors. If the DOL adopts its proposed rule, the result will be a

---

[1] The Investment Company Institute (ICI) is a leading, global association of regulated funds, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI's U.S. fund members manage total assets of $18.1 trillion and serve more than 90 million U.S. shareholders.

[2] At the end of 2014, U.S. retirement assets totaled $24.7 trillion, DC plan assets were $6.8 trillion, and IRA assets were $7.4 trillion. Investors held $3.5 trillion of IRA assets and $3.7 trillion of DC plan assets in mutual funds. *See* Investment Company Institute, *The U.S. Retirement Market, Fourth Quarter 2014* (March 2015), available at www.ici.org/info/ret_14_q4_data.xls.

regulatory hodgepodge that does not promote the best interests of retirement savers. In fact, it may well harm their interests.

ICI will submit a detailed comment letter to the DOL addressing our concerns about the proposed rule. In this statement, I will focus first on the DOL's failure to provide a sound economic rationale for its proposal. I will then describe some of the key ways in which the proposal is flawed.

The DOL's Regulatory Impact Analysis Is Fundamentally Flawed

The DOL relies on its Regulatory Impact Analysis to justify its proposed rule. But the Regulatory Impact Analysis fails to demonstrate the DOL's assertion that there is a "substantial failure of the market for retirement advice."[3] It also does not properly consider how the proposal actually could limit retirement savers' access to guidance, products, and services, or how such limits could affect savers—particularly lower- and middle-income savers with smaller account balances.

The DOL argues in its Regulatory Impact Analysis that broker-sold funds "underperform," "possibly due to loads that are taken off the top and/or poor timing of broker sold investments."[4] The DOL's analysis does not provide a benchmark for returns against which it measures this claim of "underperformance." It contends that such underperformance could cost IRA mutual fund investors "$430 billion over 10 years and nearly $1 trillion across the next 20 years."[5] The DOL has arrived at these numbers by misinterpreting and incorrectly applying the findings of the academic research that it cites as the foundation of its conclusions. In fact, these assertions do not stand up when tested against actual experience and data.

The DOL also has on its website a white paper prepared by the White House Council of Economic Advisers (CEA). That white paper claims that "conflicted advice costs Americans about $17 billion in foregone retirement earnings each year."[6] This assertion is also not supported by sound analysis or data, as I explain below.

Adjusting for the errors in the DOL's analysis, we find that the claims touted by the DOL simply have no basis. Indeed, the DOL's proposal, if adopted, could actually have a significant net societal harm. The proposal's costs and burdens, including those on retirement savers, do not support adoption of the proposed rule. I have five points to explain why.

---

[3] DOL, *Fiduciary Investment Advice Regulatory Impact Analysis* (Apr. 14, 2015), available at: www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf, at p. 7.

[4] *Id.*, at p. 98.

[5] *Id.*

[6] CEA, *The Effects of Conflicted Investment Advice on Retirement Savings*, (Feb. 2015), p. 21. The CEA white paper is available at: www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

1. ***Contrary to the DOL's claims, investors who own funds that are sold with front-end loads actually have concentrated their assets in funds that outperform—not underperform—the average return for their fund category.***

The DOL claims that if its proposal is not implemented, retirement investors will lose nearly $1 trillion over the next 20 years due to excess fees and underperformance losses. The analysis that the DOL uses to back this claim is deeply flawed.

Front-end loads are a form of commission used to compensate brokers who sell mutual funds. The DOL bases its claim of investor harm on the idea that front-end loads create incentives for broker-dealers to recommend particular funds, and that those funds tend to "underperform" by 100 to 200 basis points per year.[7] The DOL assumes that, after adoption of its proposed rule, the amount invested in underperforming funds that pay front-end loads will substantially decrease and that retirement savers will invest in higher-performing funds.

The DOL's calculation of $1 trillion in harm rests heavily on an academic paper that uses a set of computations to try to explain the range of loads that funds pay to brokers.[8] This paper finds evidence that a subset of funds—those whose front-end loads result in higher broker compensation than can be explained by the average of similar funds—underperformed the average return of their fund category during the next year. The DOL then assumes that *all* IRA assets that are invested in front-end load funds suffer the same underperformance—mistakenly applying a result from a subset of load funds to all load funds.

A simple test with hard data exposes the DOL's leap in logic and breaks down the central claim of its Regulatory Impact Analysis. In fact, investors who own funds that are sold with front-end loads have concentrated their assets in funds that outperform—not underperform—the average return for their fund category.

We examined front-load fund shares sold in each year from 2007 to 2013. Using Morningstar performance data, we measured fund returns net of expenses in the year after the sale (for example, we measured 2008 performance for fund shares sold in 2007, and 2014 performance for shares sold in 2013). For shares sold during the 2007 to 2013 period, the sales-weighted average returns for shares sold with front-end loads actually outperformed the Morningstar average return for all funds with similar investment objectives by 27 basis points per year. This demonstrates that investors who purchased front-end load funds concentrated their purchases in funds that outperformed their Morningstar average. This fact directly contradicts the DOL's assertions and raises serious questions about the DOL's contention that the market for retirement advice suffers from a substantial market failure.

[7] As noted above, the DOL does not provide a benchmark for returns against which it measures underperformance.

[8] DOL, Regulatory Impact Analysis, at p. 98, citing Christoffersen, Evans, and Musto (2013). Attached to this written statement is a brief analysis of this and other key papers that the DOL relies on in its Regulatory Impact Analysis.

We have no explanation for why the DOL would choose not to test assertions and suppositions that are so critical to its conclusions against real and widely available data—a basic step in any economic analysis. By contrast, our test looks directly at the performance of actual fund shares sold with a load. The fact that investors concentrated their purchases of fund shares sold with a front-end load in those funds that outperformed the average return for their category undermines the DOL's analysis and eliminates almost all of the rationale the DOL uses to justify its proposal.

2. ***The DOL ignores market realities and assumes brokers will continue to offer advice and services despite substantial reductions in their compensation. It ignores the costs that investors will face if in fact they cannot use brokerage accounts for retirement savings.***

The DOL's analysis is flawed in another fundamental way: it ignores the cost of advice and services outside of broker-sold funds, resulting in an inappropriate overstatement of the benefits of the proposal. The DOL focuses solely on the costs of advice and assistance paid through a fund—through an up-front sales charge, for example. But the DOL fails to consider how these costs compare to the costs that investors incur when they pay a financial advisor directly for advice (for example, using an asset-based fee that an investor pays directly to a financial advisor) rather than paying through a fund. Ignoring the market realities of the cost of advice and assistance, the DOL exaggerates the benefits from lower loads resulting from their proposal and ignores possible costs that investors could incur if they move to fee-based advice.

How significant is this omission? The DOL argues that IRA investors currently pay between 26 and 28 basis points per year in front-end loads, in addition to fund expenses. A recent study by Cerulli Associates finds that fee-based accounts—the most likely alternative to brokerage accounts—cost investors 111 basis points per year on average, in addition to fund expenses.[9]

In the Regulatory Impact Analysis, the DOL asserts that retirement savers will continue to use brokers if its proposed rule is adopted, under its proposed "Best Interest Contract Exemption." It predicts that the Exemption will induce brokers to reduce loads. The DOL claims that annual front-end load costs will fall by 65 percent over the next 20 years.[10]

In fact, as I discuss below, the Best Interest Contract Exemption is prohibitively costly, in addition to being convoluted and unworkable. Brokers subject to the Exemption's many new limitations, burdens, and costs, as well as increased exposure to liability, are not likely to work for *less* compensation, as the DOL presumes.

---

[9] Cerulli Associates, Inc., *Cerulli Report RIA Marketplace 2014*, p. 20. The average asset-based fee includes high-net worth accounts, which typically are charged lower asset-based fees. Accounts of average or smaller size may pay higher fees.

[10] DOL, Regulatory Impact Analysis, at p. 113.

The DOL itself notes elsewhere in its Regulatory Impact Analysis that front-end loads already have fallen significantly. It states that these charges probably cannot fall much further without reducing the level of service and advice that brokers provide to fund investors.[11] It is difficult to reconcile that statement with the idea that adoption of the proposed rule—with its substantial new costs and liabilities—would induce brokers to accept commissions that are two-thirds below current levels.

In fact, many investors will still want to receive advice and will need to continue to pay for it. If brokers are largely foreclosed from providing that advice, investors will need to turn to fee-based accounts, if those accounts are available to them. In that event, many could end up paying even more, as evidenced by the current Cerulli data. For many investors—particularly those with small or even average balances—the total costs of fee-based accounts typically are higher than the cost of purchasing funds with front-end loads.

The DOL's failure to consider asset-based charges ignores the fact that a move to fee-based advice could raise costs for many IRA investors with small or even average balances.

3. The DOL fails to demonstrate that investment performance is different when an investor is advised by a fiduciary compared to when the investor is advised by a provider that is not a fiduciary.

The DOL relies on a string of academic studies to buttress its claims that investors are harmed by their use of brokers.[12] These studies do not support the conclusions that DOL draws. The problem is that none of these academic studies actually compares the outcomes of investing with a financial advisor that is a fiduciary to the outcomes of investing with a broker-dealer or other financial advisor that is not a fiduciary. Thus, the DOL does not actually measure—and cannot measure, based on these studies—whether an investor using a fee-based ERISA fiduciary advisor will experience a different investment outcome than an investor using another financial advisor that is not an ERISA fiduciary.

Attached to this statement is a brief summary of the primary studies relied on by the DOL. The attachment also provides our analysis of why the papers offer little, if any, support for the DOL's hypothesis that investors purchasing funds through broker-dealers receive significantly lower returns than investors using fiduciary advisors. After careful review, it is our conclusion that the studies do not support the Regulatory Impact Analysis used to justify DOL's proposal.

4. The DOL fails to identify and analyze societal harms resulting from its proposal.

In its estimates of the cost of its proposed rule, the DOL focuses only on administrative or compliance costs. It makes no attempt to acknowledge, much less measure, a significant harm that

---

[11] DOL, Regulatory Impact Analysis, at p. 123.

[12] The CEA cites many of the same studies and draws the same conclusions as the DOL analysis. The CEA's misreading of the studies is also similar to the DOL's.

can occur if it adopts the proposed rule—the inevitable risk that at least some retirement savers would lose access to advice and information they currently rely on to meet their savings goals.

Research shows that investors with access to advice have more diversified portfolios and take on more appropriate levels of risk than those who do not receive advice or information. Indeed, in its justification of an earlier rule change, the DOL said that retirement investors who do not receive investment advice are twice as likely to make poor investment choices as those who do receive that advice.[13] The benefits of advice—and, conversely, the harm of losing access to advice—are significant.

The DOL's apparent belief that investors are ill-served by brokers ignores the fact that its rule could eliminate the guidance, products, and services that investors receive from broker-dealers that are compensated with front-end loads. Financial advisors, regardless of their standard of care, are unlikely to work in an environment of greater costs, limitations, and exposures to liability for less compensation. Indeed, many broker-dealers are likely to exit the market for retirement advice under the proposed rule. The DOL thus ignores the impact of its proposed rule on the quality and appropriateness of investment choices that retirement savers must make.

As a result, retirement investors may be left with no choice but to seek asset-based fee accounts to obtain the investment assistance that they need. But as we have already established, the total costs of investing through those accounts can be greater—not less—than the cost of investing with brokers.

Asset-based fee accounts pose an even more significant barrier. These accounts often require investors to have substantial balances that are significantly larger than the typical IRA balance.[14] As a result, fee-based accounts may not be available to lower- and middle-income IRA investors who cannot meet minimum balance requirements. Other market participants may seek to overcome the proposed rule's barriers and find ways to serve retirement savers who now rely on broker-dealers. It is entirely foreseeable, however, that many IRA investors would no longer be able to obtain advice under the proposed rule.

American workers will be worse off if they cannot get the assistance they need to determine how best to save for retirement. It is entirely inappropriate, and not credible economic analysis, for the DOL merely to ignore the harm that would come from retirement savers losing access to advice.

---

[13] *See* Investment Advice—Final Rule. 76 Fed. Reg. 66136, 66152 (October 25, 2011).

[14] The median IRA balance in 2012 was $25,170. *See* Holden, Sarah, and Steven Bass. 2014. "The IRA Investor Profile: Traditional IRA Investors' Activity, 2007–2012." *ICI Research Report* (March). Available at www.ici.org/pdf/rpt_14_ira_traditional.pdf.

5. *IRA investors are concentrated in funds that have lower costs on average—not in higher-cost funds, as the CEA white paper asserts.*

The DOL has posted on its website a link to a CEA white paper that claims that variable compensation paid to broker-dealers and other financial advisors creates "conflicted investment advice," which in turn "can lead to underperformance: excessive fees, excessive trading, market mis-timing, and so forth."[15] The CEA white paper cites academic literature to support its claim that IRA investors using brokers suffer an underperformance of 100 basis points per year.

Unfortunately, the CEA, like the DOL, supports its claims by selectively choosing statistics and commentary from the academic studies it cites. The CEA also offers a hypothetical calculation of fees to illustrate the factors that it claims are harming IRA investors. The CEA first assumes that typical 401(k) plan investors pay fund expenses of only 20 basis points. It then assumes that investors pay 130 basis points in fund expenses after they roll their assets over to an IRA. The resulting assumed difference in fees—110 basis points—reduces returns for IRA investors by $17 billion annually, according to the CEA's illustration.

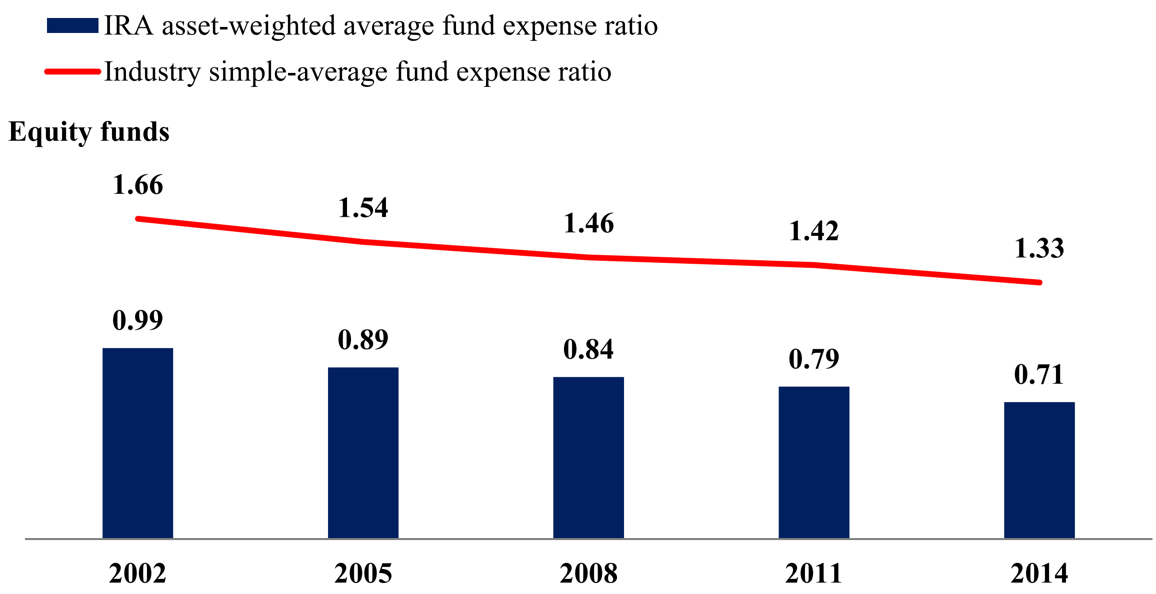
Actual data show that the CEA's illustration is far off the mark. The average fee paid by IRA investors in stock funds in 2014 was only 71 basis points. The average fee paid by 401(k) investors for investing in stock funds was actually 54 basis points. So the real difference in fees, based on what investors are actually paying, was 17 basis points—far less (almost 85 percent less) than the 110 basis point difference claimed by the CEA.

Further data show that actual IRA investors pay fees that are below the average fee for similar funds. As the chart below shows, IRA investors tend to concentrate assets in funds with expense ratios (the bars) that are far less than the simple-average expense ratio of all funds (the line). In 2014, for example, the average expense ratio paid by IRA investors on equity funds was 71 basis points—or 62 basis points less than the average expense ratio for all equity funds.[16] This pattern also holds true in hybrid and bond funds.

[15] CEA study, p. 16. Accessed on June 7, 2015.

[16] Calculation: 133 basis point average expense ratio on all equity funds minus 71 basis point average paid by IRA investors on equity funds equals a 62 basis point difference.

IRA Investors Pay Below-Average Fees



Note: Data exclude mutual funds available as investment choices in variable annuities.
Sources: Investment Company Institute and Lipper

Our data do show that 401(k) investors pay lower fees in mutual funds than IRA holders pay. This in part reflects economies of scale, as employer plans aggregate the savings of hundreds or thousands of workers. In addition, average fees are somewhat higher for mutual funds in IRA accounts because some IRA investors pay through fund fees for services, such as professional investment advice and assistance that are not available through their 401(k) plans.

The DOL's Proposed Rule, Like Its Regulatory Impact Analysis, Is Flawed

The DOL's rule proposal is confusing and convoluted.

Confusing. The DOL's rule proposal leaves quite unclear the circumstances under which a provider of investment information will be an ERISA fiduciary. Based on our initial analysis, providing even the most basic information—such as that offered in many common call-center and web-based interactions—will trigger ERISA fiduciary status. The result will be the restriction of even basic information provided to retirement savers, for fear that the information later will be viewed as advice triggering ERISA fiduciary status.

To provide a workable framework for its proposed rule, the DOL must provide clear and unambiguous thresholds for determining when a service provider is offering fiduciary advice. It must allow service providers to continue to offer meaningful investment education to retirement savers without inadvertently triggering fiduciary status.

The proposal breeds more confusion by asking a series of questions about a blanket exemption from ERISA prohibitions for so-called "high-quality low-fee" investment products.

The DOL does not actually propose such an exemption, nor does it specify how such an exemption would work and what investments might qualify. Indeed, the DOL's questions are hopelessly vague. DOL simply has not provided the public with enough information about this aspect of its proposal to comment in any meaningful way.

The DOL and other financial regulators must promote investor choice and remain product-neutral. Cost is not, and cannot be, the sole factor in making an investment decision. Nor does trust law, in articulating the nature of fiduciary duty, sanction low cost as a consideration exclusive of others. And regulators cannot and should not set themselves the task of determining what constitutes a "high-quality" investment product. We know of no useful criteria for this purpose that take into account the diverse portfolio needs of the millions of American retirement savers.

Convoluted. The proposal takes a straightforward concept—that investors should receive advice that is in their best interest—and turns that principle into an overcomplicated, unworkable rule.

The proposed "Best Interest Contract Exemption" is a primary example of this problem. The DOL purportedly designed that proposed exemption to permit broker-dealers and others to continue to receive variable compensation, such as commissions and front-end loads, notwithstanding their status as an ERISA fiduciary. Under the Best Interest Contract Exemption, however, a financial services provider must comply with a series of unworkable conditions that are not based on fiduciary principles. Among them are the following:

- Before giving any advice, the service provider must enter into a written contract containing a panoply of waivers and commitments that create significant litigation exposure and liability. Broker-dealers and others receiving variable compensation are likely to struggle, in operational and customer-service terms, to have a written contract in advance of every interaction that could be portrayed as advice-giving.

- The service provider's individual representative must be party to that contract.

  Taken together, these first two conditions imply a set of procedures that borders on the absurd. Before asking a question or receiving any information, an investor seeking information from a call center would be required to enter into a contract not merely with the corporate service provider, but with the employee operator at the call center. If that operator needs to refer the call to a more-knowledgeable colleague, the investor presumably would then be required to enter into yet another contract with that colleague. It is difficult to imagine the system that would accommodate three-way contracts for all of a financial services firm's thousands (perhaps tens of thousands) of representatives and many thousands of customers.

- The service provider must provide point-of-sale disclosure of impossible-to-calculate projected costs of investment, extensive website disclosure, and annual disclosure to investors. These disclosures must include, among other things, the total dollar amount of all compensation received by the service provider as a result of the investor's holdings and purchases. Some of these disclosures essentially would be impossible to provide because they assume perfect knowledge of future performance of an investment.

In seeking to impose these requirements, DOL has converted the fiduciary principle into a series of compliance traps and barriers for financial advice professionals and their firms, in particular smaller firms. This emphatically is not how fiduciary duty—a relationship of confidence and trust—should be defined and crafted. ICI supports efforts to promote the best interests of investors, but any regulatory initiative to do so must be workable and not restrict the information, advice, and services that investors require to meet their goals. We fear that the DOL's confusing and convoluted rule proposal will create real harm—a loss of access to information and advice—to America's retirement savers.

Conclusion

The economic analysis used to justify the DOL proposal is fatally flawed. It appears to be crafted solely to support the agenda of adopting the DOL's proposed rule—not to measure accurately the costs and benefits of the proposal. The Regulatory Impact Analysis does not properly analyze the impacts of the proposal. The DOL does not establish that the benefits of its rule justify its significant costs. In fact, the economic analysis raises the question of whether the DOL fully understands the market for investment advice.

We agree that retirement savers, and other investors, should be served by financial advisors who act in their clients' best interest. But the added layers of complexity and confusion that the DOL proposes to pile on top of that simple best-interest principle creates the risk that many savers will receive *no* advice or service, or none that they can afford. Sadly, we expect that the proposed rule, if adopted, will make retirement saving *more* challenging and costly for many retirement savers, particularly those with modest balances.

A better approach is one that balances the need for enhanced investor protections with the desire to minimize market disruptions and preserve investor choice. Such an approach would be more likely to result from a joint effort by the DOL and the SEC to work toward a harmonized fiduciary duty for all investors. Even more important, such an approach would stay true to fiduciary principles.

Attachment A—Review of Studies Relied upon by DOL and CEA

Set forth below is a brief summary of the studies relied on by the DOL and the CEA, and why they offer little, if any, support for the DOL's conclusion that investors purchasing funds sold through brokers receive significantly lower returns than do investors using fiduciary advisors.

1. Bergstresser, Chalmers, and Tufano (2009)

The 2009 paper by Bergstresser, Chalmers, and Tufano attempts to measure the returns to investors using funds sold through brokers before accounting for fees used to compensate the broker. Significantly, the paper compared broker-sold funds with direct-sold funds but does not measure whether a fiduciary relationship produces superior returns, net of fees, over a non-fiduciary intermediary (*e.g.*, brokerage) relationship.

The Bergstresser paper does not support the DOL's characterization of the paper's conclusion (*i.e.,* that investors purchasing funds from a broker fare worse than those purchasing funds from a fiduciary). In fact, the evidence in the Bergstresser paper, even if taken at face value, is highly inconclusive: the paper suggests that, compared to investors that purchased "directly sold" mutual funds, investors who used broker-sold funds earned lower returns on broad domestic equity funds and higher returns on foreign equity funds and perhaps money market funds between 1996 and 2004. (The evidence on bond funds is statistically inconclusive.)

Simply put, if underperformance is due to the conflicted compensation structure of the intermediary—as the DOL suggests—one would expect that the underperformance would occur in all types of funds, not just one.

2. Del Guercio and Reuter (2014)

The 2014 paper by Del Guercio and Reuter cited in the DOL's Regulatory Impact Analysis finds that actively managed funds sold directly to investors outperform index funds, and that broker-sold index funds outperform broker-sold actively managed funds. The paper speculates that this result is driven by broker incentives, but does not provide any test of this theory. Consistent with the limitations of the Bergstresser paper, the Del Guercio paper does not measure the net returns to investors using a fiduciary advisor versus a broker. They also do not examine where investors in broker-sold funds are concentrating their assets.

The CEA acknowledges that a limitation of both the Bergstresser and Del Guercio studies is that such comparisons cannot incorporate differences other than the involvement of an intermediary versus a "direct sale" of the mutual fund. It explains, for instance, that "investors purchasing funds through intermediaries may be more risk-averse and less experienced with investing than those buying direct-sold shares from a mutual fund sponsor" and that "[f]ailing to account for such differences may potentially overstate or understate losses due to conflicts of interest."[17]

3. Chalmers and Reuter (2014)

The Regulatory Impact Analysis cites a 2014 paper by Chalmers and Reuter that attempts to measure the impact of broker recommendations on client portfolios. The authors find that plan participants who use brokers are likely to need help with asset allocation and fund selection. They also find that participants who were defaulted into a target-date fund received asset allocation at a lower cost than if they had used a broker. The paper does not test whether the result would have been different if they had invested with the assistance of a fiduciary advisor.

4. Christoffersen, Evans, and Musto (2013)

The DOL cites a paper by Christoffersen, Evans, and Musto that purports to measure the cost to investors of investing in funds sold through brokers. The paper finds that investors who were invested in funds that compensated brokers with higher-than-average loads, adjusting for a set of fund features, earned lower returns. Again, the paper does not measure or test if these returns were lower than those that investors would have received had they used a fiduciary advisor. Also, the paper finds that paying brokers through an annual 12b-1 fee or through revenue sharing did not produce lower returns, which is inconsistent with the argument that investors using a broker are more likely to be placed in underperforming funds. More important, however, is that the DOL does not properly adapt the findings of the paper to its economic analysis.

5. Foerster et al. (2014), Hackethal et al. (2012)

The DOL also references papers examining retail investment advice in Canada and Germany. While acknowledging that those countries' legal regimes differ from that in the United States, the DOL cites the studies as support for the conclusion that advised accounts underperformed by more than 150 basis points. This incorrectly represents what the authors claim to have found—and the papers appear to be irrelevant to the discussion here. First, while the papers do purport to study the value of advice offered by financial advisors, the papers are about investment advisors in Canada and Germany respectively, not the United States. The Foerster et al. findings are based on the authors' analysis of statistics from the Canadian Financial Monitor survey of Canadian households. The Hackethal paper relies on a review of investor accounts at "a large German bank." Whether the papers' results carry over to the U.S. regulatory regime, and thus to brokers or financial advisors in the United States, is unlikely or, at best, just not clear.

Significantly, the Foerster paper concludes that Canadian advisors induce their clients to take more risk—*i.e.*, invest a greater portion of their portfolios in equities—thereby raising expected returns. The paper also observes, however, that "the amount of risk an advisor takes in his or her own portfolio strongly predicts the risk taken by his or her clients." This suggests that the clients'

[17] CEA Report, at p. 11.

assumption of additional risk is consistent with their advisors' own beliefs—not an inherent conflict of interest resulting from the manner in which the advisor is compensated.

The Hackethal paper, based on a review of account data from a "single German bank," does find that accounts advised by an advisor had returns that were lower than the sample mean for self-managed accounts, reflecting lower holdings in equities by the accounts. Given that Germans tend to invest a lower percent of their portfolios in the stock market (23 percent of German portfolios are invested in stocks, compared to 50 percent for Americans), it is not clear that these findings reflect the outcome of broker conflicts. They might, for example, reflect investing norms in Germany, or the fact, as the study also observes, that "[o]lder clients (over 50) have significantly greater probability than investors between 18 and 30 of using an advisor," and might be at a stage of their retirement planning where they begin to reduce their holdings in equities in favor of fixed-income securities.