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Public Hearing on Definition of the Term "Fiduciary"; Conflict of Interest Rule-Retirement Investment Advice and Related Proposed Prohibited Transaction Exemptions

Before the Department of Labor

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I am Caleb Callahan, Senior Vice President and Chief Marketing Officer at ValMark Securities, Inc. I am testifying today on behalf of the Association for Advanced Life Underwriting (AALU), of which I am Chairman of the Retirement Planning Committee and ValMark is a strong supporter and partner. AALU appreciates the opportunity to testify before the Department of Labor at this hearing on the proposed rule to redefine who is a fiduciary of an employee benefit plan under the Employee Retirement Income Security Act of 1974 (ERISA) and Section 4975 of the Internal Revenue Code of 1986, including individual retirement accounts (IRAs).

AALU is the leading organization of life insurance professionals who are a trusted voice on policy issues impacting Americans' financial security and retirement savings. Our 2,200 members nationwide are primarily engaged in sales of life insurance used as part of retirement, estate, charitable, and deferred compensation and employment benefit services.

ValMark was founded in 1963, and has roughly $14 billion in assets under care. We provide both fee-based (registered investment advisor) and commission-based (broker-dealer) solutions to retirement savers—with roughly 55% of our business in 2015 on the registered investment advisor side and 45% on the broker side. Our model of providing both types of solutions enables us to have a level of independence and objectivity that allows client goals to drive the best solution. In our experience, both models for receiving advice and products are chosen regularly.

My goal here today is to offer constructive feedback on the DOL proposal based on the real world experience of our firm working directly with advisors and retirement savers. This rule is well-intentioned, with the goal of helping Americans save for retirement, but unfortunately it will have the exact opposite result—harming the clients we serve every day. It is our clients and advisors on whose behalf I speak today, and I will explain why preserving our clients' right to make choices in their best interest—as THEY determine it—is essential.

The Department Hasn't Worked Within the Current Regulatory Framework—Including Its Own Previous Efforts

I will start out by asking why the DOL took this step without first trying to work within the current non-DOL regulatory framework.

For example, the SEC has extensive experience regulating under a fiduciary duty, yet it is unclear if their deep knowledge has been fully brought into the process—we certainly don't want a rule that conflicts with SEC regulations and initiatives. FINRA also has significant expertise and authority in this space, yet it submitted a comment letter outlining a number of concerns about the proposed rule. In the letter, FINRA explained that the proposed rule did not sufficiently build on existing regulation, and in some respects conflicts with current FINRA rules and securities market trading practices. FINRA further notes that this "fractured" approach will confuse retirement savers and advisors, and cause many broker-dealers to stop serving small accounts.

Particularly concerning is the implicit assumption that there are serious problems with the sale of annuities and lifetime income products. AALU feels that these products are already the subject of robust regulation—as outlined in more detail in our formal comment letter—and the DOL has not presented any data showing serious deficiencies with the current framework.

Even more puzzling is why the Department didn't build on its recent good work to improve investor understanding in the ERISA marketplace, or show why such initiatives could not be successfully refined to address any remaining issues in the marketplace—despite the considerable time and effort that both the DOL put into crafting these rules and that the financial services industry expended to comply with the regulation.

As you know, in February 2012 the DOL issued final 408(b)(2) disclosure rules for retirement plans for the purpose of bringing clarity to consumers. The new disclosure rules requiring advisors to disclose: 1) the services they provide, 2) whether these services are provided in a fiduciary or brokerage capacity, and 3) the fees charged for such services.

In examining the business metrics of ValMark's own advisors throughout the country from 2013 (the first full business year following final disclosure regulations) and 2014, there is a clear trend that under these recently finalized disclosure rules advisors are increasingly becoming fiduciaries and charging fees as opposed to selling plans as brokers for a commission. For example, when comparing year-end 2013 results to year-end 2014 results, commission-based plans grew at a rate of 26% while fee-based plans grew by 114%. When we filter this data down to the firms whose primary business is qualified plans, the trend is even more prominent. The qualified plan specialist advisors saw a <u>decline</u> of commission-based plans by 85% between 2013 and 2014 but a 21% increase in the sale of fee-based plans.

These metrics evidence a noticeable shift in the business model. Conversations with our advisors reveal that this shift is directly tied to the new 408(b)(2) disclosure regulations. The data shows that in an environment of full disclosure there is a move for advisors to increase the number of services they provide and do so in a fiduciary capacity. However, notwithstanding this trend, some consumers still choose to engage advisors in a brokerage capacity based on size, needs and goals.

It does not seem prudent for the Department to move forward with new sweeping regulation in the ERISA marketplace without a full examination of comparable rules recently issued by the Department in this same space. For example, which specific disclosures are insufficient under previous DOL regulatory initiatives? In what areas do consumers need more information? What data supports the need for this specific rule?

Particularly given preliminary trends in our business, sufficient time should be given to fully evaluate Section 408(b)(2) rules. If this regulation is found to be deficient, then it would seem appropriate to build on it rather than enacting a complex and unworkable set of new requirements.

DOL Proposal Contradicts Other Government Goals and Initiatives

Not only does this proposed rule fail to build on the current regulatory framework, it also contradicts other governmental goals and initiatives.

Policymakers on both sides of the aisle understand that helping Americans adequately save for retirement is a top priority. In 2011, the Government Accountability Office (GAO) released a study at the request of Congress entitled "Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices," with the DOL and Treasury providing key contributions to this report. The study noted that with the steep decline in defined benefit pension plans and the rise of defined contribution plans, individuals are increasingly faced with difficult decisions about managing their financial assets to secure lifetime income.

While of course noting that increasing savings and investing wisely are crucial to achieving sufficient retirement income, the report stresses two fundamental points: 1) the importance of annuities for retirement savers; and 2) the benefits of delaying the receipt of social security and working longer.

The GAO report highlights the importance of annuities for American's retirement security. In fact, the financial experts interviewed for this GAO study typically recommended that retirees convert a portion of their savings into an annuity, and the report specifically encourages their increased utilization in qualified plans. In particular, the study highlights that middle quintile households have the most need for annuities and lifetime income solutions—while wealthier individuals can weather a financial storm, it's the average retirement saver that is most in need of access to annuities.

In addition, the GAO study makes clear that the decision to delay the receipt of social security is a crucial factor in the retirement security equation. Working longer and taking social security at a later age can result in significantly more income in retirement.

Yet the study also implies that access to professional financial advice is critical. It's not just instructing individuals about the increased savings that delayed receipt of social security can bring—making the optimal choice requires education and calculations that are tailored to each retiree's unique circumstances, including anticipated expenses, income level, health status, and risk tolerance. Professional financial advisors can guide individuals through their various options and construct a personalized plan that will provide sufficient income in retirement. Unfortunately, this rule would make providing this type of advice significantly harder.

Building on the recommendations of the GAO study, the Treasury Department—recognizing the need to offer lifetime income streams in qualified plans—finalized regulations in 2014 which promoted the use of Qualified Longevity Annuity Contracts (QLACs). Insurance companies and financial institutions have just begun building solutions to comply with these recently issued regulations, and for the first time in 2015 there are multiple QLAC solutions that retirement savers can access in the marketplace. The DOL proposed rule would make it difficult, if not impossible, for our business to offer these critical retirement savings products to our clients, contradicting this Treasury Department initiative and sending a conflicting message to Americans.

The DOL's proposed rule also conflicts with initiatives at the SEC. The Commission has listed combatting reverse churning—putting clients that aren't actively trading into fee-based accounts when a commission-based account would be a better, more affordable option–as an important priority. Many investors execute buy and hold strategies, with little to no trading over a number of years. For these savers, a fee-based account would mean paying an annual fee despite not needing or receiving any advice or services. A commission-based account would be more appropriate, only charging them when they need service from their advisor.

In other words, the SEC has made it very clear that fee-based accounts are NOT appropriate or the best deal for some retirement savers. Yet the DOL proposal would force many businesses like mine to basically put all of my clients into fee based accounts–directly contradicting this SEC initiative.

The Proposal Contains Unworkable Exemptions for Commission-Based Business Models—Resulting in Reduced Choice and Access for Average Retirement Savers

I would now like to focus on why this rule will ultimately result in reduced choice and access for average retirement savers by providing real world examples from my business. The DOL claims that the proposal is business-model neutral, but based on my experience this rule is not compatible with current commission-based business models—as FINRA CEO Rick Ketchum has himself noted.

The AALU continues to support clear, concise disclosures about the roles and obligations, product offerings, and material conflicts for all financial advisors, including broker-dealers and life insurance professionals. Yet while it is important to alleviate any investor confusion in the marketplace, regulators must ensure that consumers have meaningful choice when making decisions about their investments and retirement savings.

Unfortunately, this proposed rule makes it difficult, if not impossible, for our business to continue providing valuable life insurance and lifetime income products that offer the only solutions allowing retirement savers to transfer longevity risk and market sequence of return risk to third parties.

This loss of access to lifetime income products is particularly troubling because Americans are increasingly unprepared for retirement. In fact, many experts feel that we are facing a retirement crisis. Americans that reach retirement age are living longer than ever, yet many Americans have very little savings at all—in fact, 40 million households have saved literally nothing for retirement.[i] Further, 57% of workers reported that the total value of their entire household's savings and investments—not just for retirement—was less than $25,000, and 28% had less than $1,000.[ii] Survey after survey shows that retirement security is one of the top concerns for Americans. In short, this is exactly the wrong time to be restricting access to products that provide lifetime income.

The aforementioned 2011 GAO report discusses the significant under-utilization of annuities by investors—particularly median income savers—and academics wonder why many more retirees don't annuitize defined contribution benefits given the protection they provide.

Part of the reason is that research shows individuals often underestimate the value of an annuity. Life insurance producers have to educate savers about the benefits of annuities, and walk them through their varied and complex options. They also have to obtain detailed information about the individual's specific circumstances to appropriately tailor the product to best fit their needs. Unfortunately, the restrictions on advisors receiving commissions under this rule—from the definition of fiduciary to the conditions set forth by the BICE—will prevent our advisors from continuing to provide valuable advice to retirement savers.

In addition, annuities are buy-and-hold products by their very nature. As I discussed with reverse churning earlier, it can be much more expensive for investors that hold positions for long periods of time to be in fee-based accounts. With annuities being held in accounts for long periods of time without trading or advice around these products, commission-based accounts often offer the best choice for investors.

Quite simply, commission-based advice represents the most inexpensive option for small retail investors to receive education and access to annuities and lifetime income products. This rule will make it difficult to provide the only solution retirement savers have to transfer a portion of longevity risk and market sequence of return risk to a third party.

And it's not just access to annuities; my clients will lose access to professional financial advice and other retirement savings products.

The United Kingdom banned commissions in 2013, and it serves as example of what the DOL proposal would portend if adopted. In a study on the impacts of the Department's proposal on U.S. life insurers, Oliver Wyman found that, "While commission structures will still exist in the US, we believe that the trajectory of change is close enough to that in the UK and Australia that similar impacts will occur here. These changes will significantly affect competitive dynamics in a manner that could have profound impacts on market participants."[iii]

In the wake of the U.K. commission ban, the largest banks have significantly raised the minimum account balances required before they will offer financial advice to investors. And in the year before the commission ban went into effect, the number of advisors serving retail accounts plunged by 23%.[iv] In fact, just last week the U.K. initiated a review of the advice gap for small accounts that has occurred since 2013—a clear sign of the reduced access caused by the commission-ban.

The marketplace reality is that the size of an account is not necessarily indicative of the service required—it is often not cost-effective to provide fee-based services to smaller retail investors. For example, fee-based advisors typically charge investors a flat fee of 1% of the assets in their account, so for an IRA with a $5,000 balance the advisor would get $50 in fees, not enough to cover the costs of providing round-the-clock fiduciary service and the attendant liability.

Let me explain the disruption this rule would cause by providing a recent personal example involving my parents. They are 64 years old, and have saved about $25,000 for their retirement. The other day my Mom called me to ask a variety of retirement questions:

> *Should we file for social security now? Should we file and suspend? Should we use some of our savings to pay down our mortgage?*

These are the types of tough questions that my Mom asked, and she didn't have the right answers on her own. I was of course willing to spend a couple of hours going over these questions with my parents because I love them, and I expect to spend many more hours in these types of conversations with them. However, a fee-based advisor will not be willing to spend the time necessary to walk them through these options, as they would only make $250 on this type of account. Unfortunately, this proposed rule will make it difficult for many near-retirees that don't happen to have sons working in the financial industry.

In addition to a loss of access to professional financial advice, retirement savers are being denied the ability to make basic choices about what's best for their future. When protecting their families and saving for retirement, individuals must be able to choose what is right for them.

As discussed, long-term investors may prefer a single point-in-time payment over an ongoing, annual obligation that increases as does the value of their investment account. For many investors, the annual fee can add up to far more money paid than a point-in-time commission. To take away the right of consumers to choose how and when advisors are compensated for the services they provide in not in the best interest of average retirement savers.

Other markets do not restrict choice. Consumers are afforded the independence and freedom to make decisions about purchases based on their own determinants of value—including items that have a significant impact on retirement savings such as a home. Great platforms like standardized disclosures, data conformity, good faith estimates, consumer reports, and social media feedback are available to aid consumers in their decisions. Cheapest is not always best, and every individual will make choices based on their own determination of value relative to their goals and situation.

In addition, insurance products are distinctly different from other financial products, such as a mutual fund, and offer unique benefits. Forgoing insurance is always initially cheaper than obtaining insurance coverage—whether a house, car, etc. But whether it truly costs more is something that is unknown because it depends on future events. If we could predict the future we wouldn't need solutions like this, but of course that is the very concept of insurance—transferring risk to third parties that are better able to withstand it. Yes, consumers pay for the protection and financial security that insurance products provide—it's not free—but that is a choice individuals should be able to make.

Average Investors Have Better Investment Performance When Using Professional Advisors

The Department has chosen to focus on one area related to saving for retirement: costs. And it is certainly worthwhile to ensure that investors are best served by their professional advisors. But besides ignoring other risks faced by retirement saves such as longevity risk, the Department creates a new one: the risk that many more investors will be making investment decisions on their own.

The prospect of average retirement savers facing critical retirement savings decisions without access to professional financial advice is disturbing, because documented studies have repeatedly concluded that investors who do not have an investment professional consistently achieve lower returns than investors who use a professional advisor.

For example, the decision to stay invested in the market during times of stress is the biggest factor affecting retirement savings over the long-term. According to a recent analysis from Robert Litan and Hal Singer, restricting access to face-to-face professional advice during a future market swoon could cost investors $80 billion.[v] In another recently released study, Oliver Wyman found that investors using professional advisors have a minimum of 25% more assets than investors without professional advisors, and concluded that "advised individuals are more sophisticated and diligent long term investors who achieve better investing outcomes."[vi] And a 2014 LIMRA study outlined the important benefits from working with professional financial advisors, and noted that many consumers—particularly younger investors—desire additional advice and guidance about decisions related to their financial and retirement security.[vii]

Summary

AALU believes that the DOL has prematurely jumped for a “solution” in the retirement savings marketplace without fully stating or quantifying why this proposed rule is necessary or explaining why the existing regulatory framework cannot be built upon to address any problems. Further, the rule directly contradicts other governmental goals and initiatives, creating conflicts that will harm retirement savers.

While we appreciate the intent of the DOL to ensure that clients’ best interests are being served, this rule will have the opposite effect—reducing choice and access to professional financial advice for average retirement savers. Any final fiduciary rule from DOL must allow my firm’s customers and all retirement savers to make choices based on the best interest as they determine it to be.

AALU supports support clear and simple disclosure that provides investors with information about the roles, obligations, product offerings, and material conflicts of financial advisors. It seems that disclosure around the specific problem areas DOL finds with current regulatory framework would be a much better way to address any problems in the ERISA marketplace that the complex and unworkable rule that has been proposed.

Thank you for giving me the opportunity to testify today. I am happy to serve as a resource for the Department as you work to determine the best methods for improving the proposed fiduciary rule.

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[iii] Mick Moloney, Ramy Tadros, David Clarkson, and Anthony Bice, “Distribution Disruption: Impacts of the Department of Labor Fiduciary Standard for U.S. Life Insurers,” Oliver Wyman, 2015. Accessed July 21, 2015. Available at: http://www.oliverwyman.com/content/dam/oliver-wyman/global/en/2015/jun/Oliver_Wyman_Distribution_Disruption.pdf.

[iv] Kent Mason, “SaveOurRetirment.Org: Missing the Key Issue,” Davis and Harman LLP, February 3, 2015. Accessed July 21, 2015. Available at: http://saveourretirement.com/MissingTheKeyIssue.pdf.

[v] Robert Litan and Hal Singer, “Good Intentions Gone Wrong: The Yet-To-Be-Recognized Costs of the Department Of Labor’s Proposed Fiduciary Rule,” Economists Incorporated, July 2015. Accessed: August 11, 2015. Available at: http://www.dol.gov/ebsa/pdf/1210-ZA25-00070.pdf.

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[vii] “Matters of Fact: Consumers, Advisors, and Retirement Decisions (and Results),” LIMRS Secure Retirement Institute, May 2015. Accessed July 21, 2015. Available at: http://www.limra.com/uploadedFiles/limra.com/LIMRA_Root/Posts/PR/_Media/PDFs/Facts-about-retirement-decisions.pdf.