



Written Testimony of

John Berlau

Director,

Center for Investors and Entrepreneurs

Competitive Enterprise Institute

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Hearing on the Proposed Regulation

To Amend the Definition of “Fiduciary”

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Assistant Secretary Borzi and members of the panel, thank you for the opportunity to testify at this hearing regarding the proposed regulation defining the term “fiduciary” in connection with the provision of investment advice under ERISA (the Proposal).¹

My name is John Berlau, and I am the director of the Center for Investors and Entrepreneurs at the Competitive Enterprise Institute. The Competitive Enterprise Institute (CEI) is a non-profit public policy organization dedicated to advancing the principles of limited government, free enterprise, and individual liberty. Founded in 1984, our mission is to promote both freedom and opportunity. We make the uncompromising case for economic freedom because we believe it is essential for entrepreneurship, innovation, and prosperity to flourish.

In January, President Obama issued Executive Order 13563, intended to reemphasize the principles of Executive Order 12866 that govern the regulatory development and review process. Regarding his new Executive Order, the President wrote:

“...We are seeking more affordable, less intrusive means to achieve the same ends—giving careful consideration to benefits and costs. This means writing rules with more input from experts, businesses and ordinary citizens. It means using disclosure as a tool to inform consumers of their choices, rather than restricting those choices... I am directing federal agencies to do more to account for—and reduce—the burdens regulations may place on small businesses.”²

Unfortunately, the Proposed regulation we are discussing today fails to meet any of these objectives.

- The Proposal does not utilize “more affordable, less intrusive means.” Instead, the Proposal dramatically expands the applicability of the highest and most restrictive standard of fiduciary conduct in Federal law to entire classes of market participants never before considered ERISA fiduciaries. In fact, the Department did not even consider less restrictive alternatives to the Proposal in its economic analysis.
- The Proposal does not “give careful consideration to benefits and costs.” In fact, the economic analysis does not quantify costs or benefits; it admits that both are subject to significant uncertainty and that the rule could have a large market impact; and it fails to consider any impact at all on the more than \$4 trillion Individual Retirement Account (IRA) marketplace.³

¹ 75 Fed. Reg. 65263 (Oct. 22, 2010)

² “Toward a 21-st Century Regulatory System,” President Barack Obama, The Wall Street Journal, January 18, 2011.

³ See “The U.S. Retirement Market: Third Quarter 2010,” Investment Company Institute, January 2011.

- The Proposal does not “us[e] disclosure as a tool to inform consumers of their choices rather than restricting those choices.” In fact, the Proposal would limit the choices of consumers, especially in the IRA marketplace, by making it difficult or impossible for consumers to keep the service agreements they have now with providers they personally selected. Furthermore, the Department recently completed regulations providing for new disclosure tools for plans and participants, which could alleviate many of the concerns about hidden conflicts of interest that are said to justify the proposal we are discussing today, but the Department intends to finalize this more burdensome fiduciary rule before the disclosure regulations may even take effect.⁴
- The Proposal does not “account for—and reduce—the burdens regulations may place on small businesses.” In fact, the Department decided it could not determine the number of small entities affected by the Proposal, though the available hard data from the Form 5500 showed that 98% of service providers to plans with 100 or more participants have total revenues attributable to ERISA plan clients that are below the small entity threshold.

Based on our review of this Proposal and its economic justification, we are deeply concerned that the Department has failed to abide by the requirements of the regulatory process, from conducting a thorough and required analysis of the impact of the regulation to denying the public a meaningful opportunity to comment on its contents.

We are also very concerned that the effect of the Proposal will be to reduce the availability of choice, options and freedom to individual Americans who own IRAs, to employers offering workplace retirement plans, and to workers participating in those plans. Individual choice is the hallmark of IRAs and defined contribution plans, such as 401(k)s, and we believe this proposal will make it more difficult for workers to get the information or advice they seek to make informed decisions. Plan sponsors and workers should be free to select service providers on a non-fiduciary basis to assist them in making their own decisions—we believe the likely effect of the Proposal would be to limit the ability of plans and workers to make that choice.

As noted by other commenters, the Proposal as written will likely cause many attorneys, accountants and actuaries who provide their services to plans to be defined as fiduciaries. As a result of the costs of the new liability of falling under this definition, these professionals may sharply increase their fees for these services. Or many may decide it’s simply not worth the costs to provide their expertise to ERISA-covered plans, concentrating instead on segments of the financial market that serve only wealthy investors. Either way, middle-class workers in

⁴ DOL officials have stated a final fiduciary rule will be issued before the end of 2011, while the service provider and participant disclosures rules promulgated by the Department in 2010 do not take effect until January 1, 2012 (assuming a calendar-year plan year in the case of the participant disclosure rule).

ERISA plans would lose out, as they would either be deprived of or pay much more for the skills of these professionals.

Let me try to sum up in one sentence why we are so concerned with the economic analysis in this case: this Proposal would redefine one of the fundamental concepts of an entire body of law governing roughly \$10 trillion in retirement savings of more than 100 million workers, retirees and their families.⁵

In our view, when an agency is proposing to make changes on this scale, it is incumbent on the agency to demonstrate that it has fully considered the impact of the Proposal, and can, with some reasonable degree of certainty, justify the transition and ongoing costs it may impose. We do not believe the agency has met this burden.

Economic analysis is supposed to inform and shape regulatory policy, not serve as a rubber stamp for a predetermined policy view. That's why we were very troubled to read a report yesterday quoting an agency official saying that testimony at these hearings asking the Department to "go back to the drawing board...is not going to be well-received."⁶

At the risk of not being well-received, that is exactly what we request. We believe the Department must revise, reanalyze, and repropose this rule for public comment. Let me be clear—we support the Department's effort to review this regulation, and we are open to the Department's concerns about the need to revise the current rule. However, we do not believe the Proposal as written can be determined to achieve the Department's goals.

In our formal comment letter, we provided a number of comments for the Department to consider, but in the interests of time, I will focus on a few specific concerns in my testimony today.

Impact on IRAs:

Though we acknowledge that the Tax Code gives the Department the ability to interpret the prohibited transaction rules for IRAs, we do not believe that it would be wise to apply the Proposal's fiduciary definition to IRAs.

First, as I mentioned above, the Department does not appear to have considered how the rule might impact IRAs. This alone causes concern, because it is not at all clear that the same cost considerations apply given the structural differences between IRAs and ERISA plans, and also because IRAs hold more than \$4 trillion in assets.

⁵ See "The U.S. Retirement Market: Third Quarter 2010," Investment Company Institute, January 2011.

⁶ "Borzi Says Labor Department Is Expecting To Finalize Fiduciary Rule By Year's End," BNA Pension & Benefits Daily, March 1, 2011.

Second, IRAs simply are fundamentally different from ERISA plans—they are individual financial products and should be regulated as such. The Department has recognized these differences in the past, as it has previously addressed prohibited transaction issues differently for plans and IRAs.

ERISA's fiduciary provisions serve to protect workers from decisions made on their behalf by others. It provides a standard of conduct, and a series of rights and remedies designed to ensure that the people making decisions for you do so in your best interest. In an IRA, however, the individual makes her own decisions. She decides which service provider to hire and how much to pay. There is no relationship requiring ERISA fiduciary intervention to protect her interests. In effect, the actual decision-making process for the individual is the same as in a personal brokerage account or similar non-ERISA vehicle.

Applying the Proposal to IRAs would have the effect of limiting her choices and second-guessing her decisions. If her IRA-provider can be a fiduciary for providing her with a buy/sell/hold recommendation from the research department, the provider will stop providing her with information or change its business model to comply with prohibited transaction concerns. In either circumstance, the terms of the agreement she made with her provider are now being changed because the government has decided she was not capable of making her own decisions.

Reliance on Non-Public Data and Alternative Proposals:

We are also very concerned that the Department relied on non-public data in developing and justifying the Proposal. While the Department states that its enforcement experience leads it to take action, and that the Proposal is necessary to solve the Department's identified problems, the public has no way of evaluating these statements. For example, the Department did not consider any less restrictive alternative in its economic analysis. Why? Is it because literally nothing less than the full scope of this Proposal will work? The answer is—we don't know.

The public is limited in understanding and reviewing the proposal until it can see and evaluate the data on which the Department relied. Accordingly, we request that the Department provide a summary of the violations and resolution of each Consultants and Advisers Project investigation it undertook. The Department should redact the names of the parties involved as appropriate to protect the subjects of the investigations. Only by doing this can the public understand whether the Proposal is narrowly tailored to achieve the Department's objectives based on its enforcement experience. The Department should also develop and analyze new alternative regulations that narrow the scope of the Proposal to determine if these alternatives would achieve the Department's goals with less cost or greater efficiency.

Disclosure vs. Fiduciary Status:

In our comment letter, we expressed concern that the Department appeared to be double-counting the benefit of its prior disclosure regulations. This concern is due to the fact that the service provider and participant disclosure regulations were never mentioned in the Proposal—in fact, on page 65365 the Preamble incorrectly states that non-fiduciary service providers “need not disclose to the plan fiduciaries” payments received from other parties.

First, such disclosure requirements have already been promulgated in binding rules by the Department. Second, the Department’s economic analysis of those regulations claimed their benefits would exceed their costs because disclosure would improve decision-making and deter inappropriate behavior. However, both of these arguments are also claimed as benefits of the fiduciary Proposal.

Thus, the Department should answer a question—what is the additional benefit of fiduciary status, if any, that exceed the benefit of disclosure? This incremental benefit, if any, is highly relevant to the cost-benefit analysis of the Proposal.

Conclusion:

We believe the regulatory impact analysis accompanying the Proposal overstates the Proposal’s benefits and understates its costs, and does not comply with the intent of President Obama’s Executive Order 13563 or previous Executive Order 12866 and OMB Circular A-4. This is especially significant because of the broad scope of the Proposal—we need better information demonstrating that we will not be making the current situation worse by increasing the net costs borne by participants. We believe the Department should revise the Proposal based on the comments it receives, conduct a new regulatory impact analysis, and repropose the rule for public review and comment.

I’d be happy to answer any questions you may have.