Testimony of Brian H. Graff, Submitted to the U.S. Department of Labor, Employee Benefits Security Administration On Behalf of:

The American Society of Pension Professionals and Actuaries (ASPPA), the National Association of Independent Retirement Plan Advisors (NAIRPA), and the Council of Independent 401(k) Recordkeepers (CIKR)

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Hearing on the Definition of Fiduciary Proposed Regulations

INTRODUCTION

On behalf of ASPPA, and its sister organizations, NAIRPA--the National Association of Independent Retirement Plan Advisors and CIKR--the Council of Independent 401(k) Recordkeepers, I thank you for this opportunity to testify today on this important subject.

My testimony will focus on two points:

1) we generally support the proposed change to the basic definition of investment advice and want to encourage you to stay the course; and

2) we believe it is critically important that these rules NOT apply to IRAs as such application would effectively create an uneven marketplace playing field to the ultimate detriment of participants.

CHANGE IN INVESTMENT ADVICE DEFINITION

Regarding the proposed change to the definition of investment advice, many of those testifying today as well as many comments filed suggest that there is no need to change the definition since the current definition provides clarity and certainty. We agree--sort of. The current definition does provide clarity on how a non-registered broker/advisor can avoid providing what is considered "ERISA investment advice" and thus provides clarity on how a broker/advisor can avoid being subject to ERISA's fiduciary duties. The current definition also certainly is confusing to plan sponsors who really have no idea whether their broker or advisor is providing advice afforded the protections of ERISA.

A recent survey of plan sponsors reported that 60 percent of small business plan owners indicated they received investment advice on the plan. Well if that's ERISA investment advice, what are we all arguing about? That would mean that almost two-thirds of small plans are getting served by a fiduciary advisor. Of course, what we believe is that the investment advice most of these small business plans are receiving is actually non-ERISA investment advice, whatever that means--which is exactly the point.

There is nothing clear and certain about that, particularly to a small business owner trying to provide a retirement plan for his or her employees. When a broker/advisor is helping a small business owner set up a 401(k) plan and says to the owner "these are the 20 investment options that you should offer in your plan," that owner naturally thinks he or she is getting advice. If you never heard of the current 5-part definition, wouldn't you? In our members' experience, small business owners are rather surprised when they are informed that the "advice" they have received for their ERISA-covered 401(k) plan is not actually ERISA-covered investment advice. The idea that the same advice would theoretically have to be given two, three, maybe four times for the advice to be considered ERISA investment advice under the current rules is a victory of form over substance. What should matter most is the perception of plan sponsors. And to them, particularly small business owners, advice is advice is advice.

Marketplace confusion about the roles and responsibilities of brokers/advisors is not a new issue and is definitely not limited to retirement plans. The SEC recently issued a study recognizing that recipients of advice are often confused about the duties and obligations of the persons providing advice. Some commentators have argued that the Department should postpone its consideration of the proposed regulation until the SEC has completed its work on a fiduciary standard for brokers and advisors to avoid potential inconsistencies. We disagree. The issues and implications of advice given to ERISA plans are very different than retail-level advice. For instance, advice given to a plan sponsor directly impacts other individuals, namely participants, and thus it is appropriate for the Department to develop standards specifically designed for ERISA plans.

It is also important to point out that the proposed regulation would not, as some commentators have suggested, preclude commission-based brokers and advisors from working with sponsors, and thus would not eliminate an important distribution channel for plans. Under the so-called limitation in the proposed regulations, such brokers and advisors would be able to exempt themselves from the regulation, provided certain disclosures are made to the recipient of the advice.

Admittedly, we believe these disclosures are over broad and unduly harsh. The vast majority of professional brokers and advisors are dedicated and qualified and are very much focused on the interests of their clients. No broker or advisor could ultimately be successful in their practice if their interests were "adverse" to their clients and to require a disclosure indicating as such, as the proposed regulation does, is just not fair.

In these instances, what we believe is most important to be disclosed to recipients of advice are three things:

1) that the broker/advisor is NOT acting as an ERISA fiduciary and thus the advice given is not afforded the protections of ERISA;

2) that the broker/advisor's advice may not be impartial since he or she is compensated by the provider of the investment options being considered and the amount of the compensation may be affected by the investments selected; and

3) the amount of compensation the broker/advisor is reasonably expected to receive based on the investments selected, which ties into what will already have to be disclosed under the Department's new ERISA section 408(b)(2) regulations.

This kind of disclosure will reasonably and effectively give plan fiduciaries the information they need to understand what role their broker/advisor is playing and what financial relationships exist between the broker/advisor and the plan investment providers. However, it is also critical that this disclosure be clear and conspicuous and not allowed to be buried in a lengthy service agreement. We suggest the Department provide a model notice along these lines.

Interestingly, such a disclosure framework would be very much in line with what was suggested by the SEC staff in its recent study. Namely, a possible fiduciary standard would not preclude commission-based compensation, but would rather require a clear disclosure.

We believe what we are suggesting would address the current confusion of plan sponsors and would level the playing field between those providing advice that are currently ERISA fiduciaries and want to be and those that are NOT ERISA fiduciaries and don't want to be. In other words, if a broker/advisor provides to a plan what any layperson would think is advice, the broker/advisor will either:

1) be subject to the duties and responsibilities of an ERISA fiduciary; or

2) disclose they are not acting as an ERISA fiduciary and that their advice may not be impartial due to compensation received from the investment providers.

That’s it. What could be more clear and certain than that!

APPLICATION TO IRAS

I would now like to spend a few minutes talking about IRAs. The proposed regulation, as currently written would apply to IRAs. Further, the proposed regulation asked for comments on whether the definition of investment advice should extend to recommendations related to taking a plan distribution, namely IRA investments. We strongly recommend that the regulation should not apply in either case.

There is no debate that IRAs are an important retirement savings vehicle. Over 40 percent of American households own IRAs and they are the primary tool for retirees to manage their retirement assets.

But IRAs are different than ERISA-covered retirement plans. As the Department said in the preamble to the participant fee disclosure regulations, IRA holders "have considerable flexibility in the choice of their IRA provider or the ability to roll over their balances to an IRA provider of their choice." The Department thus appropriately concluded that the participant fee disclosure regulations should not extend to IRA-based plans. We believe the Department should do the same here with respect to IRAs in general.

IRAs are different than ERISA plans in another critically important respect. In contrast to the thorough enforcement regime applicable to ERISA plans, there is no federal agency that currently has a comprehensive enforcement program for IRAs. The fact is IRA enforcement appears to be more often occurring at the state level and is hodgepodge at best. Recent warnings issued by the states of Kansas and Oregon about investing IRAs in fractional shares of viatical settlements are a good example. The fact that states have felt the need to get involved in IRAs is testament to the current lack of federal enforcement.

If the Department decides to extend these regulations to IRAs this is what will happen. Players in the retirement industry who are more formally regulated with extensive compliance departments, like the firms represented by my colleagues on this panel, will comply with the rules, and those less formally regulated, who know there is no practical enforcement of the rules, will choose not to comply. While responsible firms will have limitations on their ability to distribute IRAs, less responsible firms will practically have free reign giving them a competitive advantage on an uneven playing field. Consumers will be exposed to significantly greater risk as a consequence.

Further, if the Department chooses to apply the definition of investment advice to plan distributions, including distributions to IRAs, retirement plan service providers who already have existing relationships with participants will be severely hampered from discussing IRA options with them. These service providers have done an excellent job building programs to work with employees approaching retirement to encourage them to rollover their retirement savings and prevent leakage from the retirement system. The IRAs they offer have investment options that are generally consistent with those available to the employee in the plan, are high quality and have reasonable fees.

If these service providers are effectively precluded from offering IRAs to employees, that means participants will be potentially left exposed to less responsible vendors. Making it easier for some vendors to offer retirees IRAs invested in viatical settlements is not a result anyone should want.

Some people in our industry have described the IRA market as the Wild West. If you apply these regulations to IRAs, you will, metaphorically speaking, be taking the guns away from the good guys leaving only the bad guys with guns. Forgive me, but that wouldn't be a fair fight!

Simply put, any regulatory initiative in the IRA area must be supported by an active comprehensive enforcement regime to ensure consistent application. In the absence of such enforcement, we strongly encourage you to exclude IRAs from these rules.

Thank you and I would be pleased to take any questions.