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REDEFINING 'FIDUCIARY': ASSESSING THE IMPACT OF THE LABOR DEPARTMENT'S PROPOSAL ON WORKERS AND RETIREES

HEARING

BEFORE THE

SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR AND PENSIONS

COMMITTEE ON EDUCATION AND THE WORKFORCE

U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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REDEFINING 'FIDUCIARY': ASSESSING THE IMPACT OF THE LABOR DEPARTMENT'S PROPOSAL ON WORKERS AND RETIREES

Tuesday, July 26, 2011
U.S. House of Representatives
Subcommittee on Health, Employment, Labor and Pensions
Committee on Education and the Workforce
Washington, DC

The subcommittee met, pursuant to call, at 10:05 a.m., in room 2175, Rayburn House Office Building, Hon. David P. Roe [chairman of the subcommittee] presiding.

Present: Representatives Roe, Thompson, Walberg, Hanna, Rokita, Bucshon, Barletta, Roby, Heck, Andrews, Kucinich, Loebsack, Kildee, Hinojosa, McCarthy, Tierney, Holt, and Scott.

Also present: Representatives Kline and Biggert.

Staff present: Andrew Banducci, Professional Staff Member; Katherine Bathgate, Press Assistant/New Media Coordinator; Casey Buboltz, Coalitions and Member Services Coordinator; Ed Gilroy, Director of Workforce Policy; Benjamin Hoog, Legislative Assistant; Ryan Kearney, Legislative Assistant; Brian Newell, Deputy Communications Director; Krisann Pearce, General Counsel; Molly McLaughlin Salmi, Deputy Director of Workforce Policy; Linda Stevens, Chief Clerk/Assistant to the General Counsel; Alissa Strawcutter, Deputy Clerk; Joseph Wheeler, Professional Staff Member; Kate Ahlgren, Minority Investigative Counsel; Aaron Albright, Minority Communications Director for Labor; Tylease Alli, Minority Clerk; Daniel Brown, Minority Junior Legislative Assistant; Jody Calemine, Minority Staff Director; John D'Elia, Minority Staff Assistant; Brian Levin, Minority New Media Press Assistant; Megan O'Reilly, Minority General Counsel; Meredith Regine, Minority Labor Policy Associate; and Michele Varnhagen, Minority Chief Policy Advisor/Labor Policy Director.

Chairman ROE. This hearing of the Labor and Pensions subcommittee will come to order.

Good morning everyone.

Welcome Assistant Secretary Borzi. We appreciate the time you have taken to be with us today.

Recently, we learned about the challenges confronting retirement security of workers and retirees. The lingering effects of the recession and the uncertain regulatory environment reaffirmed the need for policy makers to tread carefully as they consider changes to the rules that govern retirement investment.

Policies in this area should provide clear guidance that protect workers but also be flexible enough to permit a wide range of investment opportunities. Striking the right balance between these two competing demands remains a constant policy goal.

We are here this morning to discuss the Labor Department's proposal to redefine the term fiduciary. The Employee Retirement Income Security Act (ERISA) charges fiduciaries with the highest level of care to individuals participating in a retirement plan.

Anyone who provides investment advice should be well trained, committed to high ethical and professional standards, and devoted to the best interests of those financial resources are entrusted to their care. However, the dramatic shift proposed by the department may well disrupt stable effective relationships between retirement savers and service providers.

For more than 35 years regulations surrounding fiduciary responsibilities have provided certainty to employees and other retirement plan sponsors. Currently an investment advisor is considered a fiduciary under the law if they offer individualized advice on a regular basis for a fee.

The fiduciary's advice must be provided pursuant to a mutual agreement and be the primary basis for resulting investment decision. However, the labor department has now decided to rewrite the rules of the road. Among other changes proposed by the department, fiduciary status would no longer hinge on whether advice was provided regularly or served as a primary reason for an investment decision.

While we support looking at ways to enhance this important definition, the current proposal is an ill-conceived expansion of the fiduciary standard. It will undermine efforts by employers and service providers to educate workers on the importance of responsible retirement planning. Regrettably, the proposal may deny investment opportunities and drive up cost for the individuals it is intended to protect.

Remarkably, the department failed to examine all the potential costs of its proposal. For example, despite clear indications this proposal may force small business plan sponsors to face higher fees and receive fewer services. The department neglected to conduct any analysis of the potential ramifications.

Similarly, the department failed to explore how its proposal could affect the IRA market. One study suggests that some IRA related fees may increase by as much as 195 percent. That is an unacceptable amount of money that will never make it into a retirement account.

This is a difficult issue, and we should never lose sight of the real world impact these changes may have on the investments and long-term retirement security of workers and retirees. We need to challenge any proposal that would curb investment opportunities, raise the cost of investing and reduce the return on those investments for individuals saving for retirement.

I would like to note that leaders on both sides of the aisle have expressed worry about the department's proposal. In April, Chairman Kline and other Republican committee leaders across the Capitol expressed their concerns and urged the department to re-propose the rule.

On May 10th, members of the Democrat's Blue Dog coalitiondescribed a number of uncertainties raised by the proposal and the rushed regulatory process. And finally, members of the new Democrat coalitionasked the administration to heed public concern and begin anew.

It is not every day that such a diverse group of lawmakers find common ground on an issue. Boy, will I ever second that. [Laughter.]

Conceding the challenges that plague this proposal, the department has promised to address concerns for either targeted exemptions or future rulemaking. I am afraid this will only exacerbate the uncertainty facing investment professionals and increase risk for workers and retirees.

With all due respect, Assistant Secretary, if this proposal is so disruptive to our system of retirement saving, then the department needs to take a step back and start over. I would like to join my Republican and Democrat colleagues in urging the administration to do just that.

Once this proposal has been set aside, we believe we can work together on policies that will strengthen the retirement security of millions of Americans.

Again, we welcome Assistant Secretary Borzi, and we look forward to your testimony and the testimony of our other witnesses.

I will now yield to Mr. Andrews, the senior Democrat member of the subcommittee for his opening remarks.

Mr. Andrews?

[The statement of Dr. Roe follows:]

Prepared Statement of Hon. David P. Roe, Chairman, Subcommittee on Health, Employment, Labor and Pensions

Good morning everyone. Welcome Assistant Secretary Borzi. We appreciate the time you have taken to be with us today.

Recently, we learned about the challenges confronting the retirement security of workers and retirees. The lingering effects of the recession and an uncertain regulatory environment reaffirm the need for policymakers to tread carefully as they consider changes to the rules that govern retirement investment. Policies in this area should provide clear guidelines that protect workers, but also be flexible enough to permit a wide range of investment opportunities. Striking the right balance between these two competing demands remains a constant policy goal.

We are here this morning to discuss the Labor Department's proposal to redefine the term "fiduciary." The Employee Retirement Income Security Act charges fiduciaries with the highest level of care to individuals participating in a retirement plan. Anyone who provides investment advice should be well trained, committed to high ethical and professional standards, and devoted to the best interests of those whose financial resources are entrusted to their care. However, the dramatic shift proposed by the department may well disrupt stable, effective relationships between retirement savers and service-providers.

For more than 35 years, regulations surrounding fiduciary responsibility have provided certainty to employers and other retirement plan sponsors. Currently, an investment adviser is considered a fiduciary under the law if they offer individualized advice on a regular basis for a fee. The fiduciary's advice must be provided pursuant to a mutual agreement and be the primary basis for a resulting investment decision.

However, the Labor Department has now decided to rewrite the rules of the road. Among other changes proposed by the department, fiduciary status would no longer hinge on whether advice was provided regularly or served as the primary reason for an investment decision. While we support looking at ways to enhance this important definition, the current proposal is an ill-conceived expansion of the fiduciary standard. It will undermine efforts by employers and service providers to educate workers on the importance of responsible retirement planning. Regrettably, the pro-

posal may deny investment opportunities and drive up costs for the individuals it is intended to protect.

Remarkably, the department failed to examine all of the potential costs of its proposal. For example, despite clear indications this proposal may force small business plan sponsors to face higher fees and receive fewer services, the department neglected to conduct any analysis of the potential ramifications. Similarly, the department failed to explore how its proposal could affect the IRA market. One study suggests that some IRA-related fees may increase as much as 195 percent—that's an unacceptable amount of money that will never make it into a retirement account.

This is a difficult issue, and we should never lose sight of the real world impact these changes may have on the investments and long-term retirement security of workers and retirees. We need to challenge any proposal that could curb investment opportunities, raise the costs of investing, and reduce the return on those investments for individuals saving for retirement.

I'd like to note that leaders on both sides of the aisle have expressed worry about the department's proposal. In April, Chairman Kline and other Republican committee leaders across the Capitol expressed their concerns and urged the department to re-propose the rule. On May 10, members of the Democrats' Blue Dog coalition described a number of uncertainties raised by the proposal and the rushed regulatory process. And finally, members of the New Democrat Coalition asked the administration to heed public concern and begin anew. It's not every day such a diverse group of lawmakers find common ground on an issue.

Conceding the challenges that plague this proposal, the department has promised to address concerns through either targeted exemptions or future rulemaking. I am afraid this will only exacerbate the uncertainty facing investment professionals and increase risk for workers and retirees. With all due respect, Assistant Secretary, if this proposal is so disruptive to our system of retirement saving, then the department needs to take a step back and start over. I would like to join my Republican and Democrat colleagues in urging the administration to do just that. Once this proposal has been set aside, I believe we can work together on policies that will strengthen the retirement security of millions of Americans.

Again, welcome Assistant Secretary Borzi, we look forward to your testimony and the testimony of our other witnesses. I will now yield to Mr. Andrews, the senior Democrat member of the subcommittee, for his opening remarks.

Mr. ANDREWS. Well, good morning, Chairman. I apologize to you, the other members, and our witnesses for my tardiness. I try to be prompt, and I apologize for that this morning.

There was a survey released last week that said that about half the people in the country think the American dream is dead. That is a very sobering thought, irrespective of which political party we come from or what point of view we come from. I would think we have a very high common purpose here to rejuvenate the reality of the American dream and people's faith in the American dream.

A big piece of that American dream for people is that they work very hard week after week, month after month, year after year, and they save money for their retirement. They count on that money to give them the kind of lifestyle that they have earned and so richly deserve in their retirement years.

The rule we are talking about today is about protecting that piece of the American dream. It is about making sure that every one of the 70 million people, who are now really their own pension board of trustees, because they have a defined contribution account for their pension, that every single one of those 70 million Americans, when they get advice, are getting advice that is solely in their best interest and not in someone else's. That is a common purpose that I think we should share and agree with.

Now, we are concerned about the situation where one of those 70 million Americans is about to make a decision about whether to put her retirement savings in Sam's mutual fund or Mary's mutual fund. That person turns to a person who is somehow affiliated with

the retirement plan that they enroll in at work. They really need to know that the person giving them advice doesn't make more money if they steer them towards Sam's mutual fund or Mary's mutual fund.

They really need to know that the advice that the advisor is giving them is based upon their interest and what will be best for their fund.

The ERISA law has enshrined in statute this conflict of interest provision since its inception. Section 321 of that law says, "A person is a fiduciary with respect to a plan that he or she renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or any property of such plan or has any authority or responsibility to do so."

Since 1974, when that statute was written, the world has changed. The number of people relying upon defined contribution accounts has skyrocketed, the complexity of investments has deepened, and the importance of the account has broadened for people.

So the purpose of this rule, which I think we need to support, is that we never want one of those 70 million Americans to be in a position where the person giving them advice about whether it is Sam's mutual fund or Mary's mutual fund has interests that are not strictly aligned with the pensioner or the workers of whom they are giving advice.

Now, we know that there are practical issues here that need to be addressed and resolved. And we have two terrific panels today. Secretary Borzi has expressed in our discussions a sincere willingness to address these practical issues, and I think she and her team are in the process of doing that.

And the second panel is really outstanding; people who know this issue from their perspective as legislators, academics, or advocates of the field. So I am looking forward to hearing what both panels have to say.

But understand this: many of us do share with the department a conviction that whether you are getting advice about what the next decision is in your work life or what the next decision is when you roll over your defined contribution plan to some other account, we want to be sure that the underlying principle of ERISA that avoids conflicts of interest in the giving of advice is universally adhered to so that piece of the American dream where someone can retire with the certainty that their assets are protected as well can become real again for the people of our country.

Seventy million Americans depend on this, and I believe it is our obligation to make sure that their dependence is well placed.

So, Mr. Chairman, I appreciate the chance to hear the panels.

Chairman ROE. Thank you, Ranking Member.

I now yield to Mr. Kildee, from Michigan, for his opening comments.

Mr. KILDEE. Thank you, Dr. Roe. I appreciate this courtesy.

I came to Congress about 34-and-a-half years ago when Frank Thompson was your counterpart, and we had a special task force on ERISA. He told me one day very early, he said, "There are only two people in Washington who understand ERISA, and that is Phyllis Borzi and John Erlenborn."

John was your counterpart, the Republican, and Phyllis, it is good to have you here again. You have been a fountain of wisdom for us through these years.

Since then I can add one more, just by the good luck of buying a good place, my neighbor right across the street is Don Myers, and if I have a question coming up on ERISA, I wait until Don walks to his mailbox, and I will walk over there then.

Stand up, Don.

He gives me some pro bono advice on this, and I appreciate it.

Mr. ANDREWS. Does that make him a fiduciary? I wonder about that, huh? [Laughter.]

Mr. KILDEE. So, anyway, thank you, Mr. Chairman.

I will say this, Dr. Roe, if everyone conducts themselves around here as you, we would have a body of civility in this Congress. Thank you, Dr. Roe.

Chairman ROE. Thank you, Mr. Kildee, for yielding back.

Pursuant to committee rule 7c, all members will be permitted to submit written statements to be included in the permanent hearing record. And without objection, the hearing record will remain open for 14 days to allow such statements and other such extraneous material referenced during the hearing to be submitted for the official record.

[The statement of Mr. Rokita follows:]

Prepared Statement of Hon. Todd Rokita, a Representative in Congress From the State of Indiana

Thank you Mr. Chairman. I would like to recognize the leadership this committee, and subcommittee, have taken on this issue. We are here talking about a proposed regulation by the Department of Labor that would have significant unintended consequences on the financial services industry, as well as active and retired workers.

While I think we all support efforts that would modernize the enforcement of the rules and laws that govern retirement investment, moving forward with this regulation—that the Department itself acknowledges the costs and effects are unknown—is just foolish. Moreover, with the recent recession and continued problems with underfunded pensions, countless active and retired workers are already facing a number of challenges. We do not need to add to that with this proposed rule.

I have significant concerns regarding the Department of Labor's proposal to redefine "fiduciary." These concerns range from the process of the rulemaking—with DoL noting in the preamble of the regulation that its costs are unknown; to the potential impact the rule will have on those that can least afford it—workers and retirees. This rule will reduce the access of workers to financial education, increase the costs of administering certain retirement plans, and potentially decrease the return on a workers' investment.

Approximately 90 Members of Congress, Republicans and Democrats, have called for DoL to listen to stakeholder feedback and go back to the table and redraft this regulation. While I agree that those who provide investment advice should be highly trained, licensed, ethical, and dedicated to the interests of their clients—this is a hastily written rule that will have far reaching implications. At a time when employers and workers are looking for economic certainty, Washington should carefully examine any proposal that could undermine the retirement savings of employees.

[The statement of Mr. Kucinich follows:]

Prepared Statement of Hon. Dennis J. Kucinich, a Representative in Congress From the State of Ohio

CHAIRMAN KLINE AND RANKING MEMBER MILLER: I strongly support the Department of Labor's (DOL) proposed rule updating the circumstances under which individuals who provide investment advice for a fee must act as a fiduciary to workers. The proposed rule would modernize the definition of fiduciary under the Employee Retirement Income Security Act (ERISA) and would dramatically reduce the confu-

sion that has long made hard-working Americans vulnerable to exploitation and led to the loss of millions of dollars of retirement assets.

Under the current rule, any person paid to provide investment advice is a fiduciary, someone who must put their client's interest first. Yet in practice, the interpretation of the term "paid investment advice" has long been used as a giant loophole by those looking to flout the meaning and the spirit of the law. Advisers can avoid the legal responsibility of a fiduciary if they claim that they didn't know their advice would be used to make an investment decision, or that they only gave the advice once and not on a regular basis.

When ERISA was adopted in 1975, neither Individual Retirement Accounts (IRAs), nor 401(k) retirement plans were in existence. The ERISA law simply attempted to define "fiduciary" in a way that tried to prevent self-dealing and conflicts of interest by those who provide financial advice. Yet today the majority of such plans are 401(k) plans where workers contribute a portion of their salary and the employer matches some or all of it. The process of investing in a 401(k) means that an employee places a significant amount of trust—and risk—in the decisions made by investment professionals selected by their employer.

Seventy million Americans want to maximize the return on their hard-earned retirement savings and many of them put their trust in investment advisors and broker-dealers. It only makes sense that the laws protecting workers and their retirements should be as clear as possible. Those criticizing the proposed rule argue that requiring both the DOL and the Securities and Exchange Commission (SEC) under the Dodd-Frank Act to create rules regarding fiduciaries will result in further confusion. However, both agencies have stated publicly that they are working and will continue to work together to coordinate the rules which both agencies are promulgating.

I recognize that those who level criticisms of the proposed rule are concerned about the impact of both the DOL's and the SEC's final rules will have on the investment industry. I believe those concerns are allayed by the fact that both rules are being promulgated with full public and Congressional input. Also mitigating the potential negative impact of the rules, under the Department of Labor's proposed rule, brokers would still be allowed to earn commissions on securities, mutual funds, insurance products and annuities. Brokers would still be allowed to act as sellers without becoming a fiduciary. They would also receive an exemption from the rule when they undertake transactions that benefit workers.

For many Americans, especially those heading into retirement, their largest asset is their home. In the wake of a recession in which Americans watched $7 trillion worth of home values disappear, they deserve the most clear and reasonable protection that the law provides when they seek out advice from someone who represents themselves as an investment professional. Adopting a clear fiduciary standard will ensure that Americans who seek to invest their money receive advice that is in their best interest, regardless of their advisers' compensation or other interests.

Chairman ROE. Today we will have two panels of witnesses. It is my pleasure now to introduce our first witness, Phyllis Borzi, well known to most people here, who is the Assistant Secretary of Labor of Employee Benefits Security Administration.

As agency head, she oversees the administration, regulation, and enforcement of Title 1 of ERISA. Previously Ms. Borzi was a professor at George Washington University Medical Center School of Public Health and Health Services.

She has also practiced law in the private sector and served as a pension and employee benefit counselor for the predecessor to this subcommittee, the House Subcommittee on Labor Management Relations of the Committee on Education and Labor for 16 years. I am glad we changed the name.

Among numerous other professional affiliations and honors, Ms. Borzi is the former chair of the American Bar Associations Joint Committee on Employee Benefits. She holds a Master of Arts degree in English from Syracuse University and a J.D. from Catholic University Law School.

Before I recognize you to provide your testimony, let me briefly explain our lighting system, which I am sure you know well. You have 5 minutes to present your testimony. You will begin and the light in front of you will turn green, at one minute amber, and then red we will ask you to wrap your testimony up at that point.

Now, will open—have your opening statement.

STATEMENT OF HON. PHYLLIS BORZI, ASSISTANT SECRETARY, EMPLOYEE BENEFITS SECURITY ADMINISTRATION

Ms. BORZI. So, thank you and good morning, Chairman Roe, Ranking Member Andrews, members of the subcommittee. Thank you so much for inviting me to discuss the Department of Labor's fiduciary proposal.

You know, a key part of EBSAs job is helping to safeguard the money that workers and employers set aside for workers retirement.

Today the retirement universe is dominated by 401k plans and IRAs, both of which require individual workers to decide how to invest their money. The vast majority of these workers and probably some of us in the room are not financial experts. They must rely on professional advisors.

Under both the Employee Retirement Income Security Act of 1974 (ERISA) and the Internal Revenue code, any person paid to provide investment advice to plan participants or IRA owners is a fiduciary.

As fiduciaries, they must refrain from self-dealing and that is when a fiduciary puts his or her own interest first. In the case of plans, they must also act prudently and in the participant's sole interest. This has been the loss since ERISA was enacted in 1974.

So on its face the law is clear enough. When retirement savings are at stake, advisors should put their clients' interests first. But, as always, the devil is in the details. So the critical question is what constitutes paid investment advice.

The proposal we are discussing today will amend a 35-year-old regulatory interpretation which severely narrowed the laws protections. The outdated rule too frequently allows advisors to avoid responsibility for ill-considered recommendations and those involving financial conflicts of interest and self-dealing.

Current business practices have focused on building a trust relationship between the advisor and the client. However, under the current rule advisors are not fiduciaries if they claim that they didn't understand that their advice would serve as the primary basis for the investment decision.

Likewise, an advisor is not a fiduciary if the advice is given just once and not on a regular basis. So when a worker nearing retirement is advised to invest both his or her savings to purchase a particular annuity product, the advisor is not a fiduciary.

Let me put a human face on this problem. Larry Brown who lives in Tennessee lost one-third of his retirement savings after relying on conflicted broker recommendations.

The broker promised Larry that if he retired he could retire at 55, withdraw an amount equal to his monthly salary at work and still have a nine-percent growth rate on the money he invested

with him. Instead, to make ends meet, Larry had to take odd jobs for his church as a janitor and at the daycare center.

The narrowness of this regulation has harmed plans, participants, and IRA holders. We see it in the research that is linked advisor conflicts with under performance. We see it in the SEC reviews of certain financial sales practices and in FINRA adjudications.

We see it in EBSAs own enforcement experience. And finally, we see it in the underperformance of IRAs relative to plans.

EBSA estimates that from 1999 to 2007 the average annual return for IRAs, controlling for risk in any other factors, were 4.5 percent compared with 5.4 percent for 401ks.

The problems we are seeing with biased advice weren't contemplated when the department wrote its regulation 35 years ago. There were no 401k plans, congress didn't even recognize them until 1978, and not many IRAs.

Today there are trillions of dollars in each of these markets. The variety and complexity of financial products have increased, innovations in products and compensation of multiplied opportunities for self-dealing and made fee arrangements far less transparent.

Our proposal is a response to these dramatic changes to the market and addresses the problems that have emerged.

Let me just quickly, I know I am running out of time, respond to some of the concerns.

First, the new definition will not limit access to investment education or information. Second, brokers will not have to eliminate commission-based fee arrangements, restructure all their compensation as wrap fees, or convert all brokerage IRAs to advisory accounts. Exemptions are already on the books to allow brokers who provide fiduciary advice to receive commissions for trading the types of securities and funds that make up the large majority of IRA assets today.

And finally, we are continuing to coordinate our efforts with the SEC, the CFTC, Treasury, and the IRS. I can assure you that we are working together to integrate our rules and won't put out final regulations that contradict each other.

We continue to work to improve the rule with input from the public. The October proposal drew more than 200 comments. We held 2 days of hearings, left the record open for additional comments.

I met with more than 20 external parties representing financial service providers, some of them multiple times, and with 30 members of Congress and their staffs. We are committed to developing a rule that doesn't unduly limit the financial industry's ability to provide valuable services, but at the same time we need to correct an important problem.

Employers, employees, and IRAs investors are not well served by the current regulation.

So thank you so much for the opportunity to testify. I look forward to working with you and your questions.

[The statement of Ms. Borzi follows:]

Prepared Statement of Hon. Phyllis C. Borzi, Assistant Secretary, Employee Benefits Security Administration, U.S. Department of Labor

Good morning Chairman Roe, Ranking Member Andrews, and Members of the Subcommittee. Thank you for inviting me to discuss the Department of Labor's proposed amendment to its fiduciary regulation and activities we have undertaken to date in connection with this initiative. I am Phyllis C. Borzi, the Assistant Secretary of Labor for the Employee Benefits Security Administration (EBSA). EBSA is committed to pursuing policies that encourage retirement savings and promote retirement security for American workers.

A key part of EBSA's job is establishing policies that safeguard the money that workers and employers set aside for workers' retirement. There are about 48,000 private-sector defined benefit plans that hold approximately $2.6 trillion in assets.[1] In addition, there are nearly 670,000 private-sector 401(k) and other defined contribution account plans that hold about $3.9 trillion in assets.[2] Individual Retirement Accounts (IRAs) hold an additional $4.7 trillion.[3] In fact, nearly 50 million households own some type of IRA. That number represents more than 40 percent of the households in the United States.[4] Americans' retirement security depends in large measure on the sound investment of

The Employee Retirement Income Security Act of 1974 (ERISA) expressly provides that a person paid to provide investment advice with respect to assets of a private-sector employee benefit plan is a plan fiduciary. The Internal Revenue Code (the "tax code") has the same provision regarding investment advisers to IRAs. ERISA and the tax code prohibit both employee benefit plan and IRA fiduciaries from engaging in a variety of transactions, including self-dealing—when a fiduciary puts his or her own financial interests first—unless the relevant transaction is authorized by an "exemption" contained in law or issued administratively by the Department of Labor. In the case of an employee benefit plan, but not an IRA, under ERISA a fiduciary also owes a duty of prudence and exclusive loyalty to plan participants, and is personally liable for any losses that result from a breach of such duty. This has been the law since ERISA was enacted in 1974.

The law on its face is simple enough: advisers should put their clients' interests first. But as always the devil is in the details—in this case, in the question of what constitutes paid investment advice. The Department's current initiative will amend a flawed 35-year-old rule under which advice about investments is not considered to be "investment advice" merely because, for example, the advice was only given once, or because the adviser disavows any understanding that the advice would serve as a primary basis for the investment decision.

Investors such as pension fund managers and workers contemplating investing through an IRA should be able to trust their advisers and rely on the impartiality of their investment advice. That is the promise written into law in 1974. The Department's initiative sets out to fulfill this promise for America's current and future retirees. The impact of investment advice depends on its quality. Prudent, disinterested advice can reduce investment errors, steering investors away from higher than necessary expenses and toward broad diversification and asset allocations consistent with the investors' tolerance for risk and return. Accordingly, it is imperative that good, impartial investment advice be accessible and affordable to plan sponsors and especially to the workers who need it most.

The Department's October 2010 proposed amendment to its fiduciary rule represented its approach to accomplishing these goals. The proposal has prompted a large volume of comments and a vigorous debate. The Department is committed to developing and issuing a clear and effective rule that takes full and proper account of all stakeholder views, and that ensures that investment advisers can never profit from hidden or inappropriate conflicts of interest.

The Law

In enacting ERISA in 1974, Congress established a number of provisions governing investment advice to private-sector employee benefit plans and IRAs. Under ERISA and the tax code, any person paid directly or indirectly to provide investment advice to a plan or IRA is a fiduciary.

Prohibited transactions—Substantially identical provisions in ERISA and the tax code prohibit fiduciaries from engaging in a variety of transactions, including those that result in self-dealing, unless they fall within the terms of an exemption from the general prohibition. The relevant ERISA provisions apply to private-sector employee benefit plans, and the related tax code provisions apply to both plans and IRAs. In either case, fiduciaries who engage in prohibited transactions are subject to excise taxes. ERISA and the tax code each provide the same statutory exemptions

from the general prohibition against self-dealing. The Secretary of Labor is authorized to issue additional exemptions.

What is an exemption? From the fiduciary's point of view, an exemption is permissive: it allows the fiduciary to engage in certain transactions that would otherwise be prohibited. From a worker's point of view, an exemption should be protective, because it establishes rules of the road that fiduciaries must follow when they self-deal so that transactions are in workers' interest. In other words, if an investment adviser is compensated for steering a worker's retirement savings toward a particular financial product, the adviser must first satisfy conditions established by Congress or the Department to protect the worker's interests and rights.

Section 102 of the Reorganization Plan No. 4 of 1978 generally transferred to the Department of Labor the Treasury Department's authority to interpret the tax code's prohibited transaction provisions and to issue related exemptions, thus consolidating interpretive and rulemaking authority for these substantially identical ERISA and tax code provisions in one place—the Department of Labor. At the same time, the IRS's general responsibility for enforcing the tax laws extends to excise taxes imposed on fiduciaries who engage in prohibited transactions. Thus, the Department shares with the IRS responsibility for combating self-dealing by fiduciary investment advisers to plans and IRAs.

Fiduciary duties—ERISA additionally subjects fiduciaries who advise private-sector employee benefit plans to certain duties, including a duty of undivided loyalty to the interests of plan participants and a duty to act prudently when giving advice. Fiduciaries face personal liability for any losses arising from breaches of such duties. ERISA authorizes both participants and the Department to sue fiduciaries to recover such losses. These ERISA provisions, however, generally do not extend to fiduciaries who advise IRAs.

Problems with the Existing Regulation

In 1975, the Department issued a five-part regulatory test defining "investment advice" that gave a very narrow meaning to this term. The regulation significantly narrowed the plain language of the statute as enacted, so that today much of what plainly is advice about investments is not treated as such under ERISA and the person paid to render that advice is not treated as a fiduciary. Under the regulation, a person is a fiduciary under ERISA and/or the tax code with respect to their advice only if they: (1) make recommendations on investing in, purchasing or selling securities or other property, or give advice as to their value; (2) on a regular basis; (3) pursuant to a mutual understanding that the advice; (4) will serve as a primary basis for investment decisions; and (5) will be individualized to the particular needs of the plan.

An investment adviser is not treated as a fiduciary unless each of the five elements of this test is satisfied for each instance of advice. For example, if a plan hires an investment professional on a one-time basis for advice on a large complex investment, the adviser has no fiduciary obligation to the plan under ERISA, because the advice is not given on a "regular basis" as the regulation requires. Similarly, individualized, paid advice to a worker nearing retirement on the purchase of an annuity is not provided on a regular basis. Thus, the adviser is not a fiduciary even though the advice may concern the investment of a worker's entire IRA or 401(k) account balance.

In a different example, consider an IRA holder who consults regularly with a paid adviser, and regularly buys and sells securities pursuant to that person's advice. The IRA holder may rely on the advice as a primary or even the sole basis for investment decisions, but if the adviser cannot be shown to have agreed or understood that the advice would be a primary basis for the investment decisions—then the adviser avoids fiduciary status and is free to self-deal. This example is particularly important. Today many service providers (such as brokers) attempt to avoid fiduciary status simply by including disclaimers in their written agreements with IRA holders explaining that they are not acting as registered investment advisers and that their advice will not constitute a primary basis for the IRA holders' decisions.[5] An authoritative study by RAND for the SEC demonstrated that consumers often do not read such agreements and do not understand the difference between brokers and registered advisers or the services they provide.[6]

The narrowness of the existing regulation opened the door to serious problems, and changes in the market since the regulation was issued in 1975 have allowed these problems to proliferate and intensify. The variety and complexity of financial products have increased, widening the information gap between advisers and their clients and increasing the need for expert advice. Consolidation in the financial industry and innovations in products and compensation practices have multiplied opportunities for self-dealing and made fee arrangements less transparent to con-

sumers and regulators. At the same time, the burden of managing retirement savings has shifted dramatically from large private pension fund managers to individual 401(k) plan participants and IRA holders, many with low levels of financial literacy. These trends could not have been foreseen when the existing regulation was issued in 1975.

In 1975, private-sector defined benefit pensions—mostly large, professionally managed funds—covered over 27 million active participants and held assets totaling almost $186 billion. This compared with just 11 million active participants in individual-account-based defined contribution plans with assets of just $74 billion.[7] Moreover, the great majority of defined contribution plans at that time were professionally managed, not participant directed. In 1975, 401(k) plans did not yet exist and IRAs had just been authorized as part of ERISA's enactment the prior year. In glaring contrast, by 2008 defined benefit plans covered just 19 million active participants, while individual-account-based defined contribution plans covered over 67 million active participants—including 60 million in 401(k)-type plans.[8] Ninety-five percent of 401(k) participants were responsible for directing the investment of all or part of their own account, up from 86 percent as recently as 1999.[9] Also, in 2010, almost 50 million households owned IRAs.[10] In dollar terms, by 2010, defined benefit plans, with $2.6 trillion in assets, had been eclipsed by defined contribution plans which held $3.9 trillion. IRAs held the most: $4.7 trillion, with most of this attributable to rollovers from plans.[11]

The narrowness of the regulation has harmed some plans, participants, and IRA holders. Research has linked adviser conflicts with underperformance. SEC reviews of certain financial sales practices may also reflect these influences. Finally, EBSA's own enforcement experience has demonstrated specific negative effects of conflicted investment advice.

One academic study found that investors purchasing funds through brokers generally get lower returns, even before paying the brokers' fees, than those who buy them directly, and do no better at asset allocation. The study's authors say this might be evidence of harmful conflicts of interest, but might also be evidence that investors are buying something "intangible" from their brokers.[12] Another study finds that advisers' compensation structures matter—those with conflicts give poorer advice. 13 Other research, relevant to valuation advice, finds that accountants value property higher when working for sellers than for buyers.[14] Still other research finds that disclosure of conflicts fails to protect consumers. A conflicted adviser may feel morally licensed by disclosure to pursue his self interest, and he may exaggerate his advice to compensate for the possibility that a consumer will discount it. The consumer may be reluctant to question the advice, not wanting to imply that the adviser is being dishonest or come between the adviser and his pay.[15]

It is worth noting that none of this research evidence necessarily demonstrates abuse. On the contrary, it seems to suggest that conflicts may color advice in some instances from honest advisers without their even realizing it. But whether deliberate or inadvertent, the result where conflicts exist is often the same: adviser conflicts are a threat to retirement security. Academic research suggests this, and experience bears it out.

For additional evidence, consider the underperformance of IRAs relative to plans. Some gap might be expected, as the comparison is between retail and institutional customers. But the size of the gap is troubling. Unlike plan participants, IRA holders do not have the benefit of a plan fiduciary, usually their employer, to represent their interests in dealing with advisers. EBSA estimates that from 1998 to 2007, the average annual returns for IRAs were 4.5 percent, compared with 5.4 percent for 401(k)s.[16] Further, in a recent report, the Government Accountability Office stated that IRA holders often pay fees that can be two to three times higher than the fees paid by employee benefit plan participants for in-plan investments.[17]

A 2007 SEC report provides more evidence. The report examines "free lunch" sales seminars that market financial products to retirees. The SEC conducted 110 examinations of financial services firms providing "free lunch" seminars. Of these, only five found no problems or deficiencies. More than half found that materials used might have been misleading or exaggerated. Twenty-five found that unsuitable recommendations were made. Seminar attendees often may not have known that presenters had a financial stake in the products they recommended, the SEC said.[18]

Finally, consider the evidence provided by EBSA's enforcement experience. Too often advisers who put their own interests first escape fiduciary status through a loophole in the existing regulation. For example, consider the following case: A financial services firm often recommended mutual funds that paid it revenue sharing. Even though some of its consulting agreements with plans acknowledged the firm's status as an ERISA fiduciary, it denied being a fiduciary for any ERISA clients. Consequently, the Department had to interview dozens of the clients in order to de-

termine whether the firm's advice met the current regulation's five-part test. In many cases, the advice did not meet the "regular basis" requirement because the firm's representatives had infrequent contact with plans after the selections of mutual funds. Due to the ambiguous nature of the evidence on the firm's fiduciary status under the existing rule, DOL could not pursue enforcement against it.

Another example involves improper appraisals in connection with employee stock ownership plans (ESOPs). Since the early 2000s, EBSA began to identify issues involving ESOPs, encompassing a variety of different violations of ERISA and affecting over 500,000 participants. In many instances, the most important investment advice to a plan concerns how much to pay for an asset. In the case of ESOPs, in particular, the key decision is typically not whether to buy stock—the plan was established precisely to buy and hold employer stock—but rather what price to pay for the stock. The Department has uncovered abuses reflecting flawed valuation methodologies, internally inconsistent valuation reports, the use of unreliable and outdated financial data, and the apparent manipulation of numbers and methodologies to promote a higher stock price for the selling shareholders. Under ERISA, a loss remedy is only available from plan fiduciaries. As a result, under the current regulatory structure, neither the Secretary nor plan participants can hold the appraiser directly accountable for disloyal or imprudent advice about the purchase price, no matter how critical that advice was to the transaction. The sole recourse available to the Secretary and plan participants is against the trustee who relied on the advice, rather than against the professional financial expert who rendered the valuation opinion that formed the necessary basis for the transaction.

Consequently, the Department believes there is a need to re-examine the types of advisory relationships that should give rise to fiduciary status on the part of those providing investment advice services. The 1975 regulation contains technicalities and loopholes that allow advisers to easily dodge fiduciary status. Plan fiduciaries, participants, and IRA holders are entitled to receive impartial investment advice when they hire an adviser. Overview of Proposed Regulation

On October 22, 2010, the Department published a proposed regulation defining when a person is considered to be a "fiduciary" by reason of giving investment advice for a fee with respect to assets of an employee benefit plan or IRA. The proposal amends the current 1975 regulation that may inappropriately limit the circumstances that give rise to fiduciary status on the part of the investment adviser.[19] The proposed rule takes into account significant changes in both the financial industry and the expectations of plan fiduciaries, participants and IRA holders who receive investment advice. In particular, it is designed to protect participants from conflicts of interest and self-dealing by correcting some of the current rule's more problematic limitations and providing a clearer understanding of when persons providing such advice are subject to ERISA's fiduciary standards, and to protect IRA holders from self-dealing by investment advisers.

The proposed regulation would modify the 1975 regulation by: (1) replacing the five-part test with a broader definition more in keeping with the statutory language; and (2) providing clear exceptions for conduct that should not result in fiduciary status. Under the proposal, the following types of advice and recommendations may result in fiduciary status: (1) appraisals or fairness opinions concerning the value of securities or other property; (2) recommendations as to the advisability of investing in, purchasing, holding or selling securities or other property; or (3) recommendations as to the management of securities or other property.

To be a fiduciary, a person engaging in one of these activities must receive a fee and also meet at least one of the following four conditions. The person must: (1) represent to a plan, participant or beneficiary that the individual is acting as an ERISA fiduciary; (2) already be an ERISA fiduciary to the plan by virtue of having any control over the management or disposition of plan assets, or by having discretionary authority over the administration of the plan; (3) be an investment adviser under the Investment Advisers Act of 1940; or (4) provide the advice pursuant to an agreement or understanding that the advice may be considered in connection with investment or management decisions with respect to plan assets and will be individualized to the needs of the plan.

At the same time, the proposed regulation recognizes that activities by certain persons should not result in fiduciary status. Specifically, these are: (1) persons who do not represent themselves to be ERISA fiduciaries, and who make it clear to the plan that they are acting for a purchaser/seller on the opposite side of the transaction from the plan rather than providing impartial advice; (2) persons who provide general financial/investment information, such as recommendations on asset allocation to 401(k) participants under existing Departmental guidance on investment education; (3) persons who market investment option platforms to 401(k) plan fiduciaries on a non-individualized basis and disclose in writing that they are not pro-

viding impartial advice; and (4) appraisers who provide investment values to plans to use only for reporting their assets to the DOL and IRS.

Concerns Raised about the Proposed Regulation and the Department's Preliminary Responses

The proposed regulation has prompted a large volume of comments and a vigorous debate. The Department is working hard to hear and consider every stakeholder concern.

The October proposal itself drew more than 200 written comments, many raising important and complex issues that require serious attention. The Department followed up by holding two days of hearings on March 1 and 2, providing an additional forum for 36 witnesses and prompting more than 60 additional, post-hearing written comments. We also have met individually with many groups that sought additional opportunities to explain their views. Altogether, the Department has heard from many representatives of the financial services industry, as well as from plan sponsors, advocates for small investors, service providers, academics who study the roles of financial intermediaries and the effects of conflicts between consumers and expert advisers, and interested Members of Congress. The Department is devoting a major effort to appropriately resolve the concerns raised by stakeholders. Let me offer examples of how we are thinking about some of the major ones.

Coordination with Other Federal Agencies—We have received many comments emphasizing the importance of harmonizing the Department's proposed rulemaking with certain Securities and Exchange Commission (SEC) and Commodities Futures Trading Commission (CFTC) rulemaking activities under the Dodd-Frank Act, including activities related to SEC standards of care for providing investment advice and CFTC business conduct standards for swap dealers. There are concerns that inconsistent standards could negatively impact retirement savings by increasing costs and foreclosing investment options. Likewise, concerns have been raised about the adequacy of coordination between the Department and other relevant agencies, including the SEC, Treasury Department, and Internal Revenue Service, with respect to oversight of IRA products and services.

The Department, Treasury Department, Internal Revenue Service, SEC, and the CFTC are actively consulting with each other and coordinating our efforts. Our shared goal is to harmonize our separate initiatives. We are also committed to ensuring that the regulated community has clear and sensible pathways to compliance. We are confident that these goals will be achieved.

The SEC is currently considering staff recommendations to establish uniform fiduciary duties under the securities laws for advisers and brokers. While the Department and the SEC are committed to ensuring that any future fiduciary requirements applicable to investment advisers and broker-dealers under the applicable laws are properly harmonized, the Department is also committed to upholding the separate federal protections that Congress established in 1974 for plans, plan participants, and IRAs under ERISA and the tax code.

The Department also plans to harmonize its fiduciary regulation with the CFTC's and SEC's proposed business conduct standards for swap dealers. The Department does not seek to impose ERISA fiduciary obligations on persons who are merely counterparties to plans in arm's length commercial transactions. Parties to such transactions routinely make representations to their counterparties about the value and benefits of proposed deals, without purporting to be impartial investment advisers or giving their counterparties a reasonable expectation of a relationship of trust. Accordingly, the Department's proposed regulation provides that a counterparty will not be treated as a fiduciary if it can demonstrate that the recipient of advice knows or should know that the counterparty is providing recommendations in its capacity as a purchaser or seller.

Costs and Unintended Consequences for IRAs—Many comments also raised concerns about the proposed regulation's impact on IRAs and questioned whether the Department had adequately considered possible negative impacts. Similar concerns were voiced by other stakeholders, especially those providing advice in connection with brokerage services. Some stakeholders have provided their own estimates of high costs and other major negative impacts.

The stated concerns can be summarized as follows:

• Today a large proportion of IRAs, especially smaller accounts, are brokerage accounts. Brokers often advise the IRA holders, and are compensated for that advice by means of commissions paid for trades and often by third parties, as with revenue sharing and 12b-1 mutual fund fees. Though the brokers give advice, they typically contend that they are not fiduciaries under the Department's existing rule because they disclaim any understanding that their advice might constitute a primary basis for the IRA holders' investment decisions.[20]

• The proposed rule would make brokers fiduciaries because IRA holders will at least "consider" their advice. As fiduciaries, the brokers could not accept commissions or revenue sharing payments. To do so would constitute fiduciary self-dealing, a prohibited transaction, and would trigger a requirement to return the commissions or payments to their sources and to pay an excise tax.

• Brokers therefore would be forced to restructure their compensation as "wrap fees" expressed as a percentage of assets in the account. Receipt of wrap fees in turn would force the advisers to register and conduct their business as registered investment advisors (RIAs) under the Investment Advisers Act of 1940. IRAs would have to be converted from brokerage accounts to either advisory accounts (which cost more and deliver more service than most IRA holders want) or internet-based discount brokerage accounts (which offer no personalized advice), or be closed. Advisory accounts require high minimum balances so small accounts would lose all access to advice and many would be closed.

• The result will be dramatically higher fees and widespread distributions from small accounts, both of which will undermine retirement security.

• There will be no benefits to offset these costs and other negative impacts. There is no evidence that the quality of advice currently is diminished by the conflicts that are present, so there is no reason that the proposed regulation will improve advice.

• IRAs should not be treated like plans. They are retail accounts and should be treated like other retail accounts. IRA holders do not require as much protection as plan participants because they have unlimited choice of vendors and products and are therefore empowered to secure quality services.

The Department will continue to carefully study these arguments. We have, however, the following observations on some of the comments.

We did not propose to force brokers to eliminate commission-based fee arrangements, restructure all of their compensation as wrap fees, or convert all brokerage IRAs to advisory accounts. Exemptions already on the books authorize brokers who provide fiduciary advice to be compensated by commission for trading the types of securities and funds that make up the large majority of IRA assets today. We will attempt to provide this clarification in a more formal manner as we proceed in this process.

• The Department is considering providing interpretive guidance to make this clear, as well as issuing additional exemptions. Such additional exemptions might cover, for example, revenue sharing arrangements that are beneficial to plan participants and IRA holders, and/or so-called "principal" transactions, wherein a fiduciary adviser, rather than acting as an agent, itself buys an asset from or sells an asset to an advised IRA. Such exemptions would carry appropriate conditions to protect plan participants' and IRA holders' interests.

• The Department believes there is strong evidence that unmitigated conflicts cause substantial harm, and therefore is confident that the proposed fiduciary regulation would combat such conflicts and thus deliver significant benefits to plan participants and IRA holders. As noted above, this evidence is found in academic research, IRA underperformance, SEC examinations, and EBSA's own enforcement experience. While no single piece of evidence by itself directly demonstrates or provides a basis for quantifying the negative impact of conflicts on plans and IRAs, taken together the available evidence appears to indicate that the negative impacts are present and often times large. Plans, plan participants, and IRA holders will benefit from advice that is impartial and puts their interests first.

• The tax code itself treats IRAs differently from other retail accounts, bestowing favorable tax treatment, and prohibiting self-dealing by persons providing investment advice for a fee. In these respects, and in terms of societal purpose, IRAs are more like plans than like other retail accounts. Most IRA assets today are attributable to rollovers from plans.[21] The statutory definition of fiduciary investment advice is the same for IRAs and plans. The proposed regulation therefore sensibly set forth a single consistent definition, addressing practical differences between the two by tailoring exemptions accordingly. As for the level of protection that is appropriate, while IRA holders have more choice, they may nonetheless require more protection. Unlike plan participants, IRA holders do not have the benefit of a plan fiduciary, usually their employer, to represent their interests in dealing with advisers. They cannot sue fiduciary advisers under ERISA for losses arising from fiduciary breaches, nor can the Department sue on their behalf. Compared to those with plan accounts, IRA holders have larger account balances and are more likely to be elderly. For all of these reasons, combating conflicts among advisers to IRAs is at least as important as combating those among advisers to plans.

• The Department believes that the assessment of economic impacts it provided with the proposed rule provided an economic basis for the proposal. I agree, however, that a fuller analysis is called for at this point, and we are undertaking such

an analysis now. The expanded analysis will be informed by all relevant stakeholder input, as well as by our consultations with other federal agencies, and will be provided along with any final regulation pursuant to applicable requirements.

Appraisals and valuations—Another issue raised by stakeholders relates to whether the valuation of employer securities should constitute "investment advice" as the proposed regulation would require. Although the current regulation includes advice as to the value of securities within the term "investment advice," a 1976 advisory opinion issued by the Department took the position that advice to an ESOP on the value of employer securities would not be so treated. A number of witnesses at our hearing on this proposed rule testified that the proposal would cause many qualified appraisers to discontinue ESOP valuations and would significantly increase costs of appraisals for small businesses that sponsor ESOPs. It is the Department's opinion that, in many instances, the most important investment advice to a plan concerns how much to pay for an asset. In the case of closely-held companies, ESOP trustees typically rely on professional appraisers and advisers to value the stock, often with little or no negotiation over price. Unfortunately, in our investigations and enforcement actions, the Department has seen many instances of improper ESOP appraisals—often involving most or all of a plan's assets—resulting in millions of dollars in losses. Accordingly, we believe that employers and participants will benefit from being able to rely on professional impartial advice that adheres to the fundamental fiduciary duties of prudence and loyalty. However, we will continue to work with stakeholders to structure a rule that adheres to these duties but does not cause unnecessary harm or cost to small businesses.

Distinguishing Education from Advice—A number of witnesses expressed confusion over how the proposed regulation will impact participant investor education. There were concerns about what will be considered financial literacy and education and what will be considered investment advice under the proposed regulation. In particular, there were concerns that the proposal appears to significantly reduce what constitutes financial education and raises the question as to whether Interpretive Bulletin 96-1 (IB 96-1) is still in effect. The Department believes education is important for plans and plan participants. Under the proposed regulation, employers who provide general financial/investment information, such as a recommendation on asset allocation to 401(k) participants under IB 96-1, would not be considered fiduciaries under the new regulation. The Department also has general education resources available to plans and plan participants.

Next Steps

Our current approach to the fiduciary regulation consists of multiple steps.

First, we are working to better understand how specific compensation arrangements would be affected by the proposed rule and whether clarifications of existing prohibited transactions exemptions would be appropriate. We have already begun to issue subregulatory guidance describing some of these clarifications and will continue to do so as necessary as we complete our analysis.

Next, as we further develop our thinking in this rulemaking, we are paying special attention to the two primary exceptions to fiduciary status under the proposed rule: (1) clarifying the difference between investment education that does not give rise to fiduciary status and fiduciary investment advice; and (2) clarifying the scope of the so-called "sellers' exception" under which sales activity is not fiduciary advice. In both cases, we will make sure to analyze and address the comments and concerns that were raised during our extensive public comment period.

Finally, we are exploring a range of appropriate regulatory options for moving forward, taking into consideration public comments submitted for the record, EBSA's economic analysis, and relevant academic research. In so doing, we are aiming to address conflicted investment advice while not unnecessarily disrupting existing compensation practices or business models.

Conclusion

Thank you for the opportunity to testify at this important hearing. The Department remains committed to protecting the security and growth of retirement benefits for America's workers, retirees, and their families.

ENDNOTES

[1] For estimates of the number of plans, see U.S. Department of Labor, Private Pension Plan Bulletin Abstract of 2008 Form 5500 Annual Reports (Dec. 2010), at *http://www.dol.gov/ebsa/PDF/2008pensionplanbulletin.pdf. For asset estimates, EBSA projected ERISA covered pension assets based on the 2008 Form 5500 filings with the US Department of Labor (available at http://www.dol.gov/ebsa/publications/form5500dataresearch.html), and the Federal Reserve Board's Flow of Funds Accounts Z1 Release (available at http://www.federalreserve.gov/releases/z1/Current/).*

[2] Ibid.

[3] Federal Reserve Board, Flow of Funds Accounts of the United States, June 2011, at *http://www.federalreserve.gov/releases/z1/Current/*.

[4] Peter Brady et al., The U.S. Retirement Market, Third Quarter 2010, Investment Company Institute, Jan. 2011, at *http://www.ici.org/pdf/ppr—11—retire—q3—10.pdf. this money. While some investment decisions are made by large professional money managers, today most are made by individual workers who must manage their own 401(k) accounts and IRAs. To guide their decisions, workers often rely on advice from trusted experts.*

[5] The Department does not necessarily agree that the inclusion of such language in an agreement ensures that a broker is not a fiduciary under the existing regulation.

[6] Angela A. Hung, Noreen Clancy, Jeff Dominitz, Eric Talley, Claude Berrebi, Farrukh Suvankulov, Investor and Industry Perspectives on Investment Advisers and Broker-Dealers, RAND Institute for Civil Justice, commissioned by the U.S. Securities and Exchange Commission, 2008, at *http://www.sec.gov/news/press/2008/2008-1—randiabdreport.pdf.*

[7] U.S. Department of Labor, Private Pension Plan Bulletin Historical Tables and Graphs, (Dec. 2010), at *http://www.dol.gov/ebsa/pdf/historicaltables.pdf.*

[8] U.S. Department of Labor, Private Pension Plan Bulletin Abstract of 2008 Form 5500 Annual Reports, (Dec. 2010), at *http://www.dol.gov/ebsa/PDF/2008pensionplanbulletin.PDF.*

[9] U.S. Department of Labor, Private Pension Plan Bulletin Abstract of 1999 Form 5500 Annual Reports, Number 12, Summer 2004 (Apr. 2008), at *http://www.dol.gov/ebsa/PDF/1999pensionplanbulletin.PDF.*

[10] Peter Brady et al., The U.S. Retirement Market, Third Quarter 2010, Investment Company Institute, Jan. 2011, at *http://www.ici.org/pdf/ppr—11—retire—q3—10.pdf.*

[11] Federal Reserve Board, Flow of Funds Accounts of the United States, June 2011, at *http://www.federalreserve.gov/releases/z1/Current/; Peter Brady, Sarah Holden, and Erin Shon, "The U.S. Retirement Market, 2009," Investment Company Institute, Research Fundamentals, Vol. 19, No. 3, May 2010, at http://www.ici.org/pdf/fm-v19n3.pdf.*

[12] Daniel Bergstresser et al., Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry, The Review of Financial Studies, 22, no. 10, Oct. 2009.

[13] Ralph, Bluethgen et al., High Quality Investment Advice Wanted! , SSRN Working Paper Series, Feb. 2008, at *http://papers.ssrn.com/sol3/papers.cfm?abstract—id=1102445&http://scholar.google.com/scholar?cluster=10674815933415125485&hl=en&as—sdt=0,9.*

[14] Don Moore et al., Conflict of Interest and the Unconscious Intrusion of Bias, Judgment and Decision Making, Vol. 5, No. 1, Feb. 2010.

[15] George Loewenstein et al., Pitfalls and Potential of Disclosing Conflicts of Interest, American Economic Review, forthcoming May 2011.

[16] EBSA's estimation approach was inspired by similar findings in an article using older data, see Alicia H. Munnell et al., "Investment Returns: Defined Benefit vs. 401(k) Plans," Center for Retirement Research at Boston College, Issue Brief No. 52, Sep. 2006, p. 6.

[17] GAO, 401(k) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest, Report to the Ranking Member, Committee on Education and the Workforce, House of Representatives, GAO-11-119 (Jan. 2011).

[18] Securities and Exchange Commission, Office of Compliance Inspections and Examinations, Protecting Senior Investors: Report of Examinations of Securities Firms Providing "Free Lunch" Sales Seminars, Sep. 2007, at *http://www.sec.gov/spotlight/seniors/freelunchreport.pdf.*

[19] The proposed regulation would also supersede the conclusion set forth in Advisory Opinion 76-65A (June 7, 1976), where the Department held that the valuation of closely-held employer securities that an ESOP would rely on in purchasing the securities would not constitute investment advice under the regulation.

[20] As noted above, the Department does not necessarily agree that the inclusion of such language in an IRA agreement ensures that a broker is not a fiduciary under the existing regulation.

[21] Peter Brady, Sarah Holden, and Erin Shon, The U.S. Retirement Market, 2009, Investment Company Institute, Research Fundamentals, Vol. 19, No. 3, May 2010, at *http://www.ici.org/pdf/fm-v19n3.pdf.*

Chairman ROE. Thank you. If you have any other comments, please go ahead.

Ms. BORZI. No, that is okay. My written testimony is much more detailed. So I know that will be in the record.

Chairman ROE. Okay.

Ms. BORZI. I am just happy to take your questions.

Chairman ROE. Thank you.

Dr. Heck?

Mr. HECK. Thank you, Mr. Chairman.

Thank you, Madam Secretary, for your testimony and for your written statement.

I know you mentioned in your comments that this will not cause brokers to switch from commission based to value-asset based. Yet,

I am hearing from many brokers in my district that that is exactly what is going to happen is that they are going to have to switch.

I would like for you to try to kind of clear that up. Why are so many brokers under the impression that they are going to have to switch if you are saying they are not?

And if they do switch, it would appear that it would price out small accounts that would not be able to afford the value asset based commission and how are we going to take steps to prevent that so that people do get the advice that they need?

Ms. BORZI. Well, we have heard that as well. And I think the simplest way to answer your questions is there appears to be a lot of concern, nervousness, misinformation perhaps, misunderstanding of what the current law is.

Since brokers are not—at least they take the position that they are not currently fiduciaries under ERISA. Although, I might add that if you look at the five-part test that, I think, some of them even under the current five-part test who do give advice on a regular basis and who do understand that their advice is going to be taken by their clients, might still be fiduciaries.

But I just think that there is a lot of misinformation. One of the reasons that we put these charts together is that there seems to be that first column in the fiduciary proposal, first chart, brokers would be allowed under this regulation, and certainly under our current regulations, to earn commissions on securities, mutual funds, insurance products and annuities.

That is very important because if you look at the kinds of investments that small IRA investors are invested in, those are the kinds of things they are invested in. They are not in the sophisticated financial instruments by in large.

And so, I think, to the extent that the brokers, the broker community doesn't understand that these kinds of transactions are already permitted, we have a job to do in clarifying and making them understand that they are. Because we are not intending to overturn a commission based system.

And if I could just—the regulation does exempt traditional broker activities—sell—simply selling securities. So there is what is called a seller's exemption which says if I am your broker and I come to you and you understand that all I am doing is selling you a product, I am not giving you investment advice. I am not telling you to, you know, that this is the best product you could ever buy that does not make you a fiduciary.

And to the extent that their practices beyond commissions, which we are hearing from some of the financial institutions, we are prepared to work with them to see if we can provide an exemption from the fiduciary prohibited transaction.

Mr. HECK. And I appreciate that. I guess the concern is that the smaller investor, perhaps the more unsophisticated investor——

Ms. BORZI. Exactly.

Mr. HECK [continuing]. Sets this up so that that individual would have to come to the broker and say this is what I want to buy. Not necessarily being able to receive any type of comparison, let us say, between two or three different products that that broker might provide and then allowing the buyer to make a decision on which they would want to purchase.

Ms. BORZI. Yes. I mean, the simple fact is that, as I said well, we have no interest. The Department of Labor has spent the better part of 20 years encouraging people to save for retirement, both inside of plans and in IRAs. So we wouldn't have any interest at all, and we would be very concerned about closing off advice to the small investors.

What puzzles us, of course, is that the industry seems to take the position that there are only two methods to continue to survive. One would be to keep the current broker dealer rules or the broker dealer perception that they are not fiduciaries under ERISA and do nothing to address the conflicted advice problem or the other extreme, which is to convert to an investment advisor model which will be more expensive.

We have talked with all of our sister agencies that regulate IRAs, that deal with IRAs and lots of people in the private sector looked at academic literature and we think that there is plenty of room for business models between the current conflicted advice model and going to a pure investment advisor model.

And we were happy to work with the industry to figure out how to deal with that. But I think that the broker's concern is perhaps due to misunderstanding.

Mr. HECK. Thank you, Madam Secretary.

Thank you, Mr. Chair. I yield back.

Chairman ROE. Thank you.

Mr. Andrews?

Mr. ANDREWS. Thank you, Mr. Chairman.

Madam Secretary, thank you for your testimony and your openness to members of the committee and to the public to talk about this issue. It is characteristic of your service.

A week from today, there is an increasing probability that the United States of America will lose its ability to borrow money to run our government. Presently, we borrow about 42 cents of every dollar that we spend. So we will find ourselves in a position, if this happens, where we will have 58 cents of revenue and a dollars' worth of obligations.

I am sure on a morning like this you are glad you are not the Secretary of the Treasury, who would have the obligation to figure out which bills not to pay.

There is some debate about what the consequences of this calamitous event would be for the bond market and the equity markets. The consensus of opinion is that at some point there would be significant damage to each of those markets. It is not a unanimous opinion, but I think it is a broadly held opinion.

I think that our near death experience with the TARP in 2008 when Dow Jones fell by nearly 1,000 points during the floor vote when the TARP was not adopted is a precursor of what might happen.

I know that this hearing is about fiduciary responsibilities, and there are fiduciaries all over the country who are managing pension funds, both in the private and public sector.

What is your best assessment as to what the impact on pension funds around the country would be if the United States of America were to either default on its debt service obligations or receive a

downgrade in our credit rating from the ratings agencies because of the present crisis?

Ms. BORZI. Well, it is hard to really speculate because this has never happened before. But let me just focus on a couple of things.

The first thing we know is that it would be very, very disruptive; create a climate of uncertainty. In a number of pension funds, particularly the large funds, public funds as well as—funds, their investment policy would require them to have AAA bonds.

If the treasury bond, and most of them have treasuries in one form or another, and if those bonds were no longer AAA, the fiduciaries would certainly have to figure out how to comply with their investment policy guidelines without—how not to violate their investment policy guidelines.

Mr. ANDREWS. So in other words, many trustees would find themselves in a position where purchasing of treasury securities would be prohibited by their own internal rules?

Ms. BORZI. I am afraid that is true.

Mr. ANDREWS. Which would——

Ms. BORZI [continuing]. Certainly with the larger funds. I am not sure about the smaller funds.

Mr. ANDREWS. My understanding is about a third of all the capital domestically held in the United States is in pension funds.

Ms. BORZI. That sounds right to me.

Mr. ANDREWS. A pretty significant cut in the demand for federal securities, which I assume would raise their price and raise their interest rates, if that were to happen.

Ms. BORZI. Yes. I mean one other thing that concerns me about your question is I think this would not just have an effect on the investment decisions of fiduciaries. I think it would also have a profound effect on individuals particularly in the 401k plan and IRA marketplace.

We have been, as I said, have been encouraging people to save for retirement. If individuals thought their ability to borrow outside of the retirement savings universe would be impaired because credit would be tightened up and, of course, we are still seeing that for small businesses. That is one of the problems with small business——

I think they would be less likely to put money in their plan because once it is in there it is much more difficult to get it out. So I would also be concerned on the effect of the savings rate, which we know is much lower than other countries.

Mr. ANDREWS. Of course, if people put less money in their plans, there are fewer equities purchased, fewer bonds purchased, less money available——

Ms. BORZI. Right. I think the ripple effect in the economy would be very significant.

Mr. ANDREWS [continuing]. Investment in corporate America.

Would you care to add any comments further about the other consequences of such a risk to the U.S. economy?

Ms. BORZI. You know, it is really very hard to figure out what would happen. It is very interesting to me because part of the debate has been that we need to get, and this ism I am now, this is Phyllis Borzi, public citizen. You know, I am not speaking for the Department of Labor or the administration on this——

Mr. ANDREWS. We won't tell them what you said, go ahead. [Laughter.]

Ms. BORZI. You won't tell anybody that I said this.

One of the important parts of the debate has been the need to get certainty into, make people understand that Congress is, Congress and the administration is serious about reducing the deficit. And a default, it seems to me, would go in the opposite direction.

It would certainly send a message to the American public that people aren't really serious about dealing with this. And I think that uncertainty will certainly not do anything to encourage businesses to add more jobs or, as I said, for people to save more money for retirement.

I am not an economist. I don't play one on TV, but I think nothing good could come from a default in terms of the American public and the pension system.

Mr. ANDREWS. Thank you, Madam Secretary.

Thank you, Mr. Chairman.

Chairman ROE. Thank you.

Mrs. Roby?

Mrs. ROBY. Well, since my colleague brought it up, I would just like to make a comment and say that all the more reason that we get our fiscal house in order here in the federal government. Men and women, families all over this country have been tightening their belt for the past several years and it is time this federal government tightens their belt, too.

Which is exactly what House Republicans are proposing, and we need to do all that we can to ensure the American people that we are removing this uncertainty so we can get Americans back to work.

Ms. BORZI. Well, and the administration and the Democrats believe that we need to get moving on this and be serious about the debt as well.

Mrs. ROBY. Well, tax increases——

Ms. BORZI. I don't think it is a partisan issue. I think that people have different ways of getting to the same point. But I think the goal is a shared goal.

Mrs. ROBY. Well, raising taxes on the American people right now is certainly not going to get Americans back to work.

Madam Secretary, thank you for being here.

Mr. Chairman, thank you.

President Obama issued an executive order this winter he urged regulators to ease regulatory burdens. And with all of the concerns being raised around this rule, how does this proposal fit within the president's initiative to ensure rules do not have a negative impact on investors, businesses, and the economy?

Ms. BORZI. Well, it fits within the president's executive orders, several executive orders that deal with this in a number of different ways.

First of all, the president, through an executive order, asked us to go back and look at all the regulations that all the agencies had issued over the past years to determine whether any of them were outdated, outmoded and needed to be updated.

And, honestly, that is the reason we selected this project because in reviewing these regulations, this is the one that is the linchpin

to our program and it also is the one most obviously crying out for updating.

Now, as far as burdens are concerned, when we propose a regulation we are required to look at burdens. We are required to make findings in the finalization of a reg, for sure, as to the extent of the burden, and we have to describe any alternative mechanisms we may have looked at to address the same issue.

Our proposal was just that, a proposal. It is like a first draft and it was designed to get the kind of public discussion and debate that it is engendered. And as we move along to finalize the regulation, we have a responsibility to and have been working to do a couple of things.

The first thing we have a responsibility to do is interact with the public, get public comments. Another executive order that was issued asked the agencies to allow people to comment on the comments.

When you put forward a regulation, you seek public comments, and that is what we did. We gave the public 90 days to comment on our regulation.

We got about 200 comments which isn't, you know, it is about average for the comments that we get on major regulations like this. We recognized from the beginning that this was a major regulation.

We then had requests from the public to extend the comment period, which we did twice. We then scheduled 2 days of public hearings, wherein we had, I believe it was 38 public witnesses, and then we reopened the public hearing record.

Now, typically what we do is we open the record for the people who testified. In this case, we opened the record to anybody who wanted to comment on the testimony or who wanted to renew comments.

And then, 2 weeks after we opened that comment period we extended it for another 2 weeks because we posted the transcript of the hearing——

Mrs. ROBY. And let me just say this, and I appreciate that process but both parties, members from both parties, have expressed concern about the proposed rules and yet there seems to be increasing efforts to finalize the implementation of this rule by the end of this year.

So why do you feel with all of the process that is going on, with all of the comments from both sides, why do you feel, does the administration feel that it is necessary to go ahead and rush ahead?

Ms. BORZI. We are not rushing ahead. It is more important to get this right than to comply with the dates that we have set forward on our regulatory schedule.

The reason I talk about the end of the year is because that is what our regulatory agenda calls for. But believe me, we are taking the comments that are being made by the members of Congress, by the public, very, very seriously.

We are talking, as I said, we are talking with our sister agencies. We are trying to work through issues. But it is most important for us to get it right——

Mrs. ROBY. Well, I——

Ms. BORZI [continuing]. Rather than meet that regulatory agenda. On the other hand, the process under the Administrative Procedures Act is you make a proposal and then you work towards finalization of that proposal.

Mrs. ROBY. Sure. And my time is out. But I just want to say that all of these issues, regulatory burdens, as well as the issues that are confronting Congress right now, today, this week, you are right. It is not a Democrat problem or Republican problem. It is an American problem and we gotta get it right.

And with that, Mr. Chairman, I yield back.

Chairman ROE. Thank you, gentlelady for yielding.

Dr. Loebsack?

Mr. LOEBSACK. Thank you, Dr. Roe, and thank you, Madam Secretary, for being here today. I am really happy that we are having this hearing on this important rule which updates a 35-year-old rule.

I think the importance of it is demonstrated by the fact that there are a lot of members here today. Many of us have probably the same concerns on both sides of the aisle, I think, as was already expressed.

We know that much has changed in the last 35 years, and as our country struggles to recover from the worst economic downturn since the Great Depression, I think this proposed rule is all the more important and applicable, especially given that in recent times we have had a lot of folks see their retirement savings lose 40 percent of their value in some cases.

Some saw their money disappear in risky financial gambling products. Recent employees, Employee Benefit Research Institute studies show the percent of workers saying they are very confident of retirement security is at its lowest level ever, and I think that in itself is a concern that we should all have.

While we are barely seeing some slight recovery in retirement savings, we are reminded of how quickly and how easily the market can wipe out years of years of sweat, scrimp, and save for retirement for the average individual in America.

Social Security does remain the bedrock of our retirement security in America, and it is concerning to me to think of a proposal to subject Social Security to future market crashes as well. That is another issue, but nonetheless something I think we should be thinking about.

Especially when wages have not kept up with economic growth, and we just seen the Pew study that came out that talks about a wealth gap that continues to grow in this country. I think we need to be more vigilant than ever in ensuring that employee's and IRA investor's retirement savings are protected.

There is no better standard, as I think we could all agree, than a fiduciary standard. So I do applaud your attempt to provide certainty by improving the test for investment advice as they relate to the fiduciary status, but I have a couple of concerns I would like to express.

I know we sent a letter to the Labor Secretary, and you did respond on ESOPs in particular. I sent a letter to you; it was signed by a couple of my colleagues from Iowa as well.

I have a number of companies in my district that are enthusiastic Employee Stock Ownership Plan, or ESOP, participants and I have heard first-hand on the buy-in from how the buy-in employees feel that they have in the future of that company as well because of that ESOP structure. I think it is very important.

Again, this is a concern that cuts across party lines that I am going to express. I know that the IRS and DOL require ESOPS to receive yearly valuations performed by independent appraisers and this rule would now require those appraisers to be fiduciaries, as I understand it.

We do need accurate information on valuations but the question I have is: can you explain how this rule might affect the cost of those valuations, and is there a way to ensure that the costs don't rise for the ESOP businesses and for their employees?

Ms. BORZI. That is a very good question. I am happy to address it. The plan sponsors, employers, who want to establish an ESOP have to hire or typically hire an appraiser to value the stock that is going to be contributed to the ESOP.

The most important decision to make that deal—the appraiser—the decision to invest in employer stock has already been made. That is the nature of an ESOP.

But the most important decision, or the most important piece of information to make that deal a reality is the valuation decision. How much the stock is worth.

And what we have seen over the years is a number of problems with the appraisers including flawed methodologies, including use of flawed financial data, manipulation of numbers and methodologies to tilt the scale one way or the other, to put a finger on the scale.

It is interesting because at our public hearing we had some testimony on this and we had witnesses who said, "Oh, well you are just talking about these sort of fly by night appraisers. You know if they are licensed, if they are credentialed, they don't do that."

Well, that is not our experience. The big appraisers also have appraisal problems. And the difficulty is that there is already money in the system. Money is already being paid to an appraiser to do a valuation of the stock.

And if that valuation is not objective, fair, and no finger on the scale so that when the plan is, let me see if I can get this straight, when the plan is buying stock they pay too much because they are relying on the valuator. And when they plan is selling stock they get too little. That is all the purview of the person who performs the valuation.

So the argument that people are making is that this is going to cost a lot more if people have to give valuations that are fair and objective and not tilted. I am not sure that I fully understand that because they are paying for these valuations now.

And if what the argument is it will cost more if we give you a valuation that is fair and objective as oppose to the valuations they give now, I am not sure that I need to see some evidence of that.

Clearly there is going to be some additional costs. I am not saying that there is no additional cost, but I am not sure of the magnitude of the cost.

What this is all about is accountability. Accountability. And in my written testimony, if you look beginning on page eight you will see a variety of examples where appraisers have given faulty appraisals that have resulted in huge liabilities to the plan and the plan sponsor where the appraiser would not, could not be held accountable because of our five-part test.

Mr. LOEBSACK. Okay. Thank you, Madam Secretary. We will keep working on this issue together. I really appreciate it.

Ms. BORZI. Yes, absolutely.

Mr. LOEBSACK. Thank you, Dr. Roe.

Chairman ROE. Thank you.

Mr. Rokita?

Mr. ROKITA. Thank you, Mr. Chairman. And thank you, Madam, for your testimony today.

I want to follow up on the ESOP question that the last gentleman asked and your response.

Ms. BORZI. Sure.

Mr. ROKITA. Back in February Secretary Solis was here in your seat, and I asked a question about the appraisers and the appraisals as well in regard to this proposed regulation.

Just for some background, I was the Secretary of State in Indiana for 8 years and had regulatory responsibility over these very issues. And I see the value, at least from the SEC standpoint, in addressing the fiduciary standard issue.

Not that I agree necessarily how it is being handled, but I do see the evolution that you testified about in products and in the way we access information and what technology has done for us. It empowered us as investors.

But with regard to these appraisals, Ms. Solis' response said that out of 50,000 appraisals she sighted six appraisals that had problems. And how many do you list in your testimony?

Ms. BORZI. I am sorry. I couldn't hear your question.

Mr. ROKITA. How many faulty appraisals that you talk about were listed in your testimony? You said on page eight.

Ms. BORZI. I gave you some examples of faulty appraisals.

Mr. ROKITA. And Secretary Solis gave——

Ms. BORZI. This isn't something that——

Mr. ROKITA [continuing]. Excuse me.

Ms. BORZI. I am sorry.

Mr. ROKITA. And Secretary Solis gave six out of 50,000. They weren't examples necessarily, they were just——

Ms. BORZI. Right.

Mr. ROKITA. So for six bad apples maybe and some that you list in your testimony, we have to go and re-do this whole law? This whole rule?

Ms. BORZI. Well, the simple fact is just because we have six examples of it doesn't mean that it isn't more widespread than that. The——

Mr. ROKITA. But where is your quantified data to prove that?

Ms. BORZI. The——

Mr. ROKITA. How do you know there is——

Ms. BORZI. We don't have the resource——

Mr. ROKITA. Ah. Okay.

Ms. BORZI. I mean, what you are really asking us to do is examine every single ESOP——

Mr. ROKITA. You don't have the resources to do that so based on your intuition, based on six examples——

Ms. BORZI. This is not based on intuition. It is based on——

Mr. ROKITA. Where is the quantifiable data?

Ms. BORZI. We are happy to supply you more data.

Mr. ROKITA. Oh. I thought you said you didn't have the resources.

Ms. BORZI. But I can't give you an exact quantification of how many transactions go on and how many are faulty valuations. There is simply not able——

Mr. ROKITA. But that doesn't stop you from what the Oliver Wyman study said could be a 73 to 196 percent increase in the cost.

Ms. BORZI. The Oliver Wyman study suffers from the problem that I was discussing with your colleague a little while ago. It starts from what we believe is a faulty premise that the only two options are keep the current conflicted system in place or move to an investment advisor structure which will be more expensive.

As I said before, we have talked with our colleague—our sister agencies that regulate this marketplace that have a lot of enforcement expertise in this marketplace, and they have assured us that there are a number of other business models between the stark model that the Oliver Wyman study starts with.

And, of course, if you start with a flawed premise—there are two flawed premises in the Wyman study. That one——

Mr. ROKITA. But you are acting on, excuse me, let me get my final——

Ms. BORZI. Certainly.

Mr. ROKITA. You are acting on assurances or you have seen these other studies? Or what kind of analysis have you done?

Ms. BORZI. We are in the process of doing much more thorough economic analysis that was in——

Mr. ROKITA. Okay. I will submit a question if you would like later, but I would like to hear you analysis and see if after you are done with it.

Ms. BORZI. Sure.

Mr. ROKITA. Secondly, Ms. Solis said in response to my question that, and this goes along the same lines, a more full economic analysis of the regulation would be provided when the rule becomes final. Now maybe to make a crude analogy, that sounds a lot like you can find out what is in the bill after you pass it.

Why would we be doing—I find that totally inadequate, and I am not trying to put her words in your mouth, but I would like your response to the idea that full economic analysis of the regulation could be provided after the rule becomes final.

In your practice——

Ms. BORZI. Well if you are—the final—that is what the requirements are. The OMB requirements are an agency cannot put forward a final or proposed analysis, a proposed rule for that matter, without some type of——

In a proposed rule you have to have an economic analysis as well. It is not required to be as fulsome as in the final, I mean——

Mr. ROKITA. As fulsome?

Ms. BORZI. I mean, the point of proposing a rule and putting out a proposed analysis is that you get public input so that you can refine and strengthen your analysis. I am not—maybe the words aren't clear——

Mr. ROKITA. Oh, maybe I am taking it the wrong way and I am happy to stay and have that clarified, but——

Ms. BORZI [continuing]. But what we are trying to do when we are—when we are trying to finalize a rule at the same time that the final rule is submitted to OMB, we have to have an economic analysis. And the procedure is——

Mr. ROKITA. But there is no intention from your agency to do any kind of an economic analysis after the rule becomes final? It will all be before?

Ms. BORZI. No.

Mr. ROKITA. Okay.

Ms. BORZI. It is simultaneously with it and believe me there is a lot of give and take within the administration within all the economists within the administration who have an opportunity to look at and work with us on the economic analysis.

Mr. ROKITA. How about economists outside the administration?

Ms. BORZI. We solicit comments from economic, from economists——

Mr. ROKITA. Thank you.

I yield back. Thank you, Chairman.

Chairman ROE. Thank you, gentleman, for yielding.

Mr. Kildee?

Mr. KILDEE. Thank you very much, Mr. Chairman.

Phyllis, I am going to ask a question that is just tangential to this but I—my district was the headquarters at one time of Delphi Corporation, and there are two types of Delphi salaried workers—two types of workers, salaried and the non-salaried, the hourly.

The hourly workers are protected by a contract with the UAW and General Motors, the parent corporation of what became Delphi. The salaried employees are not protected by that; therefore, they depend totally upon what help they can get from ERISA.

I know this is tangential to the purpose of this, but since you are here, do you have any suggestions of what can be done to relieve some of the real pain that the salaried people have?

Ms. BORZI. You know, this is such a hard question because while my heart goes out to the salary workers, you know the title for statutory language doesn't give them any comfort because everybody's benefits, both salary and hourly, in terms of the PBGC guarantees are the same.

Well, I mean based on their work history, et cetera, but the framework is the same. And the top up, if you will, as you indicated, came from a side arrangement, a side negotiation in the 1990s between the UAW and GM.

There certainly is nothing that the PBGC can do without violating the statutory provisions. The only recourse, I would think, that the Delphi salaried folks have is against GM. But I don't have any, believe me, Secretary Solis has asked me this question many, many, many times, and I just don't have an answer for them; although, I am quite sympathetic.

If I wanted to give a glib answer, it would be that the UAW was smart enough to figure out that there might come a time that they needed this protection. At the time that they negotiated it, as far as I could tell from the reading that I have done, it wasn't clear that they needed it, but they did.

I wish there was something that we could do because it is a very, very tragic situation.

Mr. KILDEE. Well, I appreciate your candor. I mean, you have given it exactly the only answer you can give.

I will just throw in my own feelings on this. This illustrates that millions can help. The UAW looked ahead and saw and protected. They could see what might come, whereas the nonunion members did not have that foresight.

Ms. BORZI. Well, and as I understand it, even some of the other unionized hourly employees, their unions didn't negotiate those kinds of protections. And I guess, after the fact, some of them have gotten some sort of a guarantee and others have not.

Mr. KILDEE. [Off mike.]

Ms. BORZI. So there is no question that there is disparate treatment, different treatment. I don't want to use a loaded word in the EEOC context, but there is no question that there is different treatment of these retirees, and that is really very sad.

Mr. KILDEE. Well, I appreciate you responding to a question that was not really relevant to this hearing but I appreciate it.

I go to the meetings of these people, and it is pretty hard to try to justify——

Ms. BORZI. I know.

Mr. KILDEE [continuing]. But I appreciate your candor. Thank you very much.

I yield back.

Chairman ROE. I thank the gentleman for yielding.

Mr. Thompson?

Mr. THOMPSON. Thank you, Assistant Secretary, for being here.

I want to follow up to, kind of follow along to a line of questioning Mr. Rokita had raised and opened.

Your testimony states that the department is undertaking a "fuller," and that is a quote from your testimony, "economic analysis" of the impact of the proposed role.

Will the department's forthcoming economic analysis take into account the substantial likelihood of increased litigation by the department and the plaintiff's bar and the effect that such litigation will have on plan costs and ultimately participant balances as well as the employers concerns about plan establishment and plan maintenance?

Ms. BORZI. Well, our economic analysis will take into consideration all the internal and external factors. So that factor will be taken care of or will be factored in.

It is very hard to predict what the impact will be, though, but for sure we will take a look at it.

Mr. THOMPSON. Okay. You talked a lot about, you know, and I apologize for getting into the hearing late, but just the time I have been here I have heard a lot about trust. Trust me, trust us, trust us, trust us.

And I am of the school of trust, but verify. I think that gives us all confidence.

The department thought it drafted the proposed regulation in a manner to accomplish exactly what was intended. But, again, based on comments and the department's own admissions have fell short in that regard.

Why are you so confident the department will get it right in a final regulation without further opportunity for public comment?

Ms. BORZI. Well, we haven't cut off public comment. As I said in my statement we have met with more than 20 outside financial services people to get their input, some of them more than once. And we have met with at least 30 members of Congress to get their input.

We continue to take, there isn't anybody who is a stake, you know, there isn't any stakeholder that is asked to meet with us that we don't meet with. We are very interested in getting public comment.

But there comes—I said to the ERISA advisory council the other day when I was asked a similar question like this, there comes a point where, and the computer literate people will know what I am talking about, where you push that button on your computer that says close all tabs.

There is only so much—we have been continuing to take public input. It has been weeks since we had any sort of new information given to us but we continue to take the meetings because we are open to that. And we still are open to that.

But at a point you can't just keep meeting and having the same discussion over and over again like that movie Groundhog Day. At a point, you have to move forward using your best judgment.

Now that doesn't mean that we aren't going to, still, as we develop the final rule, that we aren't going to still reach out and ask people for input. That is what we have done with all of our rules.

We haven't—once we figure out a direction and a set of amendments that we might want to implement, we often reach out to people and, while we don't hand them over the piece of paper, which, you know, we are not allowed to do under the Administrative Procedures Act, we do have discussions.

If we have options, we might call people and say well which of these options? Here is one way to go or another way to go or another way to go. And we still continue to get public input even as we move to finalize.

But this is a very, very important problem and we think it needs to be addressed. If people, and we say to people who come in, if you recognize the problem, acknowledge the problem, and you have other mechanisms that we can use short of the way that we have gone, we are open to hearing that but so far people haven't come forward.

Mr. THOMPSON. Well, first of all, let me say representing Punxsutawney, Pennsylvania, I can't get enough of Groundhog Day. [Laughter.]

I am okay with it.

Just for the record, Mr. Chairman. [Laughter.]

But can you share with us any of the concerns that were identified by the ERISA advisory council on this?

Ms. BORZI. They were just asking me about it.

Mr. THOMPSON. In terms of——

Ms. BORZI. What happens is whenever the council meets——

Mr. THOMPSON. Because if they have concerns about not having enough public comment or input based on your——

Ms. BORZI. No. I mean, some of them, they are all private sector—experts from the private sector. Some of them work for companies that put through comments, that filed comments.

Their questions to me the other day were just procedural.

Mr. THOMPSON. Okay. Well, thank you.

Thank you, Chairman.

Chairman ROE. Thank you, gentleman, for yielding.

Mrs. McCarthy?

Mrs. MCCARTHY. Thank you, Mr. Chairman. Thank you for calling this hearing. I think it is very important. Obviously, we need to know what the department's proposals are going to really be redefined as a fiduciary.

I want to thank Madam Chairman. You have been terrific meeting with us, sitting down with different groups, and we appreciate your time and your staff's time. I know that we have spoken before on this issue, and I still will appreciate it as we continue our discussions.

Listen, for matters of retirement security, especially for people my age and certainly my friends, accountability should always be paramount for your department and certainly for this Congress.

Retirement options have evolved greatly over the passage of ERISA law in 1974, I believe. I do believe that changes can and must be made in order to bring further accountability for financial advisors and protection for investors.

I think that we did a very good job with Dodd-Frank on putting in a lot of those protections. I also believe that we did a great job on protecting the consumer by giving them more information. I believe we still need to do a better job on financial literacy, for all ages.

But especially because of the wide scope of ERISA, changes must be conducted with utmost caution and thoroughness in order to ensure that the intent of the changes is realized in the final product. I think that is what we are both working for.

I can say wholeheartedly that I agree with your intent, and I do. I agree that folks deserve access to accurate and unbiased information, and I agree that a structure must be put in place that incentivizes employee's investment and long-term accumulation of retirement savings. That is what we have always worked for.

However, I am afraid I still disagree with the process by which this rule came about and ultimately what will be the final rule should this process go forward.

As a Democrat, this issue has been particularly difficult for me. In this committee and others, our friends on the other side of the aisle have made it a habit to assume that any and all agency rule makings under a Democratic administration are burdensome, overreaching, and are adverse to free-market principles.

Luckily for us, they are wrong an overwhelming majority of the time. However, in this case, I still cannot defend this rule making

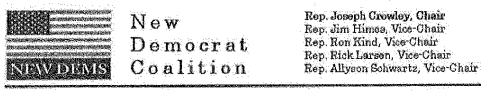
process. I do not believe—I do believe it is overbearing and has a potential to hurt our national economy.

This shouldn't come as a surprise because we have talked about this. We have had those discussions, and like I said, we have spoken many times at great length.

I also worked with the new Democrats, and we sent a letter signed by 28 of our colleagues on the Democratic side asking the department to repose this rule given coordination and consultant concerns.

Mr. Chairman, at this time I would like to ask unanimous consent of the letter that I sent to the new Democrats that was signed forth.

[The information follows:]



Rep. Joseph Crowley, Chair
Rep. Jim Himes, Vice-Chair
Rep. Ron Kind, Vice-Chair
Rep. Rick Larsen, Vice-Chair
Rep. Allyson Schwartz, Vice-Chair

May 10, 2011

The Honorable Hilda Solis
Secretary
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

The Honorable Mary L. Schapiro
Chairman
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

The Honorable Gary Gensler
Chairman
U.S. Commodity Futures Trading Commission
1155 21st Street, NW
Washington DC 20581

Dear Secretary Solis and Chairmen Schapiro and Gensler:

As members of the New Democrat Coalition, we are writing today with respect to the Department of Labor's proposal to redefine the term "fiduciary" for purposes of the Employee Retirement Income Security Act of 1974 ("ERISA") and for purposes of certain Internal Revenue Code provisions affecting IRAs and similar arrangements.

During debate of the Dodd-Frank Wall Street Reform and Consumer Protection Act, the New Democrat Coalition played a critical role in advocating for an approach that would reduce systemic risk and increase transparency and certainty in our markets. Given our work, we understand and appreciate the Department's desire to update the definition of a fiduciary in a way that is broad enough to protect the interests of retirement plan participants and sponsors seeking investment advice. While the proposed rule is intended to protect employee participants and plan sponsors from unfair and deceptive practices, we are concerned that it would have an adverse effect; ultimately limiting access to investment education and information. This would result in worse investment decisions by participants and would, in turn, increase the costs of investment products, services, and advice that are absolutely critical parts of a sound investment strategy for consumers.

We also feel strongly that these changes should be made in consultation and coordination with all the relevant regulators to avoid duplicative or contradictory guidelines governing investment in U.S. markets. A coordinated regulatory approach among the agencies will provide clarity and certainty both to investors and to advisers.

Given the complexity and importance of this issue, over 200 written submissions have been made regarding the proposed rule, in addition to those made at the Department's public

hearing. We understand the Department is considering modifications. In order to consider fully these comments and to provide more transparency and certainty to the rulemaking process, we urge the Department to provide the public with an opportunity to review these modifications through a re-proposed rule.

We appreciate the Department's leadership on this issue. We look forward to working with you in coordination with other agencies to create a balanced approach that protects plan participants and sponsors while ensuring continued access to investment education, information, and affordable investment products and services.

Sincerely,

Carolyn McCarthy
Member of Congress

Rush Holt
Member of Congress

Joseph Crowley
Member of Congress

Ron Kind
Member of Congress

Jason Altmire
Member of Congress

Jim Himes
Member of Congress

Allyson Schwartz
Member of Congress

John Barrow
Member of Congress

Shelley Berkley
Member of Congress

Russ Carnahan
Member of Congress

John Carney
Member of Congress

Gerry Connolly
Member of Congress

Martin Heinrich
Member of Congress

Gregory Meeks
Member of Congress

Chris Murphy
Member of Congress

Ed Perlmutter
Member of Congress

Pedro Pierluisi
Member of Congress

Laura Richardson
Member of Congress

Andre Carson
Member of Congress

Joe Courtney
Member of Congress

Rick Larsen
Member of Congress

Jim Moran
Member of Congress

Bill Owens
Member of Congress

Gary Peters
Member of Congress

Jared Polis
Member of Congress

Cedric Richmond
Member of Congress

David Scott
Member of Congress

Terri Sewell
Member of Congress

David Wu
Member of Congress

CC: Director Jack Lew, Office of Management and Budget

Chairman ROE. Without objection.

Mrs. MCCARTHY. Thank you.

Madam Secretary, in the preamble of the proposed rule, the department recognizes the potential broad effects that it may have. In fact, the department openly admits that there may be an uncertainty and a large market impact that may also create a smaller field of service providers.

I understand that there is always a measure of uncertainty regarding any potential rule making. However, I do think the department did not do its due diligence to ensure that it had the most information available to have a more accurate analysis of the impact.

Madam Secretary, no request for information was issued for this rule. DOL has a history of issuing RFIs on issues of retirement security. Given the overlap with other agencies, and I know you talked about speaking with other agencies, the uncertainties in regards to the market impact and the great concerns you have heard from the stakeholders throughout the industry, I ask: why wasn't an RFI issued? In hindsight, don't you believe an RFI would have paved the way to a better draft rule for folks to comment on?

Ms. BORZI. Well, that is a very good question. I am happy to answer it for you.

The regulatory process gives an agency a variety of tools to gather information. The—the RFI process is typically used really in two circumstances.

When an agency is not completely sure that there is a need to regulate or when they are thinking that there might be a need to regulate but that there are a wide variety of mechanisms to do that.

In this case, we were not unsure. We were very sure that there was a problem here. And we had nearly 40 years of experience in our own enforcement activities to identify the problem.

In addition to that, we had the benefit of an SEC study that was done a couple of years ago on consultants and advisors that confirmed, if you will, the existence of the problem. And in addition to that, there was lots of academic literature about this.

So there was no question that this was a problem that needed to be solved. And given the statutory tools that we had to solve it, there really was only one statutory way that we could through reg-

ulations deal with the problem and that was through the prohibited transaction route.

Now having said that, I contrast that with another process that we used where we used the RFI and that had to do with lifetime income. We were very concerned that a lot of people were now taking lump sums and not having the kind of lifetime income stream, monthly benefits, if you will. But we weren't sure that it necessarily was the job of the federal government to get in there and start making rules.

So we did do an RFI in conjunction with our colleagues at the treasury and the IRS. And we are now in the process—and we got lots of comments. We got over 700 comments and lots of good information. So that is the contrast.

We knew that there was a reason to regulate. We had limited pathways to do so and so we crafted the best rule we knew how, but we put it out for proposals.

Mrs. MCCARTHY. I know my time is up, and I thank the Chairman for indulgence.

I disagree with you on the SEC study, because it also shows that it is going to have a great impact on basically the brokerage relationship. But we will talk about that in the future.

Ms. BORZI. Absolutely.

Mrs. MCCARTHY. Thank you, Mr. Chairman.

Chairman ROE. I thank the gentlelady.

Mr. Barletta?

Mr. BARLETTA. Thank you.

Why has the Department of Labor decided not to make its plan changes available for public comment?

Ms. BORZI. We did make the plan changes available for public comment. We went through extensive public comment. I guess I am not quite sure what you are talking about.

Mr. BARLETTA. Well, you know, in light of all the questions and concerns would the department consider re-proposing the rule for the public comment and the questions and the concerns?

Ms. BORZI. Well, we certainly never say never to anything. But re-proposal is typically used when you put out a proposal when the commentators offer alternative approaches to solve the same problem and the public hasn't had the opportunity to comment on the alternative proposals.

We had lots of public comment. Many of the issues were issues we had actually flagged for ourselves. We have been working through the drafting issues. We have been meeting with lots of people.

But aside from don't do anything, which I guess is an alternative structure, nobody has really suggested to us an alternative structure from the structure we have proposed. They have had criticisms and comments and they have said quite accurately, because we knew we had to do it, that we need to focus more on the cost.

But I am not quite there yet that the kinds of public comments that we have gotten have suggested such a fundamental alternative that we need to re-propose it.

Mr. BARLETTA. All right. Thank you.

Chairman ROE. Dr. Holt?

Mr. HOLT. Thank you, Mr. Chairman.

Thank you, Secretary Borzi, for coming. I really appreciate your expertise and your dedication over the years to making sure that the financial integrity is protected for the benefit of ordinary people.

I have long been an advocate, as you know, and as I have told you many times, for more investment education. Clearly, people are not well informed. Surveys show that over and over again, and we see that people are ill-prepared for the tough times that come in their non-wage earning years. I get that from my constituents and lots of places.

I appreciate the efforts of your department to help Americans prepare. As you know, Representative Petri from this committee and I have introduced the Lifetime Income Disclosure Act which is intended to help people understand better where they stand and prepare for where they need to be.

I strongly support, you know, a regular basis test for increased clarity for advisors and investors so that people are armed with trusted, reliable information. But I have some questions about how we are going about this.

I have asked you before and still have not received data. You know, what is the cost of this perceived problem? We must, and you must, I think, characterize, describe, and quantify the problem that you are trying to solve. It is easy for me and it seems to be very easy for you to imagine that people will be misled and hurt by this so-called conflicted advice.

But we shouldn't make policy on what we imagine to be the problem. In your testimony, when you get to the part of the testimony where you are talking about the problem, the first part is sort of, sort of legalistic.

You are saying, well, the practice out there doesn't really meet the test that was set up 35 years ago in ERISA. Then you start to give some examples and you say, well, you have uncovered abuses of flawed valuation methodologies and internally inconsistent valuation reports. No doubt. It is not clear that they come from the so-called conflicted advice.

So let me ask again. How many people will be affected? What will be the cost? Where are the data on investor behavior? Where are the data on advisor behavior and dealer behavior?

It seems to me you can break out of this, what did you call it, the repetitious interactions that you were talking about, and I won't call it Groundhog Day, by actually working harder to draw out the evidence and then draw out the guidance from that evidence.

You know, I got into this because some years ago I innocently asked a few questions about where these, before you even started working on these regulations when other people were talking about it. As you said, academics have written about it.

I realized that it seemed to be focused more on trying to restrain the investment corporations than empowering the employee investor. A moment ago you said there, this is, I think, pretty close to a quote, there is no question about the problem.

I get a little bit worried when somebody is so sure that they will look right past the evidence. I mean the absence of evidence here might be a problem in itself, and you said we were very sure. That

is what seems to be behind these regulations, and that is what troubles me a great deal.

You say that there can be a model between investment advisor or broker dealer. Well, sketch that out for us, please. And——

Ms. BORZI. I will be happy to send you some press articles that gave us some information on that.

Mr. HOLT [continuing]. And, yes. It is, I mean, if we are, you know, our job here in Congress is not to preserve the business model that has existed for 35 years, but if you are going to upset that business model, we had better know why and we had better know where we are going. I have yet to see that.

So, I mean, I have not given you time to answer; I have been talking. But I hope you will, because these will respond more than you could, I mean, this will require a response of more than a few seconds or a few minutes anyway. I hope you will respond to these.

And then ask, and then answer, you know, right now there are so many other regulations to be implemented by the SEC, through Dodd-Frank, and so forth, section 913 for example on a standard of conduct.

Why, after this has been around for 35 years, has it moved to the head of the queue something to be dealt with now in the next 5 months in final form while all of these other things are still in play, related other things?

So——

Chairman ROE. If the Secretary will hold——

Mr. HOLT. With that, I should yield back. I thank you——

Chairman ROE. If the Secretary will hold that thought, I am going to continue his line of the questioning.

Ms. BORZI. Okay. Could I just answer——

Chairman ROE. Well, I am going to continue in just a moment.

Ms. BORZI. Okay.

Chairman ROE. Dr. Bucshon?

Mr. BUCSHON. Thank you, Mr. Chairman. I am going to yield my time to Mr. Rokita.

Mr. ROKITA. Thank you, Mr. Chairman. I thank the gentleman from Indiana.

Two quick questions just following, I have been listening intently to what you are talking about and, again, with my background I truly believe in transparency and the due process of rulemaking.

And I am intrigued by the answer you gave to former Mayor Barletta when you talked about re-proposing and the idea that you re-propose a rule when there is an alternative presented that may not have been thought of.

What about the comments, if there were any, that disagreed with your premise, your agency's premise, that there was even a problem? What about the comments and specifically how do you weight the comments that said, we don't need an alternative. We just don't need to do this. This is where I am headed.

Ms. BORZI. Well, maybe you can help me out how re-proposal would address that we don't think there is a problem we think you should do nothing. What could we re-propose that would address that?

Mr. ROKITA. Well, that is not my question. I am just saying you said the only time you re-propose is when there was an alternative.

But what about withdrawing? What about proposing something that was in line with the comments that were made that weren't just an alternative but were saying—my question is how do you weight the comment in your agency that says don't change anything?

Ms. BORZI. We take all of the comments very seriously.

Mr. ROKITA. But how do you weight them equally with those proposals that say we do need to change or we have some alternatives or we need to——

Ms. BORZI. There are always people who don't want any change and we do weigh them. I can't say that we weigh them equally.

Mr. ROKITA. What is your formula for weighing comments?

Ms. BORZI. We don't have a formula for weighing it because we look at what the rationale behind the comments——

Mr. ROKITA. How do you judge that rationale in a comment? What formula do you use to judge?

Ms. BORZI. We put it in the context of all the comments that we have, we weigh it against the other evidence we might have, and I eluded to some of it, that there is a problem, and then we spend a lot of time talking with people trying to understand exactly what their concerns are.

Mr. ROKITA. And that is my second question and then we can get on with the hearing. You mentioned a couple of times that you have met with groups, you have met with people. Are these private meetings? Are these meetings on the record? Is there a transcript of these meetings?

Ms. BORZI. Well, they are—no, there are not transcripts.

Mr. ROKITA. Do you have a list?

Ms. BORZI. We keep a list. I mean, we are required to keep a list of who we met with, who the people were at the meetings, and then for our own purposes we all have our own notes.

And what we would do in the preamble to the final rule what we typically do is we list, you know, we talk about, because we are required to respond to the public comments and that is one way that——

Mr. ROKITA. So according to the Administrative Procedures Act, have you published this list of meetings?

Ms. BORZI. Yes. We do.

Mr. ROKITA. Okay. Okay. So that is available.

Ms. BORZI. Well, it is available in the final regulation. We can certainly——

Mr. ROKITA. Would you mind getting my office a copy of that list?

Ms. BORZI. I am sure we could. I would have to check with my lawyers, but I don't see a reason that we couldn't.

Mr. ROKITA. I mean before the final rule goes out and all that sort of, as soon as possible?

Ms. BORZI. Sure, we can certainly give you; it is not secret who we meet with.

Mr. ROKITA. Okay. Great. Thank you very much.

I yield.

Chairman ROE. I thank the gentleman for yielding.

Mr. Tierney?

Mr. TIERNEY. Thank you, Mr. Chairman.

Thank you for your testimony here today, the work that you are doing, and the cooperation of your office in answering a number of questions that we have had on a variety of issues. I appreciate that.

I know that a lot of material has been covered here, and you did speak to the ESOP issue, the Employee Stock Option Plan, just a little bit. But I was wondering, there is indication from your office that you were going to try to clarify that the fiduciary standard only required an impartial evaluation. Is that correct?

Ms. BORZI. Yes. We have had this back and forth with the appraisers who seem to think that being a fiduciary means you have to put the finger on the scale towards participants and that is not how ERISAs fiduciary rules work.

What ERISAs fiduciary rules say is that you have a duty to be fair, objective and meet professional standards of conduct. And what we have said to the appraisers is if there is any concern that that is not what we mean, we are more than happy to clarify it.

Mr. TIERNEY. Do you have an idea of how it is you are going to clarify it?

Ms. BORZI. I am sorry?

Mr. TIERNEY. Do you have an idea of how it is that you are going to clarify it?

Ms. BORZI. Well, we would put in an——

Mr. TIERNEY. Specifically state that——

Ms. BORZI [continuing]. Operative text of the regulation so that there would be no question about it, yes.

Mr. TIERNEY. Okay. Thank you very much. I have no further questions.

Chairman ROE. I thank the gentleman for yielding.

Mr. TIERNEY. I yield to my—I am sorry, I will yield to my colleague.

Mr. HOLT. Thank you because I didn't give you a chance to answer. As I said, a full answer to my various questions will take more than either the remaining time now or even this morning.

Let me add one more question to that and give you a few seconds to make any comments on what I said.

What if a call center representative says, for example, a particular mutual fund is good for people interested in investing in large cap equities? Would that violate——

Ms. BORZI. If that is all the person said, no. It would fall under this——

Mr. HOLT. So that is education. So you actually said earlier we won't limit access to education, which is great. I mean, it is a high principle for me.

What if a call center representative says younger investors should hold some equities in their portfolio to help grow their savings? Is that—?

Ms. BORZI. That is general advice. It is what we might call generally accepted financial and investment——

Mr. HOLT. But, well, it is reassuring to hear you say that.

Ms. BORZI. If that is all the person said, but if the person went on to say, and here are three funds that would help you achieve that objective. That might cross the line.

But if all they are doing is giving generalized investment information and honestly, that distinction that we are drawing in this discussion has been true since 1996 since our investment bulletin 96.1 was issued.

And there are people who have asked us to be more clear as to what this line is between investment advice and investment education and that is certainly one of the things that we are working on in conjunction with this.

Could I just say one thing about you question about cost?

Mr. HOLT. Please.

Ms. BORZI. We are taking seriously your questions, and we are in the process of working through the cost issues, collecting information. And we haven't completed that process yet. So——

Mr. HOLT. Thank you for doing that. I am surprised that you didn't do that up front; that we had to ask for it, actually.

Ms. BORZI. We did. We did. And in fact in our own regulation in the preamble, we asked people to help us out by giving us information about it and the Wyman study that some of your colleagues referred to is one bit of information.

It is not the dispositive. As I said before, it is not dispositive because it is premised on what we think is not a correct two premises that the only alternative is not this investment advisor model.

And the second problem with the Wyman study is that it assumes that commissions can no longer be paid, and that is not correct. But it is certainly not that we are disregarding it.

It is certainly a piece of information and every one of the people who come in to talk with us, we have asked them. Do you have information about cost? Please give it to us so that we can try to make our best estimates. And we are working with others in the administration about that on that issue as well.

We all have a very, very—we all consider it very, very important to get the best cost estimates that we can. There is always going to be some uncertainty in it but we are looking to have the most solid cost information that we can get to justify the rule.

And if it turns out, I mean, that is part of what is going on here, if it turns out that there are features that we have proposed that we can figure out a less burdensome, less costly way of doing, that is what we will be working towards.

Mr. HOLT. Okay. Also, those data that we have asked for about the behavior of investors, the behavior of advisors versus feelers?

Ms. BORZI. Yes. Well, we have some studies on that.

Mr. HOLT. And I thank Mr. Tierney for yielding time to give you a little more opportunity to elaborate.

Thanks.

Mr. TIERNEY. You bet.

Ms. BORZI. Sure.

Chairman ROE. I thank the gentleman for yielding.

We have a member of the full committee here, Mrs. Biggert, and you are now recognized.

Mrs. BIGGERT. I thank the chairman. I appreciate the being able to participate.

Welcome. We have met before and we have discussed this issue. And I just wanted to follow up on a couple of questions that we have discussed before.

In your testimony earlier this morning, you mentioned that you are coordinating with other agencies to ensure that your proposals do not conflict. And, as you are aware, Congress has mandated that the SEC study this matter under section 913 of the Dodd-Frank Act.

Can you explain why you are moving forward with the regulations proposal before the SEC has finished their study and how does that affect the Department of Labor?

Ms. BORZI. Well, it is my understanding that the staff study is completed. The commission hasn't taken any action on it.

There are a couple of things. First of all, our proposal was preceded Dodd-Frank. We have been working on this for a couple of years.

But second of all, we have two entirely different statutory structures. The section 913 study in Dodd-Frank, the research question that the staff was asked to address was whether or not broker dealers under the securities law should be held to the same standard as investment advisors under the securities law.

Our statute is very different. Under the securities law it is basically a disclosure statute and our statute is not a disclosure statute. It is a statute that is designed to prohibit conduct that is potentially harmful to plan participants and plan sponsors unless there is an exemption administrative or statutory exemption for that conduct.

So we have two fundamentally different statutory structures and two different we protect plan sponsors and participants. So we have two different statutory structures and that is why before our regulation, our proposed regulation was even sent through our own building for clearance or through OMB and the administration for clearance, we consulted our friends at the SEC.

We sent them the draft regulation. We asked them whether they saw anything in the draft regulation that would conflict with or impair their ability to do their job under Dodd-Frank. And those conversations, they said no as part of those conversations. So we went forward.

Mrs. BIGGERT. Could you elaborate a little bit more with your discussions with the SEC on that?

Ms. BORZI. Well, I wasn't—it is a discussion our staff, our two sets of staff talked about it. They had a few questions, as I understand it, they had a few questions about some of the provisions in our regulation, but the bottom line was they didn't see anything that would conflict with what they were doing. And so we went forward.

We have had this longtime working relationship with the SEC including an MOU on enforcement, and so we have continued to have multiple conversations with them as they move forward to implement their responsibilities under Dodd-Frank and as we move forward on this regulation. And, I must say, a variety of other issues including target date funds and a bunch of other things.

Mrs. BIGGERT. Have you considered, since the SEC study has been completed, was there any consideration for any of the things that were in that study for you making your ruling?

Ms. BORZI. Well, I mean, we certainly discussed—we had a briefing on the study and we certainly discussed the direction that the

SEC believed it was going in, which was not incompatible with our direction, different, but they have different statutory mandates than we do.

And so what I have said over and over again I said at the public hearing is that our job is not to let the industry have only one standard. There are multiple fiduciary rules that apply to every industry.

But we do have an absolute responsibility, and I take it very seriously, that we do not put plan sponsors or financial institutions in the position where compliance with one set of rules will put them out of compliance with another set of rules. So that is why my pledge is they won't be conflicting standards. I can't promise they will be the same standards 'cause we have got two different statutory frameworks.

Mrs. BIGGERT. Okay. It just seems that, you know, the financial services industry is really concerned about——

Ms. BORZI. Yes, they are.

Mrs. BIGGERT [continuing]. About the consequences of this proposal. Do you see any way to alleviate those concerns?

Ms. BORZI. Well, I am not sure what else except giving, I mean, we pledge to continue working with the SEC and we have done the same with CFDC. We are working with treasury and the IRS as well, because all of them have responsibilities under Dodd-Frank.

And by working with them, I don't mean just sending paper or, you know. We have discussions with them. They tell us what they are thinking about doing. We think about and talk about how what one agency does will impact another, and we do promise that we won't, that the industry will not be subject to conflicting regulations because we intend to fully continue that harmonization process.

But I can't guarantee that they won't wind up with different rules because the statutory frameworks are just too different sets of rules.

We don't have any intention of trying to put anybody out of business. There is no interest on our part in doing anything but getting rid of the potential conflicts of interest because we think this is all about accountability, transparency, and eliminating conflicts of interest.

And the SEC rules have a very different—a very different focus.

Mrs. BIGGERT. I have asked them, too. Thank you.

Ms. BORZI. You are welcome.

Mrs. BIGGERT. I yield back.

Chairman ROE. I will finish up this round of testimony with a couple of things.

I think Dr. Holt had hit on some questions that I was going to have is that, I guess, what I would start out by saying is, and I am going to bring us back down to the real world because I have dealt with this as being a, and I am, I was never quite sure whether I was a fiduciary or not trying to interpret these rules, to run the pension plan in my own practice. We had about 300 people that participated in our pension plan.

And trying to go through these rules, and I will just tell you what will happen to us and what will happen to small IRA owners,

right now we can afford to purchase financial advice who is a fiduciary, they would be a fiduciary, I understand that.

I was never quite sure whether I was on our pension committee or now, whether I was a fiduciary or not, and I am less sure when I look at these rules that I have seen so far.

What we do is, and to put that in perspective of what we have here in Congress. Here the best I can tell it is just a free-for-all. You pick out whatever you think will work, which is not a good idea.

Education is an extremely important part. We bring all of our employees in. We sit down and we explain all their options to them. And I think that is a good thing. And I think Dr. Holt brought that up.

The question I have is what problem are you trying to fix. And I understand this won't fix Bernie Madoff.

Ms. BORZI. No.

Chairman ROE. A crook is a crook. So it is not going to fix that. So by doing this it looks to me like it is going to be a little more complicated and what problem out there that you have identified with information? I am not talking about personal testimonials like I got the best doctor in the world. That is a personal testimonial. Maybe you do, maybe you don't.

But real data. Are there data that you can put in this record right here to say that this is a problem. Not an individual person out there that—it is like if I give penicillin to somebody and one person has a reaction, it doesn't mean you quit using penicillin.

Ms. BORZI. No, and we wouldn't act if we thought it was not an important problem.

Chairman ROE. Well, where is the data?

Ms. BORZI. Let me focus on your question vis-a-vis small business. Let me tell you what the problem is for small business.

Small business owners sacrifice a lot to have pension plans for their employees.

Chairman ROE. That would be me.

Ms. BORZI. That would be you. And I will be that you are not the only small business owner in this room who provided a pension plan for your employees.

But I also bet that you are not in the business, I know you are not because we talked, you were not in the business of providing—you weren't an investment professional.

Chairman ROE. No.

Ms. BORZI. So you sought assistance from an expert and you, I would assume, and correct me if I am wrong, you assumed when you hired that expert that that expert was going to give you the very best advice for you and for your employees. And I hope, and I am sure that lots of those experts do do that.

But here is the problem. There is no guarantee that the person who you hired is going to give you the best advisement for you and your employees. I know you don't want to talk about cases, but we have numerous examples where the advice that was given was conflicted.

The person giving the advice got additional compensation, enhanced compensation, because he or she steered——

Chairman ROE. Let me interrupt you there. As long as that is transparent, and I do well with that advice, I don't have a problem with that.

Ms. BORZI. But it is not transparent.

Chairman ROE. Well, we talked about this last year, this past year on making that transparent. That is one of the things that we did do. And I think one of the things that the investment advisors that are out there is that they were like I was. They were trying not to break the law and yet advise people and give them the best investment advice that they could.

And let me ask one other question real quickly because my time is about to expire.

Ms. BORZI. And then may I finish my example?

Chairman ROE. Yes, quickly, if you would.

Ms. BORZI. So here is the problem. Then the advice that the small businessman has been given is inappropriate, imprudent, and a loss occurs to the participants in the plan. In comes the Department of Labor and we investigate. And we conclude, yes, there is been a breach of fiduciary duty. But we cannot go after, under the current regulation, the advisor who gave that employer the advice.

We have to go after the small employer who is the victim. He paid for advice that was not appropriate. So that is the problem we are trying to solve in the plan space.

Chairman ROE. If you have someone who is involved in a swap transaction, will they be a fiduciary?

Ms. BORZI. Not under our regulation, and we have been working closely with the CFTC to make sure that whatever they do in their in their business conduct rules do not make them a fiduciary under ERISA.

And in fact I sent a letter, which we can certainly provide from the letter, to CFTC Chair, Gary Gensler, saying that we do not intend that in these swap transactions they become a fiduciary solely for compliance in the rule. And we have said we will clarify that in our final regulation.

Chairman ROE. Okay. And one last, very quick question is someone who does an appraisal for an ESOP, Mr. Tierney was asking this question, someone who does that, are they considered a fiduciary? Because people that have differing accounts of what something is worth. Look at what bank examiners do to certify the appraisers right now. That doesn't mean that anything was done wrong.

Ms. BORZI. Well, certainly with respect to the initial valuation of the stock, how much is this stock worth, they would, yes, be fiduciaries under this rule.

Chairman ROE. Okay. I have used up my time.

Mr. ANDREWS. Mr. Chairman?

Chairman ROE. Yes?

Mr. ANDREWS. If I may, because it is relevant to this section of the hearing, I would ask you unanimous consent to submit for the record a document from the committee for the fiduciary standard which is selected articles on fiduciary duties applicable to personalized investment advice.

[The compilation of articles may be accessed at the following Internet address:]

http://thefiduciarystandard.org/images/2010__August_The_Fiduciary_Reference_Law_RIA_BD_Issues_final_.pdf

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Chairman ROE. Without objection, so ordered.

I would like to thank you, our witness for taking your time this morning. Certainly it has been very helpful.

I will now ask the second panel to come forward and you are excused, and thank you for being here.

Ms. BORZI. Thank you, Mr. Chairman. I look forward to working with you and talking to all of you and your staff.

Chairman ROE. Thank you.

Ms. BORZI. Thank you.

Chairman ROE. It is now my pleasure to introduce our second panel of witnesses.

Mr. Donald Myers. Mr. Myers is a partner of Morgan, Lewis, & Bockius, LLP where he focuses his practice on the fiduciary responsibility provisions under ERISA.

Prior to entering private practice, Mr. Myers was counsel for ERISA regulations and interpretations at the U.S. Department of Labor. He has chaired various subcommittees of the American Bar Association and has been an adjunct professor at Georgetown University Law Center.

Mr. Myers lectures and writes extensively on employee benefits issues including seminal text on ERISA class exemptions. He earned his LL.M. in taxation from Georgetown University Law Center and his J.D. from Cornell Law School, and his B.A. from the College of the City of New York.

Welcome.

Mr. Kent Mason. Mr. Mason is a partner of Davis & Harmon, LLP where he works primarily with major employers, large plans and national vendors of retirement plan services. He also serves as a council to trade associations including the American Benefits Council.

Prior to joining Davis & Harmon, Kent served as a legislation attorney for the joint committee on taxation as an attorney advisor in the office of tax policy for the U.S. Department of Treasury.

Mr. Mason has a B.A. from Amherst College and received his J.D. magna cum laude from the University of Pennsylvania. After law school he served as a law clerk on the 11th Circuit.

Mr. Norman Stein. Before joining the faculty at Drexler University, Professor Stein was a Douglas Arant Professor of Law at the University of Alabama. He is the co-author of a treatise on Qualified Deferred Compensation Plans.

Professor Stein is a member of the GAOs expert panel on retirement security. He also served on the Department of Labor advisory council on Employee Welfare and Pension Benefits Plan and was a delegate at the White House conference on retirement savings.

He is currently a member of the Board of Governors of the American College of Employee Benefits Council, a fellow of the National Academy of Social Insurance, a member of the Board of Advisors of BNA Pension and Benefit Reporter and a senior policy advisor to the Pension Rights Center.

Professor Stein received a J.D. from Duke University School of Law.

Mr. Jeffrey Tarbell. Mr. Tarbell is the Director of the Houlihan Lokey, San Francisco office. He is a member of the firm's Financial Opinions and Advisory Services Practice.

He has 20 years of experience providing transaction related financial opinions and advisory services to private and publicly traded companies.

Mr. Tarbell speaks frequently on securities of valuation, capital markets, and other financial issues. He has served as reviewer, editor, contributing author, or technical advisor for several valuation text books and publications.

Among other professional accreditations and affiliations, Mr. Tarbell is an Accredited Senior Appraiser of the American Society of Appraisers and an elected member of its Business Valuation Committee.

He is a member of the National Center of Employee Ownership and the Valuation Advisory Committee of ESOP Association.

Mr. Tarbell earned a BS from the University of Oregon, an MBA from the University of Chicago Booth School of Business. And welcome.

Kenneth Bentsen. Mr. Bentsen is the Executive Vice President for Public Policy and Advocacy at the Securities Industry and Financial Markets Association.

From 1995 to 2003 Mr. Bentsen served as a member of the United States House of Representatives from Texas where he sat on the House Financial Services Committee and on the Budget Committee.

He has extensive private sector investment banking experience. Mr. Bentsen has a B.A. form the University of St. Thomas and MPA from American University.

And I can say, as an obstetrician, all these lawyers make me a little nervous. [Laughter.]

Before I recognize you for your testimony, let me explain the lighting system as we did previously. The red light, excuse me, the green light goes on for 4 minutes, amber light for one, and then, please, we won't interrupt you, but if you would wind up your comments at the end of that time I would appreciate that.

And now, I will recognize Mr. Myers for your opening statement.

STATEMENT OF DONALD MYERS, PARTNER, MORGAN, LEWIS & BOCKIUS, LLP

Mr. MYERS. Thank you. Chairman Roe, Ranking Member Andrews, other members of the subcommittee, thank you for the opportunity to speak today.

I have provided a written statement, and I will just summarize the high points of that statement. I will briefly provide some background on the proposal and then talk about some of the process issues involved at the Department of Labor.

The centerpiece as we heard today of the ERISA fiduciary rules is the fiduciary. ERISA defines the fiduciary using a functional test to the extent a person provides investment advice for a fee. To that extent, the person is a fiduciary.

Fiduciaries are subject to ERISAs general fiduciary standards as well as its prohibited transaction rules. The latter prohibits a wide variety of transactions, many of which occur in the ordinary course of business.

There are serious consequences for violating these rules. Where the transaction is prohibited, the fiduciary who caused the transaction has potential liability and the disqualified person involved in the transaction, which could be the fiduciary, would be liable for an excise tax of 15 percent of the amount involved in the transaction until the transaction were corrected. There are additional taxes and civil penalties that could be imposed.

One of the major problems raised by the proposed redefinition of the term fiduciary is DOLs broad interpretation of these rules. According to DOL, if a person is a fiduciary by giving investment advice and receives compensation that can vary according to the advice, then the fiduciary would automatically violate ERISA even if the transaction is in the interest of the plan that would otherwise be prudent.

To lessen the potential impact of the prohibited transaction rules, DOL has granted individual and class exemptions. The latter are available to anyone who can meet the conditions of the exemption. DOL has granted 59 class exemptions and several hundred individual exemptions.

The class exemptions have created a regulatory-like framework that along with the statutory exemptions govern a significant portion of plan activities.

The proposed regulation would apply to both IRAs and ERISA plans, although they are fundamentally different. Both Congress in enacting ERISA and DOL in issuing exemptions and regulations have acknowledged those differences.

The proposal would make significant changes to the regulatory guidance that was adopted in 1975 and on which the financial services industry and others have come to rely. If adopted as proposed, the regulation would require fundamental changes in the way business is conducted.

The impact of specific provisions will be addressed by other witnesses. I will now focus the remainder of my comments on the regulatory process.

Many of the issues raised by the financial services industry stem from the concern that currently accepted and longstanding practices may suddenly become prohibited.

The DOL staff has responded that these issues can be addressed to the exemption process. I see two problems with the exemptions approach.

First, existing class exemptions would not provide necessary relief without a number of modifications or clarifications. DOL could modify or clarify existing class exemptions or propose a new exemption. So this by itself would not be an insurmountable barrier.

The second problem is that modifying a class exemption or granting a new exemption can be a long, complicated process. It is crucial to coordinate the exemptions with the final regulation.

We expect, based on the large number of comments submitted and the issues discussed at this hearing today, that there will be

a number of changes to the proposal. That alone should be a reason for DOL to re-propose its regulation.

There is also a need for the public to comment on whether any new or modified exemption effectively addresses the prohibited transaction issues. The affected public will have to determine whether the conditions of the exemptions are feasible or, on the other hand, too complicated or unworkable.

This cannot be done unless the exemptions are proposed in conjunction with re-proposal of the regulation so that the two can be considered together and modified as necessary.

For these reasons, it is my view that only by re-proposing the regulation at the same time as it proposes exemptive relief will DOL give the public sufficient opportunity to review and comment on all aspects of this new regulatory scheme.

I would be happy to answer any questions.

[The statement of Mr. Myers follows:]

Prepared Statement of Donald J. Myers, Partner, Morgan, Lewis & Bockius LLP

Chairman Roe, Ranking Member Andrews and other members of the Subcommittee, I want to thank you for giving me the opportunity to testify today.

My name is Donald Myers. I am a partner in the law firm of Morgan, Lewis & Bockius LLP in Washington DC. My practice focuses on the fiduciary responsibility rules of the Employee Retirement Income Security Act of 1974 ("ERISA"), primarily relating to investment matters. I assist pension plans and financial institutions in structuring investments for plans, and represent clients before government agencies, including the Department of Labor (the "DOL"), on ERISA-related issues.

Before entering private practice in 1984, I was Counsel for ERISA Regulation and Interpretation at the DOL. Previously, I was Assistant Chief of the Office of Disclosure Policy and Proceedings at the Securities and Exchange Commission. I have chaired various subcommittees of the American Bar Association dealing with employee benefit plans and ERISA fiduciary responsibility matters, and have been an Adjunct Professor at Georgetown University Law Center. In addition, I am a Charter Fellow of the American College of Employee Benefits Counsel. I have lectured and written extensively on employee benefits issues, with my publications including the book ERISA Class Exemptions, and chapters on class exemptions and trustee responsibility in the treatise ERISA Fiduciary Law.

My testimony today will provide some background on the ERISA fiduciary rules and then focus on the DOL's regulatory and exemptions process in the ERISA area, based on my experience at the DOL and in private practice. I am speaking here today on my own behalf.

ERISA Fiduciary Rules, Prohibited Transaction Provisions and Exemptions

The centerpiece of the ERISA framework for the administration and management of employee benefit plans is the role of the fiduciary. ERISA defines who is a fiduciary using a functional test, including the activities of discretionary management over plan assets and, as relevant to today's hearing, rendering "investment advice" for a fee or other compensation regarding plan assets.

A person who is an ERISA fiduciary is subject to the ERISA fiduciary responsibility rules, which can be divided into two categories—the general fiduciary responsibility rules, and the prohibited transaction rules.

The general fiduciary responsibility rules impose standards of fiduciary conduct. They require a fiduciary to act prudently and solely in the interest of the plan participants and beneficiaries, to diversify plan investments unless clearly prudent not to do so, and to follow the plan documents and instruments so long as they are consistent with ERISA.

The prohibited transaction rules consist of two parts. The first part prohibits transactions between a plan and parties with certain relationships to the plan, so-called "parties in interest" or "disqualified persons"; these include non-fiduciary service providers. The second part prohibits plan fiduciaries from engaging in self-dealing and conflicts of interest.

There are two sets of consequences to a breach of fiduciary duty. First, the breaching fiduciary can be personally liable to the plan for any loss suffered by the

plan in the transaction that was a breach, or any gain received by the fiduciary as a result of the transaction. Second, where the transaction is prohibited, the disqualified person engaging in the transaction with the plan (which person may or may not be the fiduciary) is liable to the government for an excise tax of 15% of the amount involved in the transaction for each year until the transaction is corrected; if the transaction is not corrected, a 100% excise tax may be imposed. The DOL also may impose civil penalties of 20% of the amount it recovers from a breaching fiduciary in an enforcement action. These are serious consequences.

In my experience, financial services firms seek to avoid these potential liabilities and penalties by implementing policies and procedures intended to comply with DOL regulations and interpretations of the ERISA fiduciary rules.[1]

This is in large part because the DOL has interpreted the prohibition on fiduciary self-dealing in an expansive way. According to the DOL, a fiduciary violates this prohibition wherever it has the authority to affect the amount of compensation it receives from the plan, or in connection with a transaction involving plan assets. Under this view, if a person becomes a fiduciary by giving investment advice for a fee for a transaction involving plan assets, and receives variable compensation as a result, the person has violated ERISA, even if the transaction is in the interests of the plan and is otherwise prudent.

To lessen the potentially broad scope of the prohibited transaction rules, ERISA contains a series of exemptions from those rules, and authorizes the DOL to establish a procedure for granting exemptions. The DOL may grant an individual exemption to a particular party, or a "class" exemption that is available to anyone in a defined class that is able to comply with its conditions. To grant an exemption, the DOL must first find that the exemption is (1) administratively feasible, (2) in the interests of the plan and its participants and beneficiaries, and (3) protective of the rights of plan participants and beneficiaries. Exemptions are published for comment in the Federal Register, and, if the exemption provides relief from the prohibited transaction provisions on fiduciary self-dealing and conflicts of interest, there must be an opportunity for a hearing. Using this authority, the DOL has granted 59 class exemptions, several hundred individual exemptions, and additional exemptive relief through an expedited exemption procedure. The class exemptions have given rise to a regulatory framework that, along with the statutory exemptions, governs a significant portion of plan activities.

1975 Fiduciary Regulation and Class Exemptions

The ERISA fiduciary rules came into effect on January 1, 1975. According to the ERISA conference report, the conferees were concerned that the application of ERISA's fiduciary standard could be disruptive to the established business practices of financial institutions.

In 1975, the DOL both granted an exemption, Prohibited Transaction Exemption ("PTE") 75-1, covering securities brokerage transactions and related services, and issued a regulation defining the scope of the "investment advice" prong of the fiduciary regulation. PTE 75-1 established the conditions under which broker-dealers could continue to provide multiple services to plan clients without running afoul of the prohibited transaction rules. The regulation created a five-part test for determining when a "person" becomes a fiduciary to a plan by reason of providing "investment advice."

For almost 36 years, this five-part test has provided certainty and clarity as to whether a person had entered into a relationship that would subject that person to the ERISA fiduciary rules. It forms the basis upon which financial services firms historically have based their compliance procedures, structured their financial products and services, implemented their fee and compensation arrangements, established their business relationships and distribution channels, and generally interacted with their plan clients. The five-part test has now been in place for nearly four decades without any objection from Congress that it was contrary to legislative intent.

Rules for Individual Retirement Accounts of IRAs

There are currently more than 40 million IRAs. Most IRAs are not subject to ERISA or ERISA's standard of care. However, they are covered by the Internal Revenue Code's (the "Code's") prohibited transaction provisions, which are substantially

[1] It should be noted that, with limited exceptions, individual retirement accounts ("IRAs") are not subject to ERISA, but are subject to the prohibited transaction rules through parallel provisions in the Internal Revenue Code. While fiduciaries of IRAs thus would not be subject to liability for a fiduciary breach under ERISA, disqualified persons (such as fiduciaries) of IRAs could still be subject to an excise tax under the Internal Revenue Code for engaging in prohibited transactions.

parallel to those of ERISA. While responsibility for interpreting the Code's prohibited transaction provisions has been transferred to the DOL, the Internal Revenue Service (the "IRS") retains full enforcement authority over these Code provisions. Thus, DOL has no enforcement jurisdiction over the vast majority of IRAs.

As individual accounts, IRAs are fundamentally different from ERISA plans. These accounts are generally small and are overseen by the IRA beneficiary, who has the ability to choose an IRA's service providers and can generally move the account at will. Congress recognized these differences when it applied a comprehensive fiduciary standard of care to ERISA plans and only applied the prohibited transaction rules to IRAs. On a number of occasions, the DOL also recognized these differences, applying different conditions when crafting certain of its prohibited transaction exemptions and regulations. For example, PTE 86-128 (and its precursor PTE 79-1), a class exemption for securities brokerage, and the Interim Final regulation under ERISA section 408(b)(2), which contains disclosure requirements, do not apply certain of their conditions to IRAs.

Proposed Fiduciary Regulation

The proposed regulation that is the subject of this hearing would make significant changes to the regulatory guidance that was adopted in 1975, and upon which the financial services industry has come to rely. I am not going to speak on the pros and cons of specific features of the proposal—those issues have been addressed in several hundred comment letters, and will be discussed further by the other witnesses on this panel. Instead, I am going to focus on the regulatory process.

There is much concern in the financial services industry about potential ramifications if the proposal is adopted in its current form. Many (if not most) of the issues being raised by the financial services industry stem from concern that currently accepted and long-standing business practices may, under the new regime, suddenly become prohibited transactions. The DOL staff has responded that these issues can be addressed through the exemptions process. In view of prior DOL practices, this is a logical response where new-found fiduciary status raises concerns about violations of the ERISA prohibited transaction rules.

What could facilitate this process is that there are already several class exemptions that could cover some of the transactions that would be affected by the new DOL rule. The three that come to mind are: (1) PTE 86-128, for a fiduciary to cause a plan to execute securities transactions for a fee through itself or an affiliate (i.e., agency brokerage); (2) PTE 84-24, for a fiduciary to cause a plan to pay the fiduciary or an affiliate a commission as an insurance agent or broker in connection with the purchase of an insurance or annuity contract (i.e., insurance brokerage) or as a mutual fund principal underwriter; and (3) PTE 75-1, Part II, for transactions in third-party mutual fund shares.

The question is whether the approach of dealing with the anticipated impacts of the new rules through the exemptions process would be effective here. I see two problems with the exemptions approach.

The first problem is that the existing class exemptions would not, without modification or clarification, provide exemptive relief for all transactions that would be affected by the proposal. The DOL could work to modify and/or clarify the existing exemptions, or propose a new class exemption more specifically focused on the business practices that would be affected. So this, standing alone, would not necessarily be a barrier.

However, this leads to the second problem, which is that modifying a class exemption, or granting a new class exemption, can be a long, complicated process. On average, the process usually takes at least a year, and frequently longer. For more complicated transactions and arrangements, as could be involved here, more time may be needed to sort through the necessary relief and to develop conditions that are workable for the plan fiduciaries and service providers. Yet more time would be necessary if a hearing were requested, which could be the case for a major exemption that affects a large portion of the financial services industry. The point is that modifying existing exemptions takes time, and developing a new exemption would take even more time—the process must allow for that.

The timing issue is important when considering how to coordinate the exemptions with the finalization of the regulation. It is likely, based on the 201 comments that were filed with the DOL on the original proposal, the testimony at the DOL hearing in March and the 65 additional comments submitted after the hearing, that there will be a number of significant changes to the proposal. That alone should be a reason for the DOL to re-propose its regulation, in order to give affected firms an opportunity to review the new provisions and comment on how they are dealing with the issues that were raised on the original proposal. Another reason is that the proposal did not mention IRAs, except for a brief reference in the opening summary,

and provided no economic analysis of the impact on IRAs (the focus of the economic analysis was entirely on ERISA plans). There should be an analysis of the effect on IRAs, including whether there is any benefit to additional regulation of IRAs under the Code's prohibited transaction rules in light of the current regulatory regimes that govern the IRA market, and an opportunity to comment on that analysis.

There also is a need for affected parties to comment on whether any new or modified exemption proposed by the DOL effectively addresses the prohibited transaction issues created by the new rules. The parties will have to determine whether it is feasible for them to operate under the conditions of the exemptions—if the conditions are too complicated or unworkable, the exemptions will not be of any help. This cannot be done unless the exemptions are proposed in conjunction with re-proposal of the fiduciary definition regulation, so that the two can be considered together and modified as necessary based upon the comments.

For these reasons, it is my view that if the DOL elects to rely on exemptions to deal with the effects of an expanded fiduciary definition, it should re-propose the changes to the fiduciary definition in coordination with its proposal of exemptive relief. This would give affected parties sufficient opportunity to review and comment upon all aspects of this new regulatory structure.

Again, thank you for giving me the opportunity to testify, and I would be happy to answer any questions that you may have.

Chairman ROE. Thank you.

Mr. Mason.

STATEMENT OF KENT MASON, PARTNER, DAVIS & HARMAN, LLP

Mr. MASON. Thank you.

My name is Kent Mason. I am with the law firm of Davis & Harmon, and I have to admit that having worked in the benefits area for almost 30 years, hard since I am, you know, just 35. [Laughter.]

I want to thank you, Mr. Chairman, Ranking Member Andrews for holding this hearing and for inviting me to testify.

I want to focus today on five issues. First, I want to focus on really on something that hasn't been talked about which is the common ground between the industry and the department.

Second, I would like to talk about the process, third, I would like to talk about the issue of conflicted advice, fourth, I would like to talk about swaps which have been briefly mentioned, and fifth, I would like to talk about the effect on small business.

Okay. First, although there has been a tremendous amount of concern articulated with respect to these proposed regulations, I think that there is actually a significant amount of common ground between the department and the industry.

For example, I think the basic notion that we should be revisiting and—and reviewing a regulation that is 36 years old and was written at a time that was vastly different, I don't think that is something that I think the industry as I talk to them have any concern about.

In addition, I think a number of the principles that the department has articulated, you know, make solid sense. For example, the department has said that advisors should be legally required to stand behind their advice. That makes sense.

Another thing the department has said is that if an advisor tells a customer that they are a fiduciary they shouldn't be able to disclaim that status later on. Again, that makes sense. These are just examples.

Second, I want to turn to process. Briefly, this regulation needs to be re-proposed. The department did not do an economic study of

IRAs. This department in its preamble repeatedly indicated that they were not sure what the economic effect of the regulation would be.

These economic studies need to be completed and they need to be available for public comment. It would not be appropriate for these economic studies to show up for the first time in a final regulation with no opportunity for public comment.

In addition, the concern that has been noted here today with respect to this regulation is widespread and bipartisan. Republicans and Democrats have written, far more Democrats than Republicans, employer groups, the Consumer Federation of America, all have expressed the same concern that this regulation has the potential to greatly reduce the availability of investment services and thus retirement savings.

So the question really isn't whether to re-propose. The question is why would anyone not want to re-propose? The important part is we need to get this right.

Third, and I want to briefly talk on this, some have suggested that the industry position is in favor of what is called conflicted advice. On the contrary, the industry position supports the fiduciary principles articulated in Dodd-Frank, and I don't think there are many in Congress who believe that Dodd-Frank stands for the principle of conflicted advice.

Fourth, swaps. There is a direct conflict between the proposed fiduciary regulations and the proposed business conduct standards coming out of the CFTC. That conflict would prohibit plans from using swaps which could cost plans, large plans, somewhere in the neighborhood of 100 million to a billion dollars annually.

The department has written a letter to the CFTC, as Phyllis mentioned, saying there isn't a conflict. The ask in this regard is very simple and that is what the department said in its letter needs to be reflected in binding legal guidance issued on or before the final business conduct standards are issued.

The last thing, I want to talk about small business. Today broker dealers and other financial institutions provide critical help to small businesses in putting together their retirement plans. Under these regulations, that help would be illegal.

In addition, under these regulations investment education, unless this is clarified, investment education would dry up and that is critical to small businesses.

Lastly, the small business owners would face much higher costs and potential liabilities in forming a plan. All of this will sort of greatly decrease plan formation along small businesses and exacerbate our coverage challenges.

Thank you, and I would be happy to take any questions.

[The statement of Mr. Mason follows:]

Prepared Statement of Kent A. Mason, Davis & Harman LLP

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 almost 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, Mr. Chairman and Ranking Member Andrews, 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. I have been asked to focus my comments today primarily on the challenges that the proposed regulation creates for plan sponsors. That is an area that has received less attention, and I am very happy to address it.

But first I will discuss three fundamental questions: (1) should the definition of a fiduciary be reviewed, (2) if so, what process should be used to review that definition, and (3) if the proposed regulation is revised to address industry concerns, would harmful conflicted advice be permitted?

Should the Fiduciary Definition Be Reviewed?

The threshold question is whether the definition of a fiduciary should be reviewed and updated. The community that I work with understands the desire to update a regulation that was drafted 36 years ago when the retirement savings world was vastly different.

In addition, the community I work with agrees with certain basic objectives that the Department has set out to achieve. For example:

• Those who provide advice regarding investments should be required to stand behind their advice legally. I believe that that is generally the case already, but to the extent it is not, that should be made clear.

• A service provider who represents himself or herself to be a fiduciary should not be permitted to later contest that status if an investor makes a claim against the advisor. When a service provider purports to be a fiduciary acting exclusively for the benefit of a plan, participant or IRA owner, the service provider should not be able to retroactively disclaim that status.

• The law regarding fiduciary status needs to be clear so that all parties fully understand the nature of their relationship.

• It is critical to draw a distinction between selling and advising, so that the fiduciary rules do not preclude normal selling activities.

In short, I believe that there is a vast amount of middle ground where the Department and the industry can come together.

The Process

Background. The definition of a "fiduciary" is a critical component of the protections provided by ERISA. The definition can also trigger enormous responsibility and potential liabilities. In this context, it is essential that the issue be addressed deliberately through a full public policy dialogue.

The Department has in recent years approached numerous topics in a very deliberate, inclusive manner by issuing a "Request for Information" ("RFI") prior to issuing a proposed regulation. This was not done here. That put the Department at an informational disadvantage as it set out to draft the proposed regulation.

This information disadvantage naturally was reflected in the proposed regulation:

• The Department did not perform any cost analysis with respect to the effect of the proposed regulation on IRAs.

• In the preamble to the proposed regulation, the Department repeatedly stated that it did not know the effect of the proposed regulation on the market.

• "The Department's estimates of the effects of this proposed rule are subject to uncertainty * * * It is possible that this rule could have a large market impact."

• "For example, the Department is uncertain regarding whether, and to what extent, service provider costs would increase * * *. The Department is also uncertain whether the service provider market will shrink because some service providers would view the increased costs and liability exposure associated with ERISA fiduciary status as outweighing the benefit of continuing to service the ERISA plan market."

• "The Department * * * tentatively concludes that the proposed regulation's benefits would outweigh its costs." (emphasis added)

• "The Department is unable to estimate the number of small service providers that would be affected by the proposal."

• "The Department also is unable to estimate the increased business costs small entities would incur if they were determined to be fiduciaries under the proposal."

• "It is possible that some small service providers may find that the increased costs associated with ERISA fiduciary status outweigh the benefit of continuing to service the ERISA plan market; however, the Department does not have sufficient information to determine the extent to which this will occur."

• The proposed regulation has raised grave concerns across the political spectrum, among Democrats and Republicans, among employer groups and the Consumer Federation of America. The concern is that the proposed regulation would have very adverse unintended consequences and result in a dramatic decrease in both the avail-

ability of critical investment information for low and middle-income employees and the efficient delivery of workforce retirement plans.

• The existence of these unintended consequences run contrary to the Department's stated goal of ensuring that individuals have access to reliable advice, and result from the Department's information disadvantage; without the RFI process, the Department had to write the regulation in a data vacuum.

• A study in the IRA area stated that if the proposed regulation is finalized in its current form:

• Approximately 360,000 fewer IRAs would be established every year.

• Solely within the study example, over seven million IRAs would lose access to an investment professional. Since the study sample included 40% of the IRA market, this could mean that nationally approximately 18 million IRAs could lose such access.

• Within the study sample, it was established that there could be a $96 billion reduction in IRA assets through 2030; if that number is extrapolated to the national market, the loss would be approximately $240 billion.

• Costs for those who retain access to an investment professional would roughly double.

• The Department has informally stated on many occasions that in order to make the proposed regulation workable and avoid depriving investors of investment information, the class exemption rules needs to be modified. To date, no modifications have been proposed.

• The Department's regulations would force the restructuring of plan systems that have developed over 36 years based on the current definition of a fiduciary. To avoid widespread disruption, it is critical that any changes to this fundamental rule be done very carefully based on a full public policy dialogue. Without such a careful review, we are risking an enormous reduction in investment information and retirement savings. We could also trigger a very significant wave of job losses throughout the industry, including, for example, registered representatives who are not licensed to provide advice.

Recommended process. The point here is that the proposed regulation could well have vast and very serious unintended consequences. In that context, the next steps seem clear.

• The economic studies of the effect of the proposed regulation need to be completed.

• Those studies need to be the subject of public comment. It would be strikingly inappropriate not to give the public an opportunity to review the economic basis for the regulation.

• At the same time that the economic study is made available for public comment, the regulation itself should be reproposed. In the light of the concerns that have been raised on a bipartisan basis and the importance of the topic, there would not appear to be any reason not to repropose. Why not get this right through a robust public dialogue?

• At the same time as the regulation is reproposed, all associated new class exemptions needed to make the regulation work need to be proposed. The regulation and these new class exemptions have to work together. To finalize the regulation and then work on the class exemptions does not make sense. Moreover, if the regulation is finalized first, financial institutions will need to immediately begin work on restructuring their businesses to reduce services; they cannot wait based on the possibility that helpful class exemptions may someday be adopted.

If the proposed regulation is revised to address concerns, would harmful conflicted advice be permitted?

The regulation can easily be modified to address concerns without permitting harmful conflicted advice.

First, many of the concerns regarding the proposed regulation relate to the fact that almost any casual discussion regarding investments becomes fiduciary advice. For example, if an employee in a company's human resources department is asked whether a participant's investment choices resemble other employees' choices, any casual response—such as "I am not an expert, but they seem similar"—would be fiduciary advice. This result is clearly erroneous and should be corrected, and correcting this type of problem cannot be said to permit conflicted advice.

Second, the Department itself recognizes that there is a sharp difference between advising and selling, and that the elements of a sale may occur over a period of time, and are not just a moment in time event. If an entity (1) is selling products or services, (2) can benefit from which product or services is chosen, and (3) makes full disclosure regarding that potential benefit, such actions are selling, not advice. Clarification of that point through a reproposal process would be extremely helpful, without raising any possibility of conflicted advice.

Third, we can all benefit from the deep consideration given to the fiduciary issue by Congress in the context of the Dodd-Frank Act. In Dodd-Frank, Congress determined that the receipt of variable compensation based on the investment advice given is consistent with a fiduciary duty and does not give rise to a harmful conflict of interest, provided that the variable compensation is fully disclosed. The industry is supportive of the principles underlying the Dodd-Frank provision and would be pleased to see those principles applied to the proposed regulation.

In short, I believe that the modifications needed to the regulation will not give rise to harmful conflicts of interest.

Plan Sponsor Concerns

Swaps

Plan sponsors use swaps to manage the funding risks inherent in defined benefit plans. Without risk mitigation strategies, fluctuations in interest rates can cause pension liabilities to fluctuate wildly, leading to extremely volatile funding obligations. A company's funding obligations can easily move by hundreds of millions of dollars—or even billions of dollars—by reason of interest rate movements. This can jeopardize the company's stability as well as undermine the security of the participants' benefits.

There are three ways to address this volatility. First, a company can reserve enormous amounts of cash in order to be prepared for the volatility. In today's economic climate, that would result in massive layoffs and stalled economic recovery. Second, a company can use swaps, which were designed for exactly this purpose. Third, a company can use bonds to hedge the risk; bonds are far less effective and more expensive than swaps. The bond approach could, for example, cost large companies from $100 million to $1 billion or more annually, when compared to swaps.

Unfortunately, the plans' ability to use swaps is threatened by the Department's fiduciary definition. There is a direct conflict between the Department's proposed fiduciary definition and the proposed business conduct standards issued by the Commodity Futures Trading Commission ("CFTC") pursuant to the Dodd-Frank Act. Briefly, the proposed business conduct standards require swaps dealers and major swap participants ("MSPs") to take three actions that would, under the Department's proposed fiduciary regulation, convert swap dealers and MSPs into ERISA fiduciaries with respect to plan counterparties: (1) the provision of information regarding the risks of the swap, (2) swap valuation, such as providing mandated daily marks, and (3) a review of the ability of the plan's advisor to advise the plan with respect to the swap. Even under the Department's current investment advice regulations, we believe that the third action could convert swap dealers and MSPs into ERISA fiduciaries. If the swap dealer is a plan fiduciary, a swap with the plan would be a prohibited transaction and thus illegal. In such a case, all ERISA fiduciaries participating in the transaction could have liability, and the dealer or MSP could be subject to an excise tax equal to 15% per year of the amount involved in the transaction. The penalties are so severe that absent regulatory clarity, no one would risk them.

The Department has written a letter to the CFTC that takes the position that the business conduct standards would not convert swap dealers and MSPs into fiduciaries under the proposed regulation, because of the "seller's exception" (also referred to as the counterparty exception) in the proposed Department regulation. Further, the Department confirms that the treatment of swaps dealers and MSPs as fiduciaries was not intended.

The letter's statement of the Department's intent is helpful, as is the letter's analysis of the regulation. Unfortunately, the letter is (1) non-binding, (2) only an informal analysis of two proposed regulations, and (3) in the view of the private sector lawyers I have talked to, inconsistent with the regulatory language. Accordingly, the Department's letter cannot be relied on by attorneys in analyzing the law or giving opinions with respect to this issue. Based on extensive discussions with the swap industry, ERISA plans, investment advisers, and swap dealers would generally be unable to obtain opinions from internal or external counsel that a swap dealer's compliance with the CFTC's business conduct standards would not expose such dealers and the plan fiduciaries to the risk of a prohibited transaction under ERISA. As noted above, because of the severe penalties involved, unless the regulation is modified so that this issue is clear, most swaps with plans will likely cease. Major plans will not take a chance that they are entering into prohibited transactions in the face of a regulation that is unclear at best and adverse at worst. Plans, their fiduciaries, and their counterparties are meticulous in their efforts to comply with the Department's prohibited transaction rules. They would likely conclude that it would be inadvisable, from both an ERISA and business perspective, to rely on a

non-binding letter in the face of a regulation that is, as noted, at best unclear and at worst adverse.

Groups have met with the Department and have suggested that the DOL issue binding guidance that simply makes it clear that the two regulations are not in conflict. Briefly, the guidance would state that no action required by reason of the business conduct standards will make a swap dealer or major swap participant a fiduciary. The Department has, however, expressed reluctance to do this. That has set off alarm bells throughout the swap industry. If the Department is not comfortable stating that there is not an irreconcilable conflict between the regulations, it is hard to imagine that the private sector can get comfortable with entering into swaps involving ERISA plans.

Very specifically, here is the language that was recommended be inserted in the preamble to the CFTC's final business conduct standards. This language can only be inserted with the Department's approval.

The Department of Labor has informed the Commission that, in the case of a swap with a plan subject to the Employee Retirement Income Security Act of 1974 ("ERISA"), no action of a swap dealer or major swap participant that is required by reason of these business conduct regulations will make such swap dealer or major swap participant a fiduciary under ERISA with respect to such plan, either under current law or under the final version of the Department of Labor's proposed regulations with respect to the definition of a fiduciary. The Department of Labor has further informed the Commission that the Department will, within 180 days of publication of the Commission's final business conduct regulations, state in regulations, rules, or similar guidance, effective as of the effective date of the Commission's final business conduct regulations, that no action of a swap dealer or major swap participant that is required by reason of these business conduct regulations will make such swap dealer or major swap participant a fiduciary under ERISA with respect to such plan.

If the business conduct standards are finalized without this or similar language, swaps with plans will generally cease. Such language is essential.

In short, in order to avoid the very negative consequences to pension plans of being unable to use swaps, on or before the finalization of the business conduct standards there needs to be legal clarity on the fundamental point that no action required by reason of the business conduct standards will make a swap dealer or an MSP a fiduciary under current law or under the final version of the DOL's proposed regulations.

Effects on Small Businesses

As discussed more fully below, the effects of the proposed regulation would be very adverse with respect to the retirement security of employees of small businesses:

- Neither broker/dealers nor other financial institutions would be able to assist small businesses with respect to critical elements of plan maintenance. If such entities cannot help small businesses in this regard, plan formation would fall sharply.
- Investment education, which can give employees the knowledge needed for them to be comfortable participating in a plan, would largely dry up.
- Small business owners who consider starting a plan would face massive increases in potential liability and uncertainty and in the cost of services, which would make them far less likely to adopt a plan.

Plan maintenance/investment options. It is very well known that retirement plan coverage among small businesses is far lower than among all other organizations. The reasons are straightforward: cost, burdens, liability, and complexity. In this context, please consider the following scenario.

A financial institution approaches the owner of a 12-employee hardware store about setting up a 401(k) plan. The owner is willing to consider adopting a plan as long as the plan's formation is simple and inexpensive and does not create any material liability for him.

The financial institution discusses the plan terms and structure. Then, the subject of investment options is raised: when the plan is established, the owner will have to choose investment options to be made available to plan participants. The financial institution has, for example, 500 investment options, which the hardware store owner will need to narrow down to, for example, approximately 20 or 25, so as not to overwhelm the employees. Today, the financial institution could, for example, provide the owner with model portfolios chosen by similar employers and could explain the differences among the portfolios so that the owner can make an informed choice.

For a plan maintained by a small business owner, in particular, the investments will predominantly be mutual funds. The funds pay the financial institution various forms of "revenue sharing." The amount of revenue sharing will vary from fund to

fund and is generally paid whether or not the fund is held in a retirement account. It is this system of revenue sharing that has made mutual funds an affordable investment form.

Under the proposed regulation, helping the owner choose the plan's investment options would make the financial institution a fiduciary. This would mean that such help would be a prohibited transaction if, as is the norm, some options benefit the financial institution more than others by reason of different levels of revenue sharing and/or the existence of both proprietary and non-proprietary funds. The help would be a prohibited transaction regardless of how small any additional benefit may be and regardless of the soundness of the help provided by the financial institution.

So the financial institution would have to tell the owner that he has two choices. First, the owner could review thousands of pages of information provided by the financial institution regarding the 500 investment options and make his own choice, subject to fiduciary liability. Or second, the owner could try to find a qualified third party to help make the selections, pay that third party for that service, and continue to pay the third party indefinitely to monitor the investment options.

This scenario would play out across the country if the Department's proposed regulation is adopted. The effect on small business retirement plan coverage would be very adverse.

Plan maintenance/brokers and dealers. Brokers and dealers play a major role in helping small businesses adopt plans. Often, a broker/dealer will have a relationship with a small business owner. The broker/dealer who handles the owner's non-retirement retail account may raise the possibility of the owner adopting a 401(k) plan. Like the financial institution situation described above, this is a very common means by which small business owners adopt plans.

Unfortunately, under the proposed regulation, the commission-based brokerage model becomes illegal due to the broker/dealer's receipt of, for example, fully disclosed revenue sharing. So the broker/dealer cannot be compensated for helping the owner with the formation and operation of a 401(k) plan. Logically, then, the broker/dealer will instead work with the owner on her non-retirement retail account, since that is the only account the broker/dealer is permitted to work with.

Investment education. It is common today for financial institutions to provide plan participants and plan sponsors with investment education. This can be very helpful in encouraging business owners to adopt plans and in encouraging employees to participate in those plans.

Under current law, it is generally agreed that information about asset allocation principles is "education" and does not trigger fiduciary status. So investment professionals can, without becoming fiduciaries, educate plan participants about different asset classes, and what mix of asset classes is most appropriate in different circumstances. The basis for the understanding regarding education is Department Interpretive Bulletin 96-1 ("96-1"). Reliance on this bulletin is widespread and the concepts behind it are generally well received. In small businesses especially, this type of education can be helpful in encouraging employees to participate in a plan. If such education triggered fiduciary status, the provision of the education would largely dry up, due largely to the prohibited transaction rules, but also due to liability concerns.

There is great concern that the proposed regulation would sharply decrease the provision of investment education. It is true that the proposed regulation expressly states that education under 96-1 does not give rise to fiduciary status. However, unlike present law, it appears that under the proposed regulation information about asset allocation would trigger fiduciary status but for the explicit exception for 96-1 education. This has caused the following concern. If education does not comply precisely with 96-1, education becomes fiduciary advice. But 96-1 is not a detailed set of rules; it is largely conceptual, which makes it hard to be certain of compliance.

In this context, many education providers have expressed grave doubts that they would continue providing investment education if the proposed regulation were finalized. This is not an unfounded concern by any means, since 96-1 itself notes that whether information is education or fiduciary advice is turns on the facts and circumstances of the particular situation. The proposed regulation states that information may be advice if it "may be considered" in connection with making plan investments. Since it can reasonably be expected that education about investment may be considered by the recipient in making investment decisions, providers of needed education will likely restrict the information that they provide due to the chance that they might become fiduciaries for providing what they consider to be educational materials.

Distribution education. In the preamble to the proposed regulations, the Department raised the possibility of modifying the law to treat distribution counseling and

education as investment advice. This issue has the potential to create significant uncertainty and dramatically reduce the provision of basic information regarding distribution issues. At a minimum, any change in the law should be implemented through the regulatory process with an opportunity to comment on proposed regulatory language.

Liability and uncertainty. Under the proposed regulation, almost any discussion of investments would give rise to fiduciary status. So small business owners would face very serious potential liabilities and uncertainties if they or their managers respond to any employee inquiries regarding plan investments. This type of exposure would be a very significant disincentive to plan formation and maintenance. Similarly, if service providers are converted into fiduciaries, the service providers will need to charge more to cover their increased potential liability. This will be another powerful disincentive to plan formation.

In short, the proposed regulation would dramatically reduce small business plan formation by precluding financial institutions from assisting small businesses in this regard. Investment education would largely dry up, making employees far less comfortable about participating in a plan. And small business owners would be discouraged from establishing a plan by the creation of far more potential liability and higher costs.

Additional Plan Sponsor Concerns

Because the proposed regulation was written without the benefit of prior input, the list of concerns is extremely extensive. I will simply provide two additional examples of plan sponsor concerns.

Plan sponsor employees: who should be a fiduciary? By very significantly lowering the threshold for fiduciary status, the proposed regulation raises serious questions regarding which plan sponsor employees may be treated as fiduciaries. For example, it is, of course, common for a plan sponsor to form a committee of senior executives to oversee plan issues, including plan investment issues. It is certainly clear that such committee has fiduciary status. But plan sponsors have expressed concern about the status of other employees who perform the research and analysis necessary to present investment issues for the committee's review and resolution.

Such other employees may provide recommendations for the committee to consider. This is simply how companies work. Middle-level employees frame issues for senior employees to resolve; issues are best presented in the context of a recommendation based on the advantages and disadvantages of any decision, so that senior employees can quickly appreciate the relevant factors. Many employees may participate in the research and the preparation of the recommendations to the committee. If all of these employees were fiduciaries, the effects would be severely negative.

- The cost of fiduciary insurance would skyrocket, if such insurance would be available at all for such employees.
- It would certainly become more difficult to get employees to work on these projects in the face of potentially staggering liabilities and lawsuits.
- Creative work and recommendations would likely be stifled as middle-level employees propose conservative approaches with less downside (and correspondingly less upside).

The bottom line is that the employees preparing the reports for the plan committee are not the decision-makers. They are the researchers who prepare recommendations based on objective criteria for the committee members to evaluate and resolve. And the proposed regulation could potentially sweep in a huge number of employees, since the middle-managers formulate their recommendations based on the work of employees who in turn work for them.

The regulation needs to address the situation where a company or committee within a company serves as a fiduciary with respect to investment decisions or recommendations. In that case, the employees who help the company or committee make those decisions or recommendations should not be fiduciaries. Otherwise, we could have a real problem as potentially hundreds of employees without decision-making power become fiduciaries. This is not to suggest that employees of a fiduciary company cannot be a fiduciary. For example, an advisor company's employee may have the advisory relationship with a plan or participant and may become a fiduciary by reason of that relationship. But such cases are different. In these cases, employees involved are making direct investment recommendations that are not filtered through supervisors or entities that are fiduciaries.

"Management of securities or other property": the proposed regulations would transform contract reviews and other non-investment advice into investment advice. The proposed regulation would include within the definition of "investment advice"

the following: "advice * * * or recommendations as to the management of securities or other property." The preamble states that:

This would include, for instance, advice and recommendations as to the exercise of rights appurtenant to shares of stock (e.g., voting proxies), and as to selection of persons to manage plan investments.

The broad language of the proposed regulations raises many questions:

• A plan decides to change trustees, chooses a new trustee, and begins negotiating a trust agreement with the new trustee. The plan asks for advice with respect to the terms of the trust agreement from the plan sponsor's internal and external ERISA and contract attorneys, as well as the plan sponsor's compliance personnel, human resources department, and tax department. The trustee is involved in the "management" of plan assets, and the terms of the trust agreement affect that management. Does that mean that all of the above personnel advising the plan with respect to the trust agreement are fiduciaries? If it does, the cost of trust agreements and many other routine plan actions will increase exponentially with the imposition of new duties and large potential liabilities. Also, many of the above persons may refuse to work on the project without a full indemnification from the plan sponsor. We do not believe that this type of cost increase and disruption was intended.

What about the persons working on the agreement for the new trustee? If such persons make any "recommendations" to the plan in the course of negotiations, they would become fiduciaries because the seller exemption, on its face, only appears to apply to sales of property and not services. Any such recommendations would thus trigger fiduciary status and corresponding prohibited transactions. Theoretically, this could chill all meaningful give-and-take during the negotiations, and many institutions may be unwilling to act as trustee. Again, we do not think that this was intended.

• A plan has decided to enter into a swap and must execute a swap agreement. The terms of the swap agreement will have a significant effect on the plan's rights with respect to the swap. The plan asks its internal and outside securities counsel to work on the swap agreement, and to consult with the plan's internal and outside ERISA counsel. The plan also asks its investment manager for input on the types of provisions that are important for plans to include (or exclude) in swap agreements. The plan accountant is also asked to review the agreement. Finally, the company's own compliance personnel, contract experts, and finance department also review the agreement.

The terms of the swap agreement affect the "management" of the swap. So do all of the above personnel become fiduciaries under the proposed regulations? If the answer is yes, plans' cost of investments will skyrocket, as an enormous new set of individuals and companies that have little material role in plan investments become fiduciaries, with far greater potential liability and a higher standard to meet. In addition, as noted above, many persons would likely refuse to review the agreement absent a full indemnification by the plan sponsor.

• A plan negotiates a loan agreement in connection with an ESOP. Is everyone who works on the loan agreement a fiduciary? Could individuals working on the loan agreement for the lender become fiduciaries if they make any "recommendations" during negotiations?

To avoid the inappropriate results described above and many other similar results, the regulation should provide a precise and appropriately narrow definition of "management" in the regulation. Under the definition, "management" would include:

• The selection of persons to manage investments;

• Individualized advice as to the exercise of rights appurtenant to shares of stock; and

• Any exercise of discretion to alter the terms of a plan investment in a way that affects the rights of the plan, unless such exercise of discretion has been specifically reviewed and agreed to by a plan fiduciary. In the swap context, for example, swap terms can be modified without plan review and consent by, for example, swap data repositories. If any such changes are made, anyone making those changes is acting for the plan and should be treated as a fiduciary. Moreover, such treatment is necessary in order to prevent harm to the plan.

This would target the actions identified by the Department in the preamble. But it would not have the inappropriately broad consequences illustrated above.

Summary

The critical message is that the decision regarding this proposed regulation could have a dramatic effect on the retirement security of millions of Americans for years to come. To rush through this project without adequate study, without a full public

policy dialogue, and without all exemptions needed to make the regulation work would be very harmful. Reproposal of the regulation is needed, as discussed above.

Chairman ROE. Thank you, Mr. Mason.

Professor Stein?

STATEMENT OF NORMAN STEIN, PROFESSOR, EARLE MACK SCHOOL OF LAW, DREXEL UNIVERSITY

Mr. STEIN. Thank you, Chairman Roe, Mr. Andrews, and members of the subcommittee.

I am testifying on behalf of the Pension Rights Center this morning, a nonprofit consumer organization that has been working since 1976 to protect the retirement security of American workers and their families.

The proposed regulations describe when a person who renders investment advice to a plan or plan participant is considered a fiduciary under ERISA. One of the principle congressional goals in enacting ERISA was to ensure that those individuals who provided investment advice with respect to retirement plan assets would be fiduciaries and as such would be subject to ERISAs prohibitions against fiduciaries entering in—transactions.

ERISA was clear and unequivocal in this issue. The term fiduciary is expressly defined to include any person who renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of the plan.

The Department of Labor's 1975 regulation, however, improperly narrowed this definition providing that investment advisors would not be considered fiduciaries unless their advice was provided pursuant to an agreement, arrangement or understanding that such services would serve as a primary basis for investment decisions with respect to plan assets and are provided on a regular basis.

In the context of the times, however, the regulations inconsistency with the statute did not create serious issues. The retirement world was then dominated by defined benefit pension plans and the rules permitting today's 401k plans were more than 5 years away.

Investment professionals were primarily advising sophisticated fiduciaries who were more capable of synthesizing market information and better able to identify and evaluate conflicts of interest than today's typical participant in a self-directed 401k plan.

Today the world is different. Most people saving for retirement are on 401k plans and individual retirement accounts, which basically or most of the money there is rollover money from employer plans, and they have to make their own investment decisions despite their lack of investment experience or knowledge.

They are, thus, highly dependent on the advice offered to them by the investment industry but unfortunately the advice they receive is sometimes subject to serious conflicts of interest.

Indeed, today some investment advisors receive revenue sharing and other payments from the vendors of the products they recommend. ERISA would prohibit some such payments if the investment advisors are ERISA fiduciaries, but a significant part of the advice industry claims that the 1975 regulations shield them fiduciary status and allow them to accept such third party payments so long as they include metaphorical fine print indicating that the

investment services are not provided under an agreement, arrangement, or understanding that the advice will be a primary advice for investment decisions or are not provided on a regular basis.

The Government Accountability Office has shown that such conflicts can have significant costs to plan participants and 401k plans.

I thought I would put a human face on this. My own. In 1987, while I was a visiting professor at the University of Texas, a man knocked at my office door. He had gotten my name from a colleague on the Texas faculty and he wondered whether he could talk with me for a moment about a 403(b) investment product.

During the conversation he learned, among other things, that I was in my 30s and that I would be at Texas for only that semester and, thus, that the contributions that I made during the semester would be my only contributions to the product he advised me to purchase.

I cannot now remember everything he told me, but he was charming and fun and was a University of Alabama fan where I was then teaching full time, and I ended up following his recommendation.

During the year I contributed $1,165 dollars in salary reductions to this investment product. Today, 24 years later, I brought the statement but I left it on my desk, the value of the investment contract is $1,506.89 which provided me, for those who are interested, in annual yield of just a smidgen over 1 percent per year. And because of inflation, my investment in 1987 dollars is worth approximately $350.

The reason that this investment performed so poorly was after various fees and charges relative to the investment earnings were substantial. The sales person should have known that this was a terrible investment choice for a person in my circumstances and my age.

But he either knew no more than I did about investing or, more likely, was motivated by the amount of compensation he would earn by selling me that particular product rather than a more appropriate product.

My real problem was that he was an investment salesman posing as an investment advisor. If he had been a fiduciary and had been free of conflicts, I would have received better advice.

And if all investment advisors to ERISA plans were fiduciaries as Congress intended and these proposed regulations would provide, millions of Americans, some who were even less sophisticated than I was in 1987, would receive better quality advice.

[The statement of Mr. Stein follows:]

Prepared Statement of Norman P. Stein, on Behalf of the Pension Rights Center

Thank you, Chairman Roe and Mr. Andrews, and members of the subcommittee, for inviting me here to speak with you this morning on the Department of Labor's proposed regulation on the definition of fiduciary. I am testifying this morning on behalf of the Pension Rights Center. The Center is a nonprofit consumer organization that has been working since 1976 to protect and promote the retirement security of American workers, retirees, and their families.

The proposed regulations that are the subject of today's hearing describe when a person who renders investment advice to a plan or plan participant is considered a fiduciary under Title I of ERISA and under the Internal Revenue Code. These reg-

ulations would replace 1975 regulations, which reflect an improper agency constriction of the relevant statutory language and congressional intent. In addition, as the Department suggests in its preamble to the proposed regulations, economic and legal developments in the fields of investments and employee benefit plans have increased the original regulations' harmful impacts.

One of the principal congressional goals in enacting ERISA was to ensure that those individuals who provided investment advice with respect to retirement plan assets would be fiduciaries, subject to ERISA's prohibitions against fiduciaries entering into certain conflict-tainted transactions. ERISA was clear and unequivocal on this issue: the term fiduciary is defined to include any person "who renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property" of a plan.

The Department of Labor's 1975 regulation narrowed this definition, providing that investment advisers would not be considered fiduciaries, unless their advice was provided "on a regular basis" and "pursuant to an agreement, arrangement or understanding that such services will serve as a primary basis for investment decisions with respect to plan assets." There is nothing in the legislative history that supported these extra-statutory limitations on the definition of fiduciary. Moreover, the terms "regular basis," "mutual agreement, arrangement or understanding," and "a primary basis" are subjective and ambiguous and have created confusion.

In the context of the times, however, the regulation's inconsistency with the statute did not create serious problems. The retirement world was then dominated by defined benefit pension plans, and the regulations permitting today's 401(k) plan were almost six years away. Investment professionals were primarily advising sophisticated fiduciaries, who were more capable of synthesizing market information and better able to identify and evaluate potential conflicts of interest than today's typical participant in a self-directed 401(k) plan.

Today, the world is different: most people saving for retirement are in 401(k) plans and individual retirement accounts (most of which hold rollover money from employer plans), and these account holders have to make their own investment decisions despite their lack of investment experience or knowledge. They are thus highly dependent on the advice offered to them by the multi-billion-dollar investment industry, but unfortunately the advice they receive is sometimes subject to serious conflicts of interest. Indeed, today some investment advisers receive payments from the vendors of the products they recommend.

ERISA would prohibit some such payments if the investment advisers are ERISA fiduciaries, but a significant part of the advice industry claims that the 1975 regulation shields them from fiduciary status and allows them to accept all third-party payments, so long as they include fine print indicating that investment services rendered are not provided under "an agreement, arrangement or understanding that the advice will be a primary basis for investment decisions" or are not provided on a "regular" basis. The Government Accountability Office has shown that such conflicts can have significant costs to participants in 401(k) plans.

I can tell a story from my own experience to illustrate the impact of such conflicts. In 1987, while I was a visiting professor at the University of Texas, a friendly and confident man knocked at my door. He had gotten my name from a colleague on the faculty, and he wondered whether he could talk with me about investing in a flexible premium fixed annuity. During the conversation he learned, among other things, that I would be at Texas for only that semester and thus the contributions I made during the semester would be my only contributions to the product he advised me to purchase. I am not certain now exactly everything he told me then, but he was a polished salesman and I ended up following his recommendation.

During the year I contributed $1,165.19 in salary reductions to this annuity product. Today, 24 years later, the value of this investment contract is $1,506.89, which provided me, for those who are interested, an annual yield of just a smidgen over 1 percent. And because of inflation, my investment today, in 1987 dollars, is worth only $229.73. I would have done better putting my money in an insured, passbook savings account at my credit union.

The reason that this investment performed so poorly for me is that the actual earnings under the plan were themselves very low, and the fees, relative to the earning, were very high. The salesperson should have known that this was a terrible investment choice for a person still in his 30s. He either knew no more than I did about investments or, more likely, was motivated by the amount of fees he would earn by selling me that particular and inappropriate product rather than another product. My real problem was that he was an investment salesman posing as my investment adviser.

If he had been a fiduciary and had been free of conflicts, I would have received better advice. And if all investment advisers were fiduciaries, millions of Ameri-

cans—some even less sophisticated than I was in 1987—would receive a better quality of advice.

Some segments of the investment community have argued that the proposed regulations would make it impossible for broker-dealers to give advice or sell products to participants in 401(k) plans and individual retirement accounts. The proposed regulation, however, would not prohibit broker-dealers from giving investment advice, and indeed many broker-dealers today give investment advice by complying with statutory and regulatory exemptions to the prohibited transaction rules.

The argument that broker-dealers would be excluded from giving investment advice apparently is based on the notion that the only permissible form of compensation paid to an investment adviser would be on a fee basis. This is not correct: the Department of Labor has a prohibited transaction exemption that permits fiduciaries to receive commission-based compensation for the sale of mutual funds, insurance and annuity contracts and has signaled its willingness and intent to issue additional exemptions. In addition, the statute itself includes a prohibited transaction exemption for investment advice if fees are leveled or if the investment advice is determined through objective computer programs. And broker-dealers are also free to provide investment education rather than investment advice.

But it is true that under the new regulations broker-dealers will not be able to use certain business models in which their objectivity is compromised by serious conflicts of interest. Will these people abandon the retirement savings market? Perhaps some will, but we are confident, given the size and importance of that market, that most will adapt. And in our view, those who are unwilling to eschew serious conflicts have no business advising retirement-plan participants.

Finally, we think public policy would be better served if those are currently trying to kill these proposed regulations instead devoted their efforts to working with the Department of Labor to help craft exemptions from the prohibited transaction rules that will accommodate a wide variety of reasonable compensation structures for those who sell, directly or indirectly, their services to participants in 401(k) and individual retirement plans. That would be good for participants and good for the industry.

(Attached to this testimony are comments of the Pension Rights Center and the National Employment Lawyers Association on the regulations, which were submitted to the Department of Labor on February 3, 2011.)

[FILED ELECTRONICALLY],
Washington, DC, February 3, 2011.

Re: *Definition of Fiduciary Proposed Rule.*

The Pension Rights Center (the Center) and the National Employment Lawyers Association (NELA) submit the following comments on the Department of Labor's proposed regulations on the definition of fiduciary. The Center is a nonprofit consumer organization that has been working since 1976 to protect and promote the retirement security of American workers and their families. NELA has been advancing employee rights and serving lawyers who advocate for equality and justice in the American workplace since 1985.

The proposed regulations would replace current regulations, adopted in 1975, that tightly circumscribe the circumstances under which a person or entity becomes a fiduciary when providing investment advice to a plan or participant for a fee. The regulations would also reverse a 1976 advisory opinion holding that a firm valuing employer stock for an ESOP was not a fiduciary.

The 1975 regulation and 1976 advisory opinion were not compelled by the statute and, in our view, reflected an improper narrowing of the congressional definition of fiduciary. In addition, as the Department suggests in its preamble to the proposed regulations, economic and legal developments in the fields of investments and employee benefit plans have rendered the earlier positions anachronistic and, at times, at cross-purposes with the statute. The proposed regulations are much-needed and long-overdue.

Background

When Congress passed ERISA in 1974, it included rules governing the conduct of fiduciaries. Senator Harrison Williams, Chair of the Senate Labor Committee and a key co-sponsor of ERISA in the Senate, explained the need for these rules when he presented the ERISA Conference Committee resolution reconciling the House and Senate versions of pension reform legislation: "Despite the value of full reporting and disclosure, it has become clear that such provisions are not in themselves sufficient to safeguard employee benefit plan assets from such abuses as self-deal-

ing, imprudent investing, and misappropriation of plan funds."[1] In other words, fiduciary standards were essential for the protection of participants in employee benefit plans. Congress crafted rules applying fiduciary standards not only to plan trustees, but to a range of individuals and entities whose actions affect the security and use of plan funds and the benefits of participants. These rules of conduct applied to "fiduciaries," which Congress defined as any person who fits one of the following categories:

(1) exercises any discretionary authority or discretionary control respecting management of a plan;[2]

(2) exercises any authority or control respecting management or disposition of a plan's assets;[3]

(3) renders investment advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of a plan, or has any authority or responsibility to do so;[4] or

(4) has any discretionary authority or discretionary responsibility in the administration of a plan.[5]

The 1975 regulations addressed the third aspect of the definition—a person who renders investment advice for a fee. The regulations narrowed the statutory language (which broadly provided that a person is a fiduciary if he renders investment advice "for a fee or other compensation, direct or indirect, with respect to any moneys or other property of" a plan) to two narrow circumstances: first, if a person has discretionary authority or control with respect to purchasing or selling securities or other property for a plan;[6] and second, if a person renders investment advice to a plan on a regular basis, pursuant to an agreement or understanding that the advice will be a primary basis for the plan's investment decisions, and that the advice is individualized to the particular needs of the plan.[7] In the preamble to the presently proposed regulations, the Department describes this as a five-part test, with a person found to be a fiduciary only if all five parts of the test are met.

The regulations also provided, in effect, a definition of the type of advice that concerned plan investments: advice concerning the value of securities or property, or advice concerning the advisability of investing in, purchasing, or selling securities or other property.

A year after the 1975 regulations were promulgated, the Department held that a consultant that provided an evaluation of employer securities for an ESOP was not a fiduciary under the regulatory definition, because the valuation would not "involve an opinion as to the relative merits of purchasing the particular employer securities in question as opposed to other securities," and would thus not serve as a "primary basis" for plan investment decisions nor "constitute advice as to the value of securities."

The newly proposed regulations would substitute a simpler and more easily understood, enforced, and administered test that bears greater fidelity to the statutory language and is appropriate to developments over the intervening 35 years in the areas of retirement plans and investments. The new test would provide that a person renders investment advice for a fee under ERISA if the person gives certain types of advice to a plan, plan fiduciary, or plan participant or beneficiary, and also falls within one of four categories of persons.

The types of advice covered by the proposed regulation are: (1) advice, appraisal, or fairness opinion concerning the value of securities or other property; (2) advice or recommendation as to the advisability of purchasing, holding, or selling securities or other property; and (3) advice or recommendations as to the management of securities or other property. The new regulations thus expand the ambit of covered investment advice from the 1975 regulations to fairness letters and appraisals of property, and eliminates the cumbersome five-part test that depends on the proof of the details of the relationship between advisor and advised and eliminates from the realm of investment advice much that any layperson would understand to be such advice.

By including advice as to the management of securities or other property in the definition of investment advice (not just advice as to valuation or the advisability of purchasing or selling securities), the Department makes explicit in the text of the regulation, its longstanding interpretation of the existing regulation, which included advice as to the selection of managers and investment options. DOL Adv. Op. 84-04A, 1984 WL 23419, *1-3 (Jan. 4, 1984). The regulations also make clear that advice as to the management of a particular asset, e.g. advice as to proxy voting or how to maximize the income incident to a piece of real property, is also fiduciary advice. In addition, they make explicit that investment advice gives rise to fiduciary status if it is furnished to a plan participant or beneficiary.

To be considered a fiduciary under the proposed regulations, a person who gives such advice meets the requirement of the regulations if the person: (1) represents

or acknowledges that it is acting as a fiduciary; (2) is already a fiduciary under the other legs of the statutory definition of fiduciary; (3) is an investment adviser under the Investment Advisers Act of 1940; or (4) provides advice or makes recommendations pursuant to an agreement, arrangement, or understanding between such person and the plan, plan fiduciary, participant, or beneficiary that such advice may be considered in connection with making investment or management decisions with respect to plan assets and will be individualized. The proposed regulations' most important departure from the 1975 regulations is that under the fourth category, the advice does not have to be rendered on a regular basis and need not be provided pursuant to an agreement or understanding that it will serve as a "primary" basis for investment.

As discussed below, however, the advice must be provided pursuant to an agreement or understanding that such advice may be considered in connection with making investment management decisions and will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary. The existing regulations provide that advice be individualized to the needs of the plan. The new regulations, in what we understand is clarification of the Department's existing interpretation, make clear that the advice may be individualized to the needs of the plan, plan fiduciary, plan participant, or beneficiary, i.e. to the needs of the recipient of the advice, to distinguish such advice from the generalized buy recommendation that a broker might issue to all of its clients on a given publicly traded stock.

The regulations also include a number of limitations on the regulations' coverage. One of the limitations provides that a person offering advice or recommendations is not an investment-adviser fiduciary if such person can demonstrate that the recipient of the advice knew, or should have known, that the person is providing the advice in its capacity as a purchaser or seller (or agent for a purchaser or seller) of securities or other property, whose interest are adverse to the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice.

The regulations also do not apply to persons who provide only investment education or persons who make available to a plan a group of investment options from which a plan fiduciary will decide which options to offer. The term investment advice also does not include advice or an appraisal or fairness opinion for purposes of complying with reporting and disclosure requirements of ERISA or the Internal Revenue Code unless such report involves assets for which there is not a generally recognized market and which serves as a basis on which a plan may make distributions to plan participants and beneficiaries.

The Preamble to the Regulations also invites comments on the question of whether a person who gives advice to participants with respect to distributions is providing investment advice.

Revision of the 1975 Regulations is Warranted

Developments in Retirement Plans and Investments Since 1975

The existing regulations were promulgated in 1975, at the dawn of the ERISA era. Since then, there have been significant changes in the retirement plan and investment universe that have undermined whatever justification there might have been for the regulations' cramped scope. As the preamble to the proposed regulations notes, there has been a seismic shift in the retirement plan world from defined benefit plans—in which investment advice was generally rendered to sophisticated plan fiduciaries—to self-directed defined contribution plans—in which investment advice is issued to individual participants, many of whom have only rudimentary financial literacy. Mutual funds, and sellers and brokers for mutual funds, who played a relatively small role in retirement plans at the time ERISA was enacted, have become dominant players in the new order. The variety and complexity of investment products has also changed markedly over the last three decades.

At the time of the 1976 advisory opinion on valuations of employer stock for ESOPs, there were only 250,000 participants in 1,600 ESOPs. Today ESOPs cover more than 12 million participants in over 10,000 plans, which hold almost 1 trillion dollars in employer securities.[8] The exponential growth of ESOPs has been accompanied by numerous cases involving improper valuations of employer stock purchased or sold by ESOPs.[9] Yet, the 1976 opinion letter effectively shields these plans' valuation advisers from fiduciary liability.

There have also been significant legal developments since the time the regulations were promulgated. The Supreme Court ruled in Mertens v. Hewitt Associates, 508 U.S. 248 (1993), that a participant generally is entitled to legal relief under ERISA only if the defendant is a fiduciary who caused monetary loss to a plan.[10] A participant can sue a person other than a fiduciary only for equitable relief, and the Supreme Court has narrowly circumscribed the extent to which such equitable relief

is available. Great West Life & Annuity Ins. Co. v. Knudson, 534 U.S. 204 (2002). The Labor Department, which filed amicus curiae briefs arguing against these positions, could not have known in 1975 that its narrowly drawn regulations and ERISA preemption would effectively create an unregulated playing field for so many actors who have a direct and substantial impact on plan investments.

Finally, in the period since 1975, the Department has determined that voting of proxies and similar issues are part of investment management and has concluded that investment advice as defined in the regulations includes advice regarding the selection of investment managers. This last point has caused controversy see Cohrs v. Salomon Smith Barney, 2010 WL 2104535 (D.Or., Aug. 31, 2005). and recently required the DOL to file an amicus brief to defend its interpretation of the old regulations. See DOL amicus brief in In Re Beacon Securities Litigation, 09-CV-077 (LBS), 2010 WL 3895582 S.D.N.Y. Although the Department's position prevailed in district court, the issue remains hotly contested and will likely be the subject of an appeal by defendants in Beacon if plaintiffs prevail on the merits. It is therefore appropriate for the Department to revise the regulations to address investment advice concerning such issues to eliminate any doubt in the courts that such advice should give rise to fiduciary status.

We have heard it argued that this view, that investment advice should include advice regarding the selection of fiduciaries to manage assets, will have the baneful effect of discouraging informal advice about, for example, the selection of independent fiduciaries from trusted advisors such as plan counsel. We disagree. Advice as to the selection of an independent fiduciary is not legal advice if it goes beyond evaluating whether a particular firm meets the legal requirements to act as an independent fiduciary or advising as to the nature of a prudent selection process. If lawyers choose to go beyond providing legal advice and provide advice as to whom a plan should select to manage plan assets, then there is no reason why those lawyers should receive a special dispensation from fiduciary status as compared to a consultant who habitually makes recommendations about asset allocations and asset manager selections, unless we adopt the too-convenient fiction that no one heeds the advice of lawyers who exceed the ambit of their professional competence. The concern that plans will be deprived of the unique perspective of lawyers who have experience working with independent fiduciaries is overblown. Lawyers can identify the independent fiduciaries with whom they have worked and describe factually their experiences with them without purporting to make a recommendation. Alternatively, they can make a recommendation and lawyers, more than anyone, understand that the implicit claim of competence in giving such advice will give rise to fiduciary responsibility.

The 1975 Regulations Improperly Narrowed the Meaning of Investment Advice

ERISA § 3(21)(A) provides straightforwardly that a person is a fiduciary if he "renders investment advice for a fee or other compensation, direct or indirect, with respect to any moneys or other property of such plan, or has any authority or responsibility to do so." The 1975 regulations narrowed the scope of this language by limiting it to investment advice that was "regular," rather than one-time or episodic; advice that was rendered pursuant to an agreement or understanding that it would be a "primary basis" for investment; and advice that is "individualized" to the particular needs of the plan.[11] These limitations are not consistent with the plain meaning of the term "investment advice," and at least in retrospect can be said to impede rather than advance the congressional goals of limiting self-dealing and of assuring prudent investment of plan assets.[12] As the Preamble to the Proposed Regulations notes, people providing investment advice not covered by the regulations have considerable influence on the decisions of plan fiduciaries and sometimes have conflicts of interest that result in lower returns and less retirement income for plan participants and their beneficiaries. The regulatory definition is also inconsistent with judicial language indicating that Congress generally intended the term fiduciary to be "broadly" construed.[13]

The problems of the regulatory definition are illustrated in judicial decisions. In Farm King Supply, Inc. Integrated Profit Sharing Plan and Trust v. Edward D. Jones & Company, 884 F.2d 288 (7th Cir. 1989), a plan followed a brokerage firm's conflicted investment advice and suffered a loss, but the court held that the brokerage firm was not a fiduciary because "there was no mutual understanding that Jones' advice would be a primary basis for Plan investments."

In a recent district court case, Bhatia v. Dischino, 2010 WL 1236406 (N.D. Tex. March 30, 2010), the trial court held that the actuarial consulting firm was not a fiduciary under the regulations, because the plaintiffs did not plead adequate facts to show that the firm "rendered advice on a regular basis as part of a mutual agreement that such advice serve as the primary basis of investment decisions."

The Department has explained that developing proof of the elements of the regulations, even where proof exists, has slowed and impeded enforcement of ERISA for the Department of Labor. The lack of support in the statute for the conditions in the regulation and the difficulties for enforcement are reasons enough for the regulation. But the Center and NELA would like to point out that Congress intended that ERISA would be enforceable by ordinary participants and beneficiaries who, unlike the Department of Labor, do not have subpoena power and have no ready access to the documents and testimony that would demonstrate fiduciary status under the detailed existing regulation. This has always been a severe impediment to enforcement of fiduciary responsibility by private plaintiffs, but it has been greatly exacerbated in recent years because the Supreme Court has adopted a "plausibility" standard for the evaluation of complaints on a motion to dismiss. As a consequence, complaints alleging fiduciary status may be dismissed if they fail to allege factual support for some element of the regulation, and factual support will typically be unavailable or limited without discovery. See e.g. Glen Ridge Surgicenter, LLC v. Horizon Blue Cross Blue Shield of New Jersey, Inc., No. 08-6160 (JAG), 2009 WL 3233427, at *6 (D.N.J. Sept. 30, 2009) ("[P]roof of [defendant]'s fiduciary status is an element of the fiduciary duty claim, and 'a formulaic recitation [in the complaint] of the elements of a cause of action will not do.'" (quoting Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007)); see also Braden v. Walmart Stores, Inc., 588 F.3d 585, 598 (8th Cir. 2009) (discussing the problem that participants are often without access to information that would allow them to plead factual support for each element of a claim).

The new regulations recognize that investment advice is no less important merely because it is rendered on a one-time basis. An individual who advises on the purchase of employer stock with all of the assets of an ESOP on a one-time basis is not less worthy of regulation than an individual who advises quarterly on asset allocation in a defined benefit plan. Moreover, the regular basis requirement finds no support in the statute or the legislative history.

Similarly, the requirement that advice be offered pursuant to an agreement or understanding that the advice will be a primary basis for making a decision is and always has been unsupported by the statute and extremely difficult to prove. As a practical matter, contracts with investment advisors are simply not written this way. An advisor agrees to provide advice of a particular sort in exchange for some form of compensation. There is no reason why the contract should specify how the advice may be used by the plan fiduciary. So while the advice may be the only real basis for an investment decision by the plan fiduciary, there will be no written agreement that the advice will be primary or even significant. Almost invariably, such an agreement or understanding will have to be inferred and will be rebutted by an integration clause in any written agreement providing for the advice. This hurdle, which the new regulations eliminate, seems to have been designed to give almost all advisors who did not specifically seek to be treated as fiduciaries a good faith argument that they are not fiduciaries. Consequently, this requirement in the old regulations is profoundly destructive of ERISA's purpose to protect participants and beneficiaries. The elimination of this requirement in the new regulations is not merely warranted, it is of critical importance.

The new regulations do not eliminate the requirement that advice be individualized, but clarify that advice should be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary. This reflects the Department's interpretation of the existing regulations but it is an important clarification. An enormous percentage of plan assets are managed in pooled vehicles holding plan assets of many plans. These may be master trusts, insurance separate accounts, fund-of-funds, and hedge funds usually organized as LLC's and operating pursuant to private placement memoranda. Advice that is "individualized" for the fiduciaries of these pooled vehicles is not individualized for a particular plan, and yet such advice is no less worthy of regulation than advice provided to one plan at a time. If anything, regulation of such advice is more critical than advice given to a single plan with the needs of that plan in mind. Similarly, many investment decisions are made by participants in 401(k) plans, and the advice given to them should not escape regulation because individual participants are uniquely vulnerable to self-interested investment pitches.

The decision in the new regulations to cover appraisals is warranted. As a practical matter, appraisers set the price of assets that are purchased or sold by plans, including and especially the closely-held employer stock that plans purchase or sell. To suggest that this advice is not investment advice defies common sense. Often an appraiser is the only outside advisor a fiduciary relies on in deciding to purchase an asset at a particular price.

In an ESOP, price is the critical concern, since diversification is excused and the courts have been skeptical of claims that employer stock may be "too risky" to be a prudent investment. We anticipate that appraisers will argue that they should not be held to fiduciary standards when their appraisals are only used for compliance and distributions. We think the proposal as it stands is appropriate. Note that the courts seem to provide a more deferential review of decisions (and by extension advice) involving only distributions. See Armstrong v. LaSalle National Bank, 446 F.3d 728(7th Cir. 2006) (fiduciary setting a value for ESOP distributions is entitled to deference because he must balance the interests of those taking a distribution with the interest of those who stay in the plan).

Equally important, the Department's longstanding interpretation of its regulation to exclude appraisals is difficult to defend. The opinions of appraisers are at least "a primary basis" for a typical plan's decision to buy or sell a hard-to-value asset at a particular price, and this is certainly understood by appraisers hired to value stock or other assets for a transaction. At best it might be argued that an appraiser is often hired for one transaction or one appraisal at a time, so an appraiser's opinion may well not be provided on a regular basis. Following the plain meaning of the statute, if not the old regulations, the advice given by appraisers that guides the fiduciary's decision to purchase or sell a particular asset at a particular price certainly falls within the plain meaning of "investment advice."

The Current Regulations Create Legal Uncertainty

The 1975 regulations also introduce inherently vague definitional concepts into the definition of investment advice. The regulations do not define what is meant by providing advice on a "regular basis," what is meant by advice that will be "a primary basis" for the plan's investment decisions, nor what is meant by advice that is "individualized to the plan's" needs. These must be determined on a case-by-case basis. The inherent ambiguity and subjectivity of these concepts creates uncertainty in the law and strains Departmental, judicial, and private resources in litigation of issues not related to the core concept of investment advice.

Comments on the Proposed Regulations

As we earlier indicated, we strongly support the Department's initiative to redefine the meaning of investment advice, although we offer the following comments that would strengthen the proposed regulation and more faithfully implement Congressional intent.

1. Section 2510-3-21(c)(ii)(D) makes a person who issues investment advice a fiduciary if, among other requirements, the advice "will be individualized to the needs of the plan, a plan fiduciary, or a participant or beneficiary." At least in cases of individual participants and beneficiaries, we are not certain why a person would be a fiduciary only if their advice was sufficiently individualized (and the regulations do not discuss when advice is sufficiently individualized to meet the proposed regulatory requirement). We have doubts that a typical participant or beneficiary will be able to discern a difference between individualized and non-individualized advice.

We are also concerned that some advisers who do not have the interests of participants at heart may be focused on selling a particular investment, rather than providing individualized advice about a variety of investments or strategies. In such instance, if the advice is directed to an individual, that advice might influence that individual's investment choices within a plan just as surely as advice that is individualized.

Finally, this aspect of the regulation might provide a perverse incentive to some providers of investment advice to not tailor the advice to the particular needs of the individual in order to avoid fiduciary status. Our concern for advice given to individual participants is heightened when the person giving the advice has been given an aura of legitimacy by virtue of having been appointed to provide advice by a plan fiduciary or who otherwise has the imprimatur of the plan, e.g., a custodian or contract administrator. At least with respect to participants, we would prefer that the regulations provide that the advice be directed to a particular participant rather than that it be "individualized." [14]

As to advice given to plans and plan fiduciaries, the regulation should be modified to eliminate the requirement that there be an agreement to provide individualized advice.

It should be sufficient that there is an agreement to provide investment advice and that the service provider performs the agreement by the providing individualized advice. Agreements generally do not specify that advice will be individualized, even when individualized advice is contemplated. For example, when a consultant is hired to recommend investment managers for a particular fund, the agreement to provide individualized advice may be unspoken or assumed by the parties—gen-

erally such a consultant will take into account the needs of the fund by providing more than a generic ranking of manager performance. Consequently, some of the very proof and investigational difficulties that inspired the new regulations will still be present unless this requirement is modified.

Moreover, the definition of "individualized" should be clarified further. The Center and NELA understand that the Department does not wish to encompass within the definition of fiduciary mere brokers or others who provide "research" on stocks, bonds, and other investments, rating them as buys, sells or holds, calculating betas or other risk measures or predicting returns. But it should be clear that when an advisor tells a fiduciary with control of plan assets (pooled or not) or a participant to buy or sell a particular investment, or that an investment without a ready market that the fiduciary is considering purchasing or selling has a particular value, then that advice is sufficiently individualized. The distinction should be between saying "you should consider buying Xerox" and "our firm rates Xerox a buy;" the first statement should be considered "individualized," regardless of the thinking or specific intent behind it. A focus on portfolio composition and diversification fails to capture this concept. Further clarification, perhaps with examples, should be undertaken in the final regulations.

2. Section 2510-3-21(c)(2)(i) provides that a person shall not be considered to be a fiduciary investment adviser if such person can demonstrate "that the recipient of the advice knows or, under the circumstances, should have known, that the person is providing the advice or making the recommendations in its capacity as a purchaser or seller of a security or other property, or as an agent of, appraiser for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants or beneficiaries, and that the person is not undertaking to provide impartial investment advice."

While we believe that this limitation may be appropriate when such advice is provided to a sophisticated plan fiduciary, it is not appropriate when the advice is given to individual participants or their beneficiaries. The Center and NELA have worked with participants for 35 and 26 years respectively, and it is our experience that most plan participants will not be able to discern when advice is impartial or conflicted. In addition, even if there is disclosure, in a one-to-one meeting, whether in person or by phone, an unsophisticated investor will often regard the adviser as acting in his interest. This is particularly true if the participant does not have access to other advisers. Indeed, an adviser's success may depend on a client's belief that the adviser is interested primarily in the customer's welfare, despite a declaration of self-interest. There is the further fact that most participants will not be knowledgeable about the types of fees and benefits that can accrue to the purchaser or seller of securities. Thus, we strongly urge the Department to revise this limitation so that it only applies to advice and recommendations given to plan fiduciaries.[15]

3. Section 2510-3-21(c)(2(iii) of the proposed regulations provides that investment advice does not include an appraisal or fairness opinion that reflects the value of an investment of a plan or participant or beneficiary, provided for purposes of reporting and compliance under ERISA or the Internal Revenue Code, unless such report involves assets for which there is not a generally recognized market and serves as a basis on which a plan may make distributions to plan participants and beneficiaries. We believe that the Department should consider revising the limitation so that it would not apply to situations when an appraisal of property for which there is not a generally recognized market would have a material effect on the funding status of a defined benefit plan. The Center and NELA recognize that appraisers will typically include scope limitations in their appraisals. For example they will say that they are relying on management projections in preparing a discounted cash flow. In such cases, it is up to the user of the appraisal to assure himself that the projections relied upon are reasonable. The Department should be able to address the concerns of appraisers by indicating that scope limitations will be respected, and appraisers will be held responsible only for the opinions that they express (complete with limitations), subject to section 405 of ERISA, so that an appraiser who knew that he was being provided with unreliable information would have a duty to take steps to remedy the situation.

4. The Department asked for comment on whether and to what extent the final regulation should define the provision of investment advice to encompass recommendations related to taking a plan distribution. The Department has taken the position that a person providing investment advice to a participant in an individual account plan is a fiduciary, even if the person is chosen by the participant and has no other connection to the plan.[16] The Department has also held that if a plan fiduciary responds to participant questions about the advisability of taking a distribution or the investment of amounts drawn from the fund, that fiduciary must act for the sole and exclusive benefit of the participant. Moreover, a fiduciary that advises

the participant to invest in an IRA managed by the fiduciary may be in violation of the prohibited transaction rules of ERISA and the Internal Revenue Code.

However, the Department has also opined that, if the person providing such advice on distributions is not connected with the plan, that person can recommend that the participant take a distribution and invest in a fund managed by that person and that does not constitute investment advice under the current regulations.[17] We see no reason for this distinction and believe that the regulations should be changed.

A recommendation to remove assets from the plan and invest them elsewhere is, in effect, a judgment about the relative merits of the plan options and the other investment(s). The person making the recommendation can have interests adverse to the plan participant and the recommendation can have a substantial effect on a participant's retirement security, both in terms of future investment performance, the loss of an economically efficient means of taking retirement income in annuity form, and tax considerations. Moreover, under the current interpretation, the person giving advice in these circumstances has no obligation under ERISA to reveal their conflict of interest. Such advice should be considered investment advice under the new regulations.

We are especially concerned about the problem of advice given by plan custodians and non-fiduciary administrators. We are aware of participants and beneficiaries who call plans to arrange for or inquire about a distribution who are then solicited to invest in products offered by the plan service provider. At a minimum the regulations should address this concern by making the entities that provide this "advice" fiduciaries. Participants and beneficiaries are inclined to believe that the persons assigned to address their inquiries regarding their rights in the plan have their interests at heart. In truth, they are unknowingly exposed to salesmen with a financial interest, whether disclosed or not. Persons using their privileged access to plan participants and beneficiaries gained through their positions (even ministerial positions) with a plan to steer participants and beneficiaries into their investment products should be held to fiduciary standards.

1. Section (c)(ii)(B) of the regulations should be clarified by adding "a plan fiduciary" after "individualized needs of the plan" and "managers" after "securities." More importantly, we are concerned that such menus that are excluded from investment advice be limited to those that give the fiduciary a broad choice to select from. At one extreme, if fiduciaries are presented with a specific or very limited lineup, it is hard to see why the individual promoting that lineup should be excused from being deemed a fiduciary, even if he discloses that he is selling a product and is not disinterested. In addition, such disclosure should specify the nature of the individual's financial interest—i.e., how is he being paid and how much he is being paid to recommend these alternatives.

2. The Preamble to the Regulations should be revised to indicate that the Department has taken litigation and administrative positions prior to the issuance of the proposed regulations interpreting the existing regulations that investment advice to a plan encompasses; a) advice to plan fiduciaries, including fiduciaries of pooled vehicles; b) advice with regard to the selection of managers; and c) advice paid for by third parties, e.g., commissions. Likewise, the Department should clarify in the Preamble that it does not view its interpretation of the existing regulations' requirement of individualized advice as precluding advice individualized to the needs of plan fiduciaries of pooled vehicles rather than a particular plan. Without such clarification, defendants will argue that the new regulations implicitly recognize that such advice would not give rise to fiduciary status under the existing regulations.

Conclusion

In sum, this is a much needed regulatory change that will better protect plans and participants and facilitate more effective enforcement when misconduct is uncovered. The Pension Rights Center and NELA applaud the Department for pursuing this initiative that will benefit both retirement plans and their participants and beneficiaries.

Respectfully submitted,

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ENDNOTES

[1] Comments of Senator Harrison Williams, Legislative History of the Employee Retirement Income Security Act of 1974, Vol. III, at 4741(Aug 22, 1974)(comments concerning the Committee of Conference on H.R. 2).

[2] ERISA § 3(21)(A)(i).

[3] ERISA § 3(21)(A)(i)
[4] ERISA § 3(21)(A)(ii)
[5] ERISA § 3(21)(A)(iii).
[6] We note that a person who has such authority would be an investment adviser even without the "investment advice for a fee" component of the statutory definition, since the person would be exercising discretionary control of a plan asset.
[7] 29 C.F.R. § 2510.3-21(c)(1)(ii)(B).
[8] The National Center for Employee Ownership, "A Statistical Profile of Employee Ownership," *http://www.nceo.org/main/article.php/id/2. These figures do not include 401(k) plans with employee stock funds.*
[9] See, e.g., Keach v. U.S. Trust Co., N.A., 239 F. Supp. 2d 820 (C.D. Ill. 2002) (appraiser not a fiduciary); Clark v. Ameritas Investment Cor., 408 F.Supp. 2d 819, (D. Neb. 2005)(appraiser not a fiduciary).
[10] ERISA §409(a). A fiduciary who breaches its responsibilities under the statute is also obligated to return to the plan any profits the fiduciary made through the use by the fiduciary of plan assets. Id. In Mertens, the Court specifically held that a non-fiduciary who knowingly participated in a breach of trust was not subject to section 409(a)
[11] The Preambles to the proposed and final 1975 regulations include virtually no explanation for the Department's introduction of these extra-statutory conditions on the meaning of investment advice. The few comments noted in the Preamble to the 1975 final regulations asked that the definition of investment advice be narrowed (the Department responded to these comments by adding to the final regulations additional limitations on the meaning of investment advice); asked that the meaning of "fee or other compensation" be clarified (the Department responded to these comments by indicating that it was still studying this issue); asked that the applicability of the regulations to investment companies subject to the Investment Company Act of 1940 be limited (the Department responded to these comments by adding to the final regulations some conditions and limitations related to the purchase and sale of securities by investment companies); and asked for clarification of certain issues involving broker-dealers and investment advice (the Department responded to these comments with a discussion of these issues in the Preamble to the final regulations). The Preamble to the final regulations is silent as to whether it received any comments suggesting that the regulations defined investment advice too narrowly, suggesting that it did not. From conversations we have had with other groups representing interests of participants, it does not appear that such groups submitted comments on the 1975 proposed regulations (neither the Center nor NELA existed in 1975). In any event, the Department, in response to a FOIA request, has indicated that it cannot locate the comments submitted on the proposed regulations.
[12] We also note that the Supreme Court had not yet decided Chevron U.S.A., Inc. v. Natural Resources Defense Counsel, Inc., 467 U.S. 837 (1984). In Chevron, the Court wrote that in determining what deference to give to an agency decision, the first question "always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress." There is no ambiguity about the meaning of the term "investment advice" and the only limitation that Congress placed on whether a person becomes a fiduciary because it rendered investment advice is that the investment advice was rendered for a fee or other compensation. Yet the regulations substituted a unique definition of investment advice by providing that the advice had to be offered on a regular basis, had to be a primary basis for a plan's investment decisions, and had to be part of an agreement to provide individualized advice.
[13] See, e.g., LoPresti v. Terwilliger, 126 F.3d 34, 40 (2nd Cir. 1997).
[14] Non-individualized advice on asset allocation and the like, however, will generally be characterized as investment education rather than investment advice.
[15] We also note an additional concern: the proposed rule appears to undercut the prohibited transaction exemptions that apply when fiduciaries provide investment advice under certain limitations designed to protect plan participants from conflicts of interest. See ERISA § 408(g). Under the proposed regulations, an investment adviser could claim that it did not become a fiduciary under the "sale or purchaser" limitation and thus was free to give investment advice without complying with section 408(g).
[16] DOL Advisory Opinion 2005-23A.
[17] Id. See also Walsh v. Principal Life Insurance Co., 49 EBC 1344 (S.D. Iowa 2010).

Mr. ANDREWS. I think the Chairman and I agree, we can say this because Mrs. Roby is not here, that listening to an Alabama fan should be a prohibited transaction——

Chairman ROE. Should have been University of Texas——

Mr. ANDREWS. It is a prohibited transaction under ERISA. [Laughter.]

Chairman ROE. Should have been UT, you would have been all right.

Thank you.

Mr. STEIN. Thank you.

Chairman ROE. Mr. Tarbell.

STATEMENT OF JEFFREY TARBELL, DIRECTOR, HOULIHAN LOKEY

Mr. TARBELL. Thank you, Chairman Roe, Ranking Member Andrews, and members of the committee for the opportunity to testify.

I am testifying today to voice concerns regarding certain unintended consequences of the proposed redefinition of the fiduciary.

These concerns are not simply shared by my firm, Houlihan Lokey, but by other providers of valuation and fairness opinion providers who I am representing today.

National associations such as the American Society of Appraisers, the ESOP Association and the American Institute of Certified Public Accounts also have raised similar concerns.

As reflected at the DOLs hearing on the subject in March, these concerns are two-fold. First, as you know, the White House issued an executive order earlier this year directing federal agencies to use the least burdensome tools for achieving regulatory ends and to select in choosing among alternative regulatory approaches, those approaches that maximize net benefits.

However, the DOL has provided no meaningful cost-benefit analysis that would satisfy this directive.

Insurance has long been used by plan fiduciaries to mitigate ERISA litigation risk, but no such product currently exists for firms like ours that provide valuation and fairness opinion services. Nor has the DOL produced any evidence projecting the cost of that insurance.

The group of firms that I represent has estimated that cost to be up to $180 million annually.

The proposed rule would also lead to a substantial increase in litigation costs to valuation and fairness opinion providers and those increase costs would translate into higher fees for employee benefit plans and their sponsors.

For many firms, the cost to defend a single case, whether found guilty or not, would likely exceed their annual profits and for smaller firms is likely to put them out of business.

Given the direct cost and increased risk, many firms, including my own, would find it difficult to continue providing these services related to ERISA plans. Thus, it wouldn't surprise me if many firms left the market which would result in reduced competition and increased cost. And, again, those increased costs will translate into higher fees for plans and plan sponsors.

Valuation and fairness opinion providers also would need to retain separate ERISA counsel to represent them on ESoft transactions which is projected to add between $30,000 and $100,000 to the cost of each transaction. The total cost for the thousands of Esoft-owned companies is estimated to exceed $50 million a year.

Second, the proposed rule directly conflicts with impartiality requirements under professional standards of valuation practice and the internal revenue code. The core elements of the ethical standards of the valuation profession require that a valuation be performed independently.

The Uniform Standards of Professional Appraisal Practice, known as USPAP, which is the generally recognized ethical standard for the valuation profession, imposes specific conduct requirements on valuation providers, including an impartiality require-

ment. Federal regulations promulgated by the IRS incorporate these ethics standards.

Furthermore, IRS regulations require valuations of employer securities to be performed by a qualified independent appraiser who is not a party to the transaction and is not related to any party to the transaction.

An independent appraiser will be deemed to have prepared a qualified appraisal if the appraisal has been prepared in accordance with the substance of principles of USPAP according to the IRS.

Thus, it is impossible for a valuation provider to provide an impartial opinion of value of privately held securities and be a fiduciary as required by the proposed regulation.

As a fiduciary, the valuation provider's duty to act with loyalty that is solely in the interest of the participants and beneficiaries would contradict the provider's ability to act impartially. The unintended consequences of the DOLs proposed rule are not outweighed by any perceived benefits. The DOL claims the proposed rule is aimed at correcting a common problem of substantial valuation work; however, the DOL has provided no empirical support showing that such a problem is widespread and, to my knowledge, the agency has no in-house expertise to make such a determination.

The agency has also provided no explanation as to the nature of the problem.

The DOLs stated goal to regulate valuation and fairness opinion providers by making them fiduciaries will lead to expensive litigation brought by plaintiff's firms but it will not transform careless valuation providers into careful ones. Nor does the agency's stated goal actually articulate any standards by which the agency would evaluate whether valuation work is satisfactory or substandard.

The DOL issued a proposed adequate consideration regulation more than 20 years ago that was intended to provide standards for plan fiduciaries in the ESOP area; however, that proposed guidance has never been finalized.

Valuation and fairness opinion providers are willing to work with the DOL to develop guidelines on valuation issues of concern to the agency.

I close by noting that valuation professionals like me share the DOLs desire to make sure that valuations are prepared carefully and appropriately. To that end, my firms and other firms I represent today welcome an opportunity to discuss standards and an appropriate enforcement framework that avoids the unintended consequences posed by the DOLs proposed rule.

Thank you for the opportunity to testify, and I look forward to questions.

[The statement of Mr. Tarbell follows:]

Prepared Statement of Jeffrey Tarbell, Houlihan Lokey

Good morning. Thank you Chairman Roe, Ranking member Andrews, and members of the Subcommittee for the opportunity to testify this morning. My name is Jeff Tarbell. I am a Director with Houlihan Lokey, an investment bank that, among other things, provides valuation and fairness opinion services related to Employee Stock Ownership Plans ("ESOPs"). I have more than 20 years of experience rendering valuations and fairness opinions, many of these related to ESOPs.

I am testifying today to voice concerns regarding certain unintended consequences of the proposed regulation issued by the Department of Labor ("DOL"), which would

amend the definition of "fiduciary" under the Employee Retirement Income Security Act of 1974, as amended ("ERISA"). These concerns are not shared simply by Houlihan Lokey, but by other providers of ESOP valuations and fairness opinion services whom I am representing today.[1]

As reflected at the DOL's March 1st and 2nd hearing on the subject, our concerns are two-fold: (1) the costs of the proposed rule on employee benefit plans and the employers who sponsor them would be significant; and (2) the proposed rule directly conflicts with longstanding professional and regulatory standards of valuation practice requiring that an appraiser provide an independent and impartial opinion of value. Furthermore, if the DOL's goal is to regulate valuation and fairness opinion providers directly, then the agency first needs to put in place regulatory standards governing the provision of valuations and fairness opinions. Houlihan Lokey and other providers of valuations and fairness opinions, as well as the ASA, are ready and willing to discuss a reasonable framework of standards and enforcement, but enforcement through fiduciary labeling is a misguided and problematic approach.

Before specifically addressing those concerns, it should be noted that the DOL's proposed rule represents a sudden reversal of the agency's longstanding treatment of providers of valuations and fairness opinions related to employee benefit plans. Firms providing ESOP valuations and fairness opinions long have relied on the DOL's 1976 advisory opinion that a person retained to conduct a valuation of privately held stock to be offered to, or held by an ESOP does not function as a fiduciary under ERISA. The factual bases for that advisory opinion continue to be true today. As the DOL noted in that opinion, an ESOP valuation or fairness opinion does not make a recommendation as to a particular investment decision, does not address the relative merits of purchasing particular employer securities, nor does the ESOP valuation or fairness opinion provider have any decision making authority over a trustee's decision whether to purchase or sell the employer securities. In other words, an ESOP valuation or fairness opinion does not constitute "investment advice." Consequently, it is contrary to the DOL's 35 year-old position and unreasonable that ESOP valuation and fairness opinion providers, or other providers valuing assets belonging to ERISA plans, now should be singled out for fiduciary treatment.

Concerns with the DOL's Proposed Fiduciary Definition

I. The Public Record Shows That The Costs Of The Proposed Rule Would Be Substantial To Employee Benefit Plans And Their Employer Sponsors

As you know, earlier this year, the White House issued an Executive Order directing federal agencies to use "the least burdensome tools for achieving regulatory ends," and to "select, in choosing among alternative regulatory approaches, those approaches that maximize net benefits." Executive Order 13563, 76 Fed. Reg. 3821 (Jan. 18, 2011). However, the DOL has provided no meaningful cost-benefit analysis that would satisfy the Administration's directive.

While insurance has long been used by plan fiduciaries to mitigate their ERISA litigation risk, the administrative record is clear that no such product currently exists for firms providing valuation and fairness opinion services related to ERISA-covered plans. Based on the stringent cost-benefit analysis that is now required by the executive branch, reliable data must be obtained to quantify the identified insurance cost. And yet, no evidence has been introduced by the DOL as to the projected cost of that insurance. The group of firms that I represent has attempted to estimate the cost of a valuation-specific insurance product by considering the cost of fiduciary insurance coverage for ESOP trustees, which is typically based on assets under management. The group understands from conversations with industry representatives and other information in the public domain that premiums range between $100 to $200 per $1 million of assets under management. See Fiduciary Insurance—Understanding Your Exposure, at 12, available at *http://www.naplia.com. The ESOP professional associations project that the total assets owned by ESOPs are roughly $900 billion. See National Center for Employee Ownership statistics, available at http://www.nceo.org/main/articl/php/id/21; The ESOP Association statistics, available at http://www.esopassociation.org/media/media—statistics.asp. Using that ratio, the aggregate fiduciary insurance costs for valuation and fairness opinion providers would range from $90 million to $180 million annually.*

In addition to increased insurance costs, the proposed rule also would lead to a substantial increase in litigation costs to valuation and fairness opinion providers. As I understand it, fiduciary insurance policies often contain a high deductible be-

[1] The firms include: Chartwell Capital Solutions, Columbia Financial Advisors, Inc., ComStock Advisors, Duff & Phelps, LLC, Houlihan Lokey, Prairie Capital Advisors, Inc., Stout Risius Ross, and Willamette Management Associates.

fore coverage begins. Thus, a provider may be faced with substantial out-of-pocket costs just to establish its compliance with professional standards. For many firms, the cost to defend a single case would likely exceed their annual profits. Those increased costs would translate into higher fees for the employee benefit plans and their sponsors.

In addition, internal costs driven by the regulation, such as additional records maintenance, and the development of policies and procedures, also will be incurred. Valuation and fairness opinion providers would need to consider these new costs in pricing their services. These increased fees would not only impose direct, immediate, and incremental costs on employers, most of whom are small or mid-size businesses, but those costs would likely increase over time. In this regard, given all the direct costs and increased risk, many firms, including my own, would find it difficult to continue providing valuation and fairness opinions services relating to ERISA plans. Thus, commentators believe that many firms—particularly the larger, better capitalized firms—would have a disincentive to continue providing valuations and fairness opinion to ERISA plans in light of the increased costs and litigation risk. Such a decrease in competition would result in further increasing costs which, again, would translate into higher fees for employee benefit plans and their sponsors.

In addition to the cost of insurance, retention and regulatory compliance, ESOP valuation and fairness opinion providers, as proposed fiduciaries, also would bear the cost of hiring their own separate ERISA counsel to represent them in ESOP engagements. It is projected that retaining ERISA counsel would add $30,000 to $100,000 to the overall cost of each ESOP purchase or sale transaction. This estimate is based on what an ESOP trustee's ERISA counsel generally charges in a transaction, and the cost of legal counsel retained by valuation or fairness opinion providers in non-ERISA transactions. One ESOP trade organization estimates that, on average, approximately 1,000 ESOP transactions occur annually. Using that figure, the projected added cost for ESOP transactions would range from $30,000,000 to $100,000,000 annually. In addition, assuming the cost of retaining counsel to review a valuation is, on average, approximately $5,000, the total cost for the 11,500 existing ESOP companies would exceed $50 million a year. Again, these costs would be passed directly on to plans and their sponsors.

II. DOL's Proposed Rule Is At Odds With Impartiality And Independence Requirements Under Professional Standards Of Valuation Practice And The Internal Revenue Code

The core elements of the ethical standards of the valuation profession require a valuation to be performed independently and without bias in favor of any party. The Uniform Standards of Professional Appraisal Practice ("USPAP"), which are the generally recognized ethical standards of the valuation profession, contains an ethics rule which imposes specific conduct requirements on valuation providers, including an impartiality requirement. See USPAP Ethics Rule, *http://www.uspap.org/2010USPAP/ USPAP/frwrd/uspap—toc.htm. (appraiser "must not perform with bias" and "must not advocate the cause or interest of any party or issue. * * *").*

Federal regulations promulgated by the Internal Revenue Service ("IRS") incorporate these industry ethical standards. In particular, IRS regulations provide that an ESOP can only be considered a qualified trust under the Code if "all valuations of employer securities which are not readily tradable on an established securities market with respect to activities carried on by the plan are by an independent appraiser," see Code § 401(a)(28)(C), as defined in Treasury regulations promulgated under Code § 170(a)(1) (emphasis added). A "qualified independent appraiser" under these regulations is a person who, among other things "is not a party to the transaction, and is not related to any party to the transaction." 26 C.F.R. § 1.170A-13(c)(5)(i)(emphasis added). Under IRS advisory guidance, a "qualified appraisal" has been conducted by a "qualified appraiser" within the meaning of § 1.170A-13 only if it is done "in accordance with generally accepted appraisal standards." I.R.B. 2006-46. The IRS has clarified that this would include appraisals "consistent with the substance and principles of [USPAP]." See Proposed Reg. 26 C.F.R. § 1.170A-17(a) (1)-(2) (proposing to codify guidance under I.R.B. 2006-46).

It is impossible for a valuation provider to provide an impartial opinion of the value of privately held securities and be a fiduciary to the holder, purchaser or seller of those securities, as required by the proposed regulation. As a fiduciary, the valuation provider's fiduciary duty to act "solely in the interest of the participants and beneficiaries" would contradict the provider's ability to act impartially. For example, the valuation provider would have a fiduciary duty to advocate the advisability of making a particular investment. However, the standards under the Code and well-established professional standards provide that the role of such a person is not to advocate for a value, or an investment, on behalf of anyone, but instead

provide an impartial opinion as to the value of a particular security, no matter who asks the question. Asking a valuation provider to ignore its ethical responsibility and be partial to plan participants is akin to asking a judge to be biased in handing down a verdict to his own client.

III. If The DOL Wishes To Correct Any Perceived Problems With Valuation Standards Of Practice, The Agency Should Establish What Those Standards Are First Before Turning To The Question Of Enforcement

The DOL has claimed that the proposed rule is designed to correct the "common problem" of substandard valuation and fairness opinion provider work. However, the DOL has provided no empirical support in the record showing that such a "problem" is widespread, and, to my knowledge, has no in-house expertise to even make such a determination. The agency also has provided no explanation as to the nature of the problem; that is, whether "faulty" valuations are the product of insufficient fact-gathering or analysis, computational errors, unreasonable use of assumptions on critical factors, or improper reliance on valuation methodologies that the DOL opposes as a policy matter.

The DOL's stated goal to regulate valuation and fairness opinion providers by making them fiduciaries, will lead to expensive litigation brought by plaintiffs' firms, but it will not transform those careless valuation providers into careful ones. Nor does the agency's stated goal actually articulate any standards by which the agency would evaluate whether valuation work is satisfactory or substandard. The DOL issued a proposed adequate consideration regulation more than twenty years ago that was intended to provide standards relating to ESOP valuation. See Proposed Regulation Relating to the Definition of Adequate Consideration, 53 Fed. Reg. 17,632 (1988). Ironically, that proposed guidance has never been finalized. Valuation and fairness opinion providers are willing to work with the DOL to develop guidance on valuation issues of concern to the Agency. Established standards would be important not only for firms providing valuation and fairness opinion services, but for ERISA fiduciaries and DOL personnel charged with reviewing and evaluating such valuations or opinions. Whether that person is an "internal" fiduciary within the company, or retained independently, the ERISA fiduciary must conduct a prudent investigation as to the merits of a proposed transaction and, therefore, would need to have a basic understanding of governing standards.

As it stands, the DOL's proposed rule is the proverbial example of putting the cart before the horse. Regulatory standards of practice governing valuation and fairness opinion provider services should be agreed upon before turning to the question of enforcement of such standards. With respect to enforcement, for the reasons above, making a valuation or fairness opinion provider a fiduciary is a misguided approach because it imposes unnecessary costs on the backs of ERISA plans and their employer sponsors, and directly contradicts established professional and regulatory standards.

I close by noting that valuation professionals like me join the DOL's desire to make sure valuations are prepared carefully and appropriately. To that end, my firm and the other valuation and fairness opinion firms I am representing welcome an opportunity to discuss standards and an appropriate enforcement framework that avoids the unintended consequences and insurmountable conflicts posed by the DOL's proposed rule.

I appreciate the opportunity to testify this morning and welcome any questions from you, Ranking member Andrews or other members of the Subcommittee at this time.

Chairman ROE. I thank you.

And, Mr. Bentsen, welcome back. And you may be glad you are on the other side of the dice today instead of here.

STATEMENT OF KENNETH BENTSEN, JR., EXECUTIVE VICE PRESIDENT, SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

Mr. BENTSEN. Well, I don't know. Thank you, Mr. Chairman, though, and I appreciate the hall pass to come around the corner from the Financial Services Committee.

I appreciate, Mr. Chairman, Ranking Member Andrews, and members of the committee for holding this very important hearing.

However well intentioned, we believe the department's proposed regulation has far broader impact than the problems it seeks to address. As has been stated numerous times, this proposed rule would reverse 35 years of case law enforcement policy and the understanding of plans and plan service providers as well as the manner in which products and services are provided to plans, plan participants and IRA account holders without any legislative direction to move from the department's contemporaneous understanding of the statute.

And, of course, the enforcement rationale behind this proposed rule cannot apply to IRAs because the department has no enforcement authority over IRAs. I would add, however, and it has not been mentioned, that the SEC and FINRA do have enforcement authority in that area as it relates to brokers and advisors.

After months of discussion with the department both in anticipation of the proposed rule and following its publication, we strongly believe the regulation should be re-proposed, and in particular re-proposed without IRAs.

The breadth and complexity of the provisions and many significant changes that need to be made and the uncertainty regarding the exemptions that will be required based on the final language underscore the need for the department to go back to the drawing board.

Further, based on our numerous conversations with the department and their acknowledgement for the need for significant change to the draft, we believe such changes in and of themselves would require re-proposal under the Administrative Procedures Act.

In addition, as has been stated, the proposed rule lacks sufficient cost-benefit analysis and absolutely no cost-benefit analysis related to its impact on IRA owners. We cannot think of a single reason barring re-proposal of this regulation, especially when the Securities and Exchange Commission will almost certainly be proposing a uniform fiduciary standard of conduct for brokers and advisors providing personalized investment advice pursuant to section 913 of the Dodd-Frank Act this fall. And that is an action that I would note that SIFMA has strongly supported throughout the consideration and final passage of Dodd-Frank.

It is also important to note that the SEC through their study, through the consideration of Dodd-Frank has been working on many of these very issues that we believe will be in conflict with where the department is heading with their rule.

By upending 35 years of established precedent and imposing a fiduciary status on a service provider who may have no relationship to a plan, the rule creates prohibited transactions and co-fiduciary liability on entities who have no understanding what the plan, or IRA, that any services at all will be provided. The selling exception in the puzzle does not even cover commissioned base sales or the selling of services let alone common investment transactions such as agency trades, futures, repurchase agreements, swaps, and security lending.

Absent a re-proposal to address such concerns and the advanced promulgation of the prohibited transaction exhibitions, our member

firms will be forced to alter and in many cases curtail services to their clients upon final publication.

To be clear, extending the implementation timeline of any final rule in order to consider a draft and promulgate exemptions, as some have suggested, will not forestall the necessity of firms to adjust their business planning operations and service delivery based upon the rule as drafted.

Firms must operate their businesses on rules as written, not based on the possibility of exemptions to come in the future.

While the department asserts that IRA owners, participants, and beneficiaries would directly benefit from the department's more efficient allocation of enforcement resources than are available under the current regulation. No example or explanation of such benefits is provided that would justify the sweeping changes, nor the unintended negative consequences to IRA owners, plans, and their participants.

And I might add that the secretary noted that while the premise of a lot of the studies that have been provided by multiple parties would suggest that there are only two business models, the broker-dealer commission based business model and the Registered Investment Advisor model and that some new model might come into play.

The fact of the matter is that hasn't happened yet, and we would argue, we would assert that it is inappropriate to design a rule based upon something that hasn't happened yet. The data is pretty clear about where the market is here.

Mr. Chairman, Ranking Member Andrews, I would like to close with this.

Obviously, the industry has a great deal of concern about this and what the impact will be on our ability to serve our clients. But it is not just the industry that has raised concerns on this. I think it is important to look at what investor advocates have said about this.

Over the last few weeks two prominent investor advocates have testified before various committees of the congress. Barbara Roper from the Consumer Federation who has been a leading advocate in the area of a uniform fiduciary standard of care has repeatedly stated in testimony and to the media and elsewhere that this rule will be harmful to investors and should be re-proposed and further that this rule will directly conflict with Congress's under Dodd-Frank with regards to swaps.

In addition, Mercer Bullard from the University of Mississippi Law School, again a prominent investor advocate, testified, I believe, 3 weeks ago before the Financial Services Committee and also published in an article in Morningstar that this rule would be bad for investors and should be re-proposed.

So we believe that the evidence is very clear that this rule needs to be withdrawn and re-proposed.

Thank you for the opportunity to testify.

[The statement of Mr. Bentsen follows:]

Prepared Statement of Hon. Kenneth E. Bentsen, Jr., on behalf of the Securities Industry and Financial Markets Association

Good morning. I am Ken Bentsen, Executive Vice President for Public Policy and Advocacy at the Securities Industry and Financial Markets Association.[1] We appreciate the Committee's decision to hold a hearing on the Department of Labor's proposed revision to the definition of fiduciary.

The Proposed Regulation

However well intentioned, we believe the Department's proposed regulation has far broader impact than the problems it seeks to address. This proposed rule would reverse 35 years of case law, enforcement policy and the understanding of plans and plan service providers as well as the manner in which products and services are provided to plans, plan participants and IRA account holders, without any legislative direction to move from the Department's contemporaneous understanding of the statute, in order to make it easier for the Department to sue service providers. That seems to us to be an inadequate basis for proposing such a dramatic change. And of course, this enforcement rationale cannot apply to IRAs, over which the Department has no enforcement authority.

After months of discussion with the Department, both in anticipation of the proposed rule, and following its publication, we strongly believe the proposed regulation should be re-proposed and in particular, re-proposed without IRAs. Many groups and individual entities representing plan sponsors, service providers, the financial services industry and investor advocates have raised issues about the proposed rule's impact on plans and participants and individual savers. The breadth and complexity in the provisions, the many significant changes that need to be made, and the uncertainty regarding the exemptions that will be required based on the final language, underscore the need for the Department to go back to the drawing board. Further, based on our numerous conversations with the Department, and their acknowledgment of the need for significant changes to the draft, we believe such changes in and of themselves would require re-proposal under the Administrative Procedures Act. In addition, the proposed rule lacks sufficient cost benefit analysis, and absolutely no cost benefit analysis related to its impact on IRA owners. We cannot think of a single reason barring re-proposal of this regulation, especially when the Securities and Exchange Commission will almost certainly be proposing a uniform fiduciary standard of conduct for brokers and advisors pursuant to Section 913 of the Dodd-Frank Act in the fall, an action that SIFMA strongly supports.

By upending 35 years of established precedent and imposing a fiduciary status on a service provider who may have no relationship to a plan, the rule creates prohibited transactions and co-fiduciary liability on entities who have no understanding with a plan or IRA that any services at all will be provided. The selling exception in the proposal does not even cover commission based sales or the selling of services, let alone common investment transactions such as agency trades, futures, repurchase agreements, swaps and securities lending. It requires the seller to announce it is adverse to the client, contrary to where the SEC is likely to go based on their Section 913 fiduciary study. Absent a re-proposal to address such concerns and the advance promulgation of prohibited transaction exemptions, our member firms will be forced to alter, and, in many cases, curtail services to their clients upon final publication of this rule. To be clear, extending the implementation timeline of any final rule in order to consider, draft and promulgate exemptions, as some have suggested, will not forestall the necessity of firms to adjust their business planning, operations and service delivery based on the rule as drafted. Firms must operate their businesses on the rules as written, not based on the possibility of exemptions to come in the future.

While the Department asserts that IRA owners, participants and beneficiaries would directly benefit from the Department's more efficient allocation of enforcement resources than are available under the current regulation, no example or explanation of such benefits is provided that would justify these sweeping changes nor the unintended negative consequences to IRA owners, plans and their participants. Instead, we believe the individual investors who hold them will suffer increased costs, significantly fewer choices and greatly restricted access to products and services—new asset-based advisory fees to replace a commission/spread based structure,

[1] SIFMA brings together the shared interests of hundreds of securities firms, banks and asset managers. SIFMA's mission is to support a strong financial industry, investor opportunity, capital formation, job creation and economic growth, while building trust and confidence in the financial markets. SIFMA, with offices in New York and Washington, D.C., is the U.S. regional member of the Global Financial Markets Association. For more information, visit www.sifma.org.

additional transaction costs, elimination of investment options and alternative vehicles, constriction of the dealer market, limits on permissible assets in IRAs, and the elimination of pricing of anything other than publicly traded assets. Absent a reproposal, we have no confidence that these fundamental flaws will be fixed. Nor are we confident that the necessary exemptions will be in place before the effective date. Millions of savers will find that they cannot invest in the products and services that they have been accustomed to having available in their retirement accounts and that the cost of such products will dramatically increase.

Costs of the Change to Plans and Participants

The proposed regulation states that the Department is uncertain about the cost of the proposal in its preamble. Promulgation of a broad and far reaching regulation, with no change in the law to prompt such change and no indication from Congress that a change is needed should not be done without adequate cost analysis. The Department's cost estimates focus on certain costs to service providers, and not the cost to plans, beneficiaries and IRA holders. While we believe the Department greatly underestimated such costs to service providers, more importantly we think this emphasis is misplaced. The real question is the cost to plans and their participants and the impact on their retirement savings. And while the Department's cost analysis leaves alarming gaps in what it does appear to understand or be certain about, its list of uncertainties does not even once mention IRAs. IRAs hold more than $4.3 trillion as of March 2010. The vast majority of these assets are in self-directed accounts. The total lack of analysis on the effect on these accounts is very hard to understand.

The costs to such account holders would be significant. From data pulled quickly from a handful of our member companies, there are over 7 million accounts that are under $25,000 and use a commission-based model. In addition, over 1 million of those accounts are under $5,000. These are currently commission-based accounts, not advisory fee accounts. This proposal will push them to an advisory model. And, most firms require a minimum account balance for advisory accounts that could result in millions of IRA account holders being dropped.

While current exemptions to the prohibited transaction rules of ERISA (PTE 86-128) permits fiduciaries to select themselves or an affiliate to effect agency trades for a commission, there is no exemption that permits a fiduciary to sell a fixed income security (or any other asset) on a principal basis to a fiduciary account. Lack of exemptive relief in this area is contrary to what Congress explicitly stated in authorizing the SEC to promulgate a uniform fiduciary standard of care for brokers and advisers providing personalized investment advice under Section 913 of Dodd-Frank. The result of that conflicting prohibition is that the broker would not be able to execute a customer's order from his own inventory but rather purchase the order from another dealer, adding on a mark-up charged by the selling dealer. That mark-up would result in an added cost for these self-directed accounts, and would disproportionately fall on smaller investors, such as small plans and IRAs. And of even more concern, it would eliminate the most obvious buyer when a plan wants to sell a difficult to see security. Further, given that the rule would eliminate a clear understanding when a broker is acting as a fiduciary, and thus increase liability risk, it is likely that brokers will transform such accounts into asset based fee arrangements or wrap accounts with their brokers so the brokers can comply with the prohibited transaction rules that govern fiduciaries under ERISA and the Code. Asset based fee accounts or wrap accounts are designed to provide on going advice at a higher fee than traditional self-directed commission based accounts. However, most individual investors with IRA accounts and most personal brokerage accounts are lower cost self -directed commission based accounts. The result would be imposing higher costs and less choice on investors.

This is particularly critical in assisting small businesses when they start up new plans. Many broker dealers help small business owners in their local communities establish retirement plans for their employees by educating them about the benefits of plans. By prohibiting commission-based sales, the proposal would make it economically unfeasible for most brokers to continue to offer this service. Payment of a separate advisory fee to set up a plan will likely deter many small businesses from providing this important employee benefit.

Intersection with Dodd Frank

As I stated, the Department's rule is in conflict with Section 913 of Dodd-Frank that authorizes the SEC to establish a uniform fiduciary standard of care for brokers and advisors when providing personalized investment advice. SIFMA strongly supported that provision of Dodd-Frank and we recently submitted a letter to the

SEC encouraging the Commission to move forward with such a rule. I have submitted our letter with my testimony for the record.

Also, during consideration of the Dodd-Frank Act, Congress considered the question of a counterparty providing a fiduciary duty to plans engaging in swaps and it rejected such an approach because it wanted to be sure that plans could continue to engage in such activities principally for hedging purposes. However, as currently drafted, the Department's proposed rule would result in a counterparty being deemed a fiduciary, which would eliminate the ability for plans to enter into swaps. Again, the SEC and the Commodities Futures Trading Commission ("CFTC") were directed by Congress to establish business conduct rules for dealers engaging in swaps with plans, and yet the Department's rule would conflict with those rules, which are currently in the proposal stage. Absent a significant change in the Department's final rule, or better a re-proposal, the Department's proposed rule will directly conflict with Congress expressed intent in Dodd-Frank.

Conclusion

Finally, while financial services providers continue to express grave concerns about the proposed rule's impact, I would point out that similar views regarding the far reaching and unintended consequences have been voiced by leading investor protection and consumer advocates. Barbara Roper of the Consumer Federation of America, in testimony before Congress last week also called for a re-proposal and asserted that the proposed rule would conflict with the business conduct provisions under Dodd-Frank. Also, University of Mississippi law professor and investor advocate Mercer Bullard, both in a published article and testimony has said the rule is bad for investors and should be re-proposed.

Mr. Chairman, Members of the Committee, SIFMA and its members have provided substantial comment and data to the Department as to why this rule must be withdrawn and re-proposed and that necessary exemptions must be promulgated in advance of any final rule. Further there must be sufficient coordination with and consideration of the SEC's likely action under Section 913. Otherwise, this proposal will have significant negative impact to millions of accountholders.

I thank you for permitting SIFMA to testify today, and would be happy to answer any questions.

Chairman ROE. I thank the panel.

I will take just a couple of minutes here to ask a couple of questions and one recurring theme is that there was no cost analysis done prior to implementation of the rule, and I think that is one of the things the uncertainty of that, about how much is this thing going to cost. And then at the end, again, I bring back the question of what problem are you fixing?

Now Professor Stein made a good point. Certainly there are outliers out there, but I know in my own dealing with my own small business that this was—we understand the rules basically now. We sort of get the rules. This is going to make it harder.

As I listen to this rule I am playing through how I go to my practice to my pension committee and how I would advocate—and it is going to be difficult.

And especially, Mr. Bentsen, if you would bring up or any of the panel members would like to, what about a small IRA investor that has got say $10,000 or $15,000 or $20,000 or $25,000? What happens to them?

I mean when you call one of these education lines the following question is going to be, "Well, what do you think I ought to invest in?" They may not know. So would you all? Anybody can take that one.

Mr. BENTSEN. Mr. Chairman, it is a very good question. The dilemma that this rule poses is that it changes the established standard that is understood by providers and how they operate.

At the very same time that the—and as it relates to IRAs. At the very same time that brokers and advisors, the same people, are

going to have their standard of care changed, again, something that we support, under section 913 of Dodd-Frank.

And the problem that exists in this rule is this rule is so broadly written without clarity to determine when is one giving advice and when is one not giving advice. And if that is not made clear, then the liability risk to a broker is going to be too great. So they will then have no choice but to move such accounts into advisory accounts where there is an established fiduciary duty.

Advisory accounts are more expensive than basic commission accounts. Most IRAs are in basic commission accounts. And so it will raise the cost.

But the other problem is the industry is organized, like any business, based upon scale and efficiency. And so most advisory accounts have a minimum amount, a minimum balance that they can have because below that it is inefficient for the firm or the broker or the advisor rather to operate it.

And so what will happen, and most of those are around $50,000 per account. So this will force a number of accounts that can't move into that advisory account to go looking for services somewhere else and at a higher cost.

Chairman ROE. Mr. Mason?

Mr. MASON. Yes, I just wanted to jump in, and I completely agree with everything Ken was saying.

I think the Oliver Wyman study, I want to just briefly mention that, it found, because of the phenomenon that Ken mentioned, it found sort of concrete, in response to your question, that within the study sample alone over 7 million IRAs would just be on their own.

They would just say, the broker's would have to say you are on your own. There is the computer. Good luck. That is a sad situation.

If you extrapolate that to the entire market, you are talking about 18 million IRAs being cut off and put on their own.

And I want to just correct, very briefly, correct one thing. I would disagree with Secretary Borzi. I think she was saying there was a flaw in the Wyman study in the sense that it did not take into account the exemptions for commissions. It did.

What the basis for the Wyman's study's conclusion was that the standard practice in the way that the brokers sort of get a significant amount of their compensation is through revenue sharing, and that there is no privative transaction for.

The Wyman study was very accurate in that regard. So I just wanted to correct that point.

Chairman ROE. Well, there is no question that a small IRA owner can't—$20,000 or $10,000 or whatever, can't afford to pay. I know our fees went down as the size of our plan went up.

And obviously a small firm would spend most of their money on fees if it was a fee-based instead of——

Mr. Myers?

Mr. MYERS. Yes, I would just like to elaborate on the common model today is for lots of intermediaries like brokers and banks to be compensated for their services to the plan from fees they receive from third parties like mutual funds.

And in fact several years ago the Department of Labor was concerned that smaller plans were paying higher fees. And they con-

ducted a study and then hearings and they learned that it does cost more per participant to provide services to a smaller plan as oppose to a larger plan. And at the same token, it costs more per participant to provide service to an IRA.

And the way the system now works is these intermediaries get compensated for that service with the fees that they receive from the funds, which they would no longer be able to receive if there are fiduciaries in the absence of an exemption.

And I would just like to elaborate or clarify a point that Ms. Borzi made that a lot of the class exemptions today would not provide the type of relief that is necessary so those exemptions would have to be modified or revised. So currently if they receive these fees in their fiduciaries, they are just going to have to, as explained by other panel members, just change their model dramatically.

Chairman ROE. Okay. Thank you.

Mr. Kildee?

Mr. KILDEE. Thank you, Mr. Chairman.

First of all, I would like to see if Mr. Stein would like to reply, I know there is some interest there, to Mr. Mason's comments.

Mr. STEIN. Yes. One of the things that I think, you know, we often lose sight of when we talk about whether people will be able to afford this if people have to charge. The revenue sharing is a fee. Right? The revenue sharing is a fee. That is not understood by most participants.

If the revenue sharing didn't take place, presumably that money would end up in the accounts of the people, ultimately as business models change, in the accounts of the people who were investing.

I mean, these services are not being provided for free. They are being provided for money and it is just that the money is provided in a way that is not visible to participants and can result where some vendors of investment products pay more in revenue sharing than others. That, in my mind, has to influence the people who are doing the selling.

Mr. KILDEE. Thank you very much.

Mr. Myers, could you further discuss what changes you would make to the proposed rule? Can it be changed? Can it be made whole or good? And how, then, could you, if you could improve it, what areas would you address?

Mr. MYERS. Well, let me go back to the original regulation which was adopted in 1975. And let us examine what was the basis for that regulation.

When ERISA was enacted there was a real concern of the consequence of being a fiduciary and there was a belief at the time that taking on a fiduciary responsibility should not be thrust upon an individual but it should be as a result of some mutual understanding between two parties.

And so for that reason, the regulation as adopted had that five part test. And what it was concerned about was that sending out recommendations to buy or sell a particular security should not cause someone to be a fiduciary.

If a plan believes that it is getting advice from someone who is a fiduciary but the person giving the information believes it is not a fiduciary, that person who is giving the information shouldn't be

subject to the fiduciary rules because they would have to change their conduct dramatically.

So the thinking at the time was you need a mutual understanding between two parties. You need an ongoing relationship that would subject that person who would be a fiduciary to all these fiduciary rules.

And so that is where—while the regulation has been criticized, I think it had a solid basis in what the concern was of the government of the time. And I think the Department of Labor was also reacting to concerns by the conferees that gave rise to ERISA that ERISA should not disrupt ordinary business practices.

So taking that into account, they came up with the five-part test, and it has worked pretty well. There are lots of courts have applied that definition.

No one has questioned the regulation, and in fact there was a recent court case involving a Madoff related investment where the plaintiff argued in that case that the advisor was a fiduciary because it met the five-part test and gave investment advice.

The other side argued no, it was not a fiduciary. The court went through all five parts and concluded that yes, that person was a fiduciary because they were giving investment advice and met all the conditions of the regulation.

So despite what Department of Labor is saying, there are courts that are concluding that people are giving advice by virtually satisfying this five-part test. So basically it has worked pretty well, and so I don't, I would say we stick with the regulation.

If the Department of Labor, despite all the comments, decides that it wants to go forward, as I mentioned in my opening statement, and I agree with other people who made the same point, the DOL should re-propose because it is so controversial, because it is going to have such an impact on business, because there are so many concerns about it, and it is likely DOL will make a number of changes to it, it should give the opportunity to the public to examine the re-proposed versions, figure out how that is going to work and how people can live with it.

Mr. STEIN. I agree partly with those comments that when in 1975 when we were dealing with sophisticated plan fiduciaries maybe making ERISA, even though this wasn't what the statute contemplated, making investment advice fiduciary status voluntary they made sense.

But if you are a participant in a 401k plan and you see an advertisement like that which says we have talked to you one-on-one so you can develop a plan that is right for you, you get personalized, practical help focused on meeting your retirement needs, you are going to think that person is giving you investment advice.

But the fine print simply quotes the regulation and says we are not giving advice that should be the primary basis of you investment decisions. It quotes the regulation word for word and it makes fiduciary status voluntary and there I disagree with Don. I don't think Congress intended ERISA fiduciary standards to be voluntary, and I think it is good it didn't.

Mr. MYERS. Well, I would say that maybe the solution is to have better transparency and better disclosure and move that fine print

further up into the body of the commercial. It doesn't necessarily require a wholesale change in the regulation.

Mr. STEIN. Well, if the regulation is not changed I am not sure how you can get that stuff higher up in the commercial.

Chairman ROE. Okay. I thank you gentleman for yielding.

Dr. Heck?

Mr. HECK. Thank you, Mr. Chairman.

My question is for Mr. Bentsen. Do broker-dealers who provide advisory programs charge an advisory fee?

Mr. BENTSEN. Most broker-dealers will, or many broker-dealers will either provide brokerage services on a commission basis and often will also provide advisory services. They are two different—they are definitely regulated, they are definitely registered. And many firms are duly registered, not all. But they operate under different rules.

Now, as Mrs. Biggert mentioned, this is something that frankly the administration in their original white paper back in 2009 and the Congress subsequently changed to authorize the SEC to establish a new uniform standard of care between brokers and advisors operating under two different statutes.

And, in fact, we believe strongly, based upon what the SEC has told us, that they will do so, that they will promulgate a rule this fall establishing that.

Mr. HECK. Well, we have seen that throughout this process. The DOL doesn't quite understand that issue. And I was wondering, have you advised DOL on this issue and if so, what is been their response?

Mr. BENTSEN. Absolutely. We have raised it with DOL. I think many others have raised it with DOL. I think that the members of Congress have raised it with DOL, and I think that it is important. The secretary said, well, look, we have been working on this before Dodd-Frank came around.

But again, Dodd-Frank began in the administrations white paper in response to the financial crisis in May of 2009. I am not sure when the DOL started working on this proposed rule.

But the House worked on Dodd-Frank through 2009. This was in the House bill, section 913. There was a similar provision in the Senate bill. This was going to happen.

And our concern, as we have said repeatedly, is let this process play itself out and then see where it all fits together because our member firms will have to operate under all these rules.

Mr. HECK. Great. Thank you very much.

Thank you, Mr. Chairman. I yield back.

Chairman ROE. Mrs. McCarthy?

Mrs. MCCARTHY. Thank you, Mr. Chairman, and thank you for your testimony. I appreciate it.

I happen to sit on not only this committee but the Financial Services Committee, and when we were working through the Dodd-Frank bill, especially here, we spent a year-and-one-half looking at every piece that we could, because when we did the first section we had to make sure that the first section wouldn't interfere with the second section and go forth.

One of the things that many of us on the committee, bipartisanly, felt very, very strongly about was the consumer finan-

cial literacy part. I think that is extremely important for people to know.

That is something that I certainly worked on here on this committee, but I also worked on it on Dodd-Frank.

One of the things that concerns me most is that when the president put out an executive order, he emphasized the need for more interagency cooperation, and we heard the secretary talk about that.

But as far as what we number of us as members, by meeting with her and talking with her and asking her direct questions. Has she talked to the SEC? Has she talked to your group? Has she talked to those interested parties?

As far as I am concerned, I don't see how this proposal has really followed the spirit of the executive order, and that is one of the things that I am concerned about.

But I think that what I would like from you gentleman, you heard her testimony. Most of you were sitting here through it. To me there were some discrepancies in her testimony from when we had talked to her, some of our colleagues, when we had met with her a couple of times.

So I guess I want to give you guys an opportunity to basically talk about where again you might disagree, where the DOL is going, where we are trying to go to come to an answer.

And the final thing I will say to you is that I think the majority of us on both sides of the aisle want to certainly protect all investors. I believe that with all my heart and soul.

ERISA has been something there, in my opinion, that has been there to protect. But again, things have changed over the last 30 years plus, and I think that we have to move with that to give our constituents who certainly are better informed today than they ever were.

Mr. Stein, I understand where you were going back years ago. I probably would have said I was the same way. But then, when I started saving, I had to look to see what were the best investments.

I think the first thing I would have done if someone came knocking at my door, I would have said no thank you.

So with that I will open it up.

Mr. STEIN. That is what I should have done but people don't do that. Some people don't and some people do, and ERISAs there to protect those who don't.

Mrs. MCCARTHY. I agree, and that is what we are still trying to do is protect ERISA.

But again with legislation that we have gone through with the Dodd-Frank and basically where we are today, I happen to think that the rule that the DOL is coming through is going to be, in my opinion, difficult for people to get the advice that they need, and I think that is something that we need to do, because financial literacy is the only way they are going to learn.

The consumer still has, in my opinion, due diligence to learn as much as possible. One of the other things in Dodd-Frank was also to give the consumers an idea what it was costing them, and those regulations are being put forward.

If anyone looks at any of their statements, there is paperwork coming through now in the mail telling you what it is costing you

to be in certain plans, what the commission—I mean, that is transparency. That is when somebody can make up their mind.

Mr. BENTSEN. Congresswoman, if I could just make two points to respond and you know this from your work on Dodd-Frank. The secretary said that this proposal would not ban commission business but, in fact, in our view, it would.

In particular, it would in direct conflict with something that you all did in Dodd-Frank in section 913 in which you said there could be principal transaction very explicitly within the act under this new fiduciary standard.

But under the standard as proposed by the department, if I am engaging with my broker for my IRA my broker will not, as it is written right now without any exemption, my broker will not be able to sell me a bond from his or her inventory. He will have to sell it to me on an agency basis where I will have to pay a markup outside of where he has to go buy it from the street.

And that raises the cost to the transaction. That is something that the committee in the Congress recognized in drafting 913 that the department in their proposal doesn't recognize. And so I think it is just one area where there is a direct conflict in the rule.

Mr. MASON. If I could just jump in for one quick comment.

I think the question is sort of what take-aways did I have from the secretary's discussion this morning, which I thought she was both eloquent and spirited and passionate. I think the one take-away was there wasn't, in the testimony this morning, in the written testimony as well as the oral, a significant amount of new data, new studies, new information.

I think what we, in some sense, I found the testimony reinforcing the need for re-proposal because we need to have a dialogue about those, that new information, that new data that we have never seen before.

It raised interesting points but it is the way our process works. The process is intended to allow that data, that information to be subject to public comment.

Mr. MYERS. Let me just elaborate on that.

I think there was one thing I found comforting is she said she wants to get it—oh, I am sorry.

Chairman ROE. I thank the gentlelady for yielding.

Mrs. Roby?

Mrs. ROBY. Well, thank you. I am sorry. I missed my colleague's comments earlier, but Mr. Stein, I don't have any questions for you, but I would tell you, Roll Tide. [Laughter.]

So I have many concerns relating to this proposed regulation and I have one specific concern related to the Employee Stock Ownership Plan or ESOP.

And I recently met with Mr. Spencer Coates who is the president of Houchens Industries and even though he is not a constituent of mine he is a constituent of our colleague Representative Guthrie from Kentucky. But almost 400 of my constituents back in the 2nd district of Alabama are employed by him.

And if this proposed regulation goes into effect it would make finding a valuation firm more expensive, it would substantially increase the cost of the transaction for companies, such as Houchens Industries as they expand by acquiring non-ESOP companies.

So for Mr. Tarbell, if you wouldn't mind answering just a couple of questions for me.

Is the ESOP appraisal valuation business sufficiently lucrative to justify assuming fiduciary liability and if not, are firms comparable to your firm driven from the market due to liability concerns who will then be left in the valuation space?

Mr. TARBELL. Okay. Well, the ESOP valuation world is a subsegment of all the various reasons valuations are performed, and I would characterize it as one of the rather low margin businesses. I have not heard the word lucrative used to describe it ever in 21 years.

I don't believe that there are room for advisors to absorb significant fees and remain in that business. I think consistent with past practice and common sense additional fees will be passed on to the client. You don't incur the risk if you don't incur the client, and so the client will pay for the risk.

But there will always be risks that cannot be passed on. You know, the risk of the first part of litigation, for example, that is not covered by insurance. And these costs are such that I think it is quite easily predictable that the fees charged on appraisals will increase, perhaps dramatically. They can't not increase.

Mrs. ROBY. I mean it was even suggested to me by Mr. Coates who I referenced that it could go from a $300,000 fee upwards of a million to $3 million because of the increased risk associated with the appraisal.

Mr. TARBELL. Your ratios are correct, but the realistic fee level for ESOP appraisals is more like going from $20,000 to $30,000. It would be a rare, rare ESOP that has a fee of the numbers you quoted.

This is a small appraisal business. The fees are not dramatic and one of the reasons they are not dramatic is because we have enjoyed not being the fiduciary in those transactions. That isn't to say, though, that there isn't a fiduciary; there is.

Mrs. ROBY. If you became the fiduciary then that could——

Mr. TARBELL. Well, of course. There is a fiduciary in an ESOP valuation. It is the trustee. So there is a system already in place and one of the concepts that is a matter of law but has been ignored by the DOL on this is that it is the trustee, not the appraisal firm, who is responsible for determining the value of the stock.

We provide advice and they make a choice among a range of values we provide. Choosing to accept our valuation as, for example, as the middle of the range is as much of a choice as choosing one end of the range.

Mrs. ROBY. Well, and so to further expand on that can you discuss the importance of your independence in the appraisal profession that why would it be so bad to put a thumb on the scale? And this is just expounding on what you have already said.

Mr. TARBELL. Well, you know, the DOL says that they are not putting a thumb on the scale, but I would say that that is, you know, that is just patently wrong. This regulation as it is written would absolutely force us to render an appraisal that is biased, that is in favor of one party, being the plan participants.

I don't understand the logic of the discussion that all they are looking for is for us to be fair and balanced. First of all, that is what we already do.

Mrs. ROBY. I was about to say, that is what you are doing right now.

Mr. TARBELL. And so if that is all we are, if that is what we are doing right now I don't know how making us fiduciary will make us do appraisals any differently.

But secondly, this concept of asking us to be fair and balanced is only half of the equation. Being a fiduciary requires care but it also requires loyalty and it is that aspect of the fiduciary duty that has been ignored by the DOL, in my opinion, asking us to be loyal to the plan, act in their best interest, yet render an unbiased and impartial opinion of value is just fundamentally inconsistent and incurable.

Mrs. ROBY. Thank you so much.

And Mr. Chairman, I yield back.

Chairman ROE. I thank the gentlelady for yielding.

Mr. Scott?

Mr. SCOTT. Thank you, Mr. Chairman.

And Mr. Bentsen, it is good to see you again.

I think one of the things about the discussion is really a question of what perspective we are taking in this debate, and I think as legislators our perspective ought to be how these laws apply or affect unsophisticated investors that may not have the fundamental information about how to invest and how we protect them from bad advice.

I mean, there is kind of generally accepted theories of how a young person, how a middle-aged person, and how an older person ought to be investing pension funds. I guess the first question is: do we, in fact, have a responsibility to unsophisticated investors, or should we just let the marketplace do what it does?

Mr. BENTSEN. I will start with that. I think the real question here comes down to when someone is giving advice on which someone is making a decision and when they are not and, again, I am going to go back like a broken record that Congress did feel it was responsible, was appropriate to do so section 913 of Dodd-Frank as it related to individual investors.

And so Congress did act in that regard. I think that was appropriate. We thought it was appropriate. We supported that effort. We support the SEC going forward. In fact, we wrote the SEC the other day and said they should go forward with that.

I think in this instance, frankly, this is such a far-reaching proposal that lacks clarity, that has raised a number of questions that the secretary even has said she intends to——

Mr. BENTSEN [continuing]. That she intends to fix that actually given the breadth of the change it is probably appropriate for Congress to insert itself here because it almost rises to a legislative type change.

Mr. STEIN. Yes. One of the things I think is sort of interesting, if this regulation, the 1975 regulation didn't exist and we were simply dealing with statutory language, that was a congressional judgment. And the congressional judgment was that people who give investment advice should be subject to ERISAs fiduciary standards.

The 1975 regulations, at least to my mind, clearly narrowed that without any justification. If these 1975 regulations were simply withdrawn and these proposed regulations were withdrawn, I think there would be considerably more difficulty for the industry than these new regulations propose, than these regulations could conceivably create.

Mr. SCOTT. Let me ask a more specific question, then. If somebody is selling what is essentially an S&P 500 mutual fund at a 2 percent annual fee when you can get exactly the same product at a .2 percent fee, and it is suggested that this is a good investment, I mean shouldn't people be protected from that kind of advice?

Mr. STEIN. Well, I certainly think they should, and I think that is what ERISA was about. ERISA is a different statute than the securities laws and had a different underlying purpose and the underlying purpose of ERISA is this is going to cover lots and lots and lots of people with relatively small investments going into their account, under 401k plans now, every month. All right?

And those are the people who need the protection of ERISA and the protections of the securities acts, while important, are not sufficient.

And the idea that these statutes are somehow the same animal and that there is a uniform concern running through these statutes of protecting all investors, I just think is inaccurate.

Mr. MYERS. Let me just say, I don't think it is an issue of this regulation or no regulation. The question is whether considering the regulatory scheme already in place that covers brokers who deal with customers, do we need another layer of regulation?

A broker is subject to FINRA rules, which is the self-regulatory organization, security law regulations, they have an obligation to——

Mr. SCOTT. I am going to ask: what does the designation of not being a fiduciary, what does that allow the person to inflict onto an unsophisticated investor?

Mr. STEIN. One of the things it allows is somebody to sell a product because they are going to make more money selling you that particular product than they would if they sold you a different product. Rather than evaluating the products that their offering and saying this is, in fact, right for you.

We know, right, human nature, people have an ability to rationalize what they are doing that is in their own self-interest and believe that it is actually in their customer's self-interest also.

And what I think happens in the market, and I think this was a judgment that Congress, not the Department of Labor today, made in 1974 is that these kinds of conflicts are going to hurt people and we need to prevent them.

Mr. MASON. I just wanted to jump in. We want to protect that person, that sort of low income person who doesn't have a lot of access to services and investment education.

And, just as Donald was saying, it is not as though current law has no protections. What we are saying is this current rule actually is severely counterproductive for exactly the persons you are trying to protect because it will say to them we can't, the financial services industry will not be able to provide you these services at all.

So you are on your own, and that is the danger. So we need to find that sort of sweet spot where the folks are protected but not with the regulation that sort of eliminates the ability to provide investment services and investment education for the people who need it the most.

Mr. STEIN. But it doesn't protect, prevent the ability to give investment education and information. It simply prevents you from, if you have a conflict of interest from selling a product, a specific product, not giving investment education.

Chairman ROE. We can carry this on afterwards. [Laughter.]

Mrs. Biggert?

Mrs. BIGGERT. Thank you, Mr. Chairman.

I guess I am beginning to sound like a broken record because I have been asking this question.

But, Mr. Bentsen, could you discuss a little bit the potential benefits of harmonizing the fiduciary regulations between DOL and the SEC?

Mr. BENTSEN. Well, brokers and advisers who are providing personalized retail investment advice, brokers and advisors generally have to organize their operations based upon who they are regulated by.

So brokers are regulated by the SEC, they are regulated by FINRA, to the extent they are engaged by ERISA products they are regulated by the Department of Labor.

Registered investment advisors are regulated by the SEC and they are regulated by the Department of Labor to the extent they are in ERISA products, and they are also both under different statutes.

Having a uniform standard given the fact that you have many firms that operate in both camps allows firms to have a more efficient operation and compliance mechanism in place.

So we think that that is one of the reasons why we thought going to a uniform standard of care made sense and why we supported it.

Now having one uniform standard of care as it relates to the SEC and another standard of care as it comes from the Department of Labor that applies to the same client and having a brokerage account with multiple accounts.

So a client who may have a purely commissioned based account, personalized investment account, they may have an IRA account most likely, based upon the data, a self-directed IRA account because most IRAs are invest and hold, and then they may have a discretionary account that all of these operating under different statutes and different rules should be harmonized so the client gets the best service they can from their financial advisor.

Mrs. BIGGERT. So you think that that is possible to do that?

Mr. MASON. One example? Sort of a simple example that we have been dealing with is a situation where say a customer comes to me as a broker and says I have got $30,000 in my retail account and $30,000 in my IRA.

He says what should I do with my regular retail account? I give some advice under the, sort of consistent with the SEC rules. And then they turn to me and say, well, what do I do in my IRA?

And I say, I can't, first of all I can't speak to you about that, and second of all you have to disregard everything I just said about the retail account in thinking about investments in thinking about investments in the IRA.

That is the kind of unworkable situation that this rule would thrust us into.

Mr. BENTSEN. And just to add to that further, that is a very good point. These are issues that the SEC is dealing with right now and it is not easy. But they are having to say, for instance, the customer comes and says, "I want my commission account but I also have an account that I am bringing of stock that I own because I worked for GE forever. And if I am going into an advisory account then I am going to have a concentration problem related to that."

And so the SEC is trying to work through all these, and they will. And then you are going to have the DOL come around with a completely different rule that is going to lay over this that is going to make it very difficult to operate these businesses efficiently.

Mrs. BIGGERT. And I want to get to that because what is bothering me is particularly, I think, the Assistant Secretary said she wants to finalize this by the end of the year and at the same time do class exemptions.

So all of the sudden there is going to be a rule but then there is going to be all these exemptions and how will that affect the SEC rulings and how—if there is going to be such a wide group that is going to be exempt to this it seems like that is not really fair as far as putting all of this together.

And I know, Mr. Myers, that you said something about this——

Mr. MYERS. Yes, and, you know, it was comforting to hear the secretary say she wants to get it right. And I think, as a regulator, and I did that for many years, you really are concerned that you get it right and that is the whole purpose of the public comment process so you can make sure that while you are acting consistent with your statutory mandate you are not disrupting normal business practice.

And so particularly since there are lots of comments, she is talking about proposing a class exemption, it just seems like the reasonable thing to do.

Mrs. BIGGERT. Well, when you are talking about a class exemption, what does that mean? What class is this?

Mr. MYERS. Well, a class exemption is—the Department of Labor has the authority to provide relief or exemptions for some of these prohibited transactions that we have been discussing today. And the Department of Labor has issued a lot of individual exemptions and a number of class exemptions that are like regulations.

And so DOL has said that they are considering issuing some class exemptions to deal with these various issues that have been discussed today, for example, to allow principal transactions or to allow payment of revenue sharing payments or other types of conditions. But that is a fairly complicated process.

And so while they are considering the regulation, and exemption is supposed to take care of the problem created by the regulation. So since the exemption is supposed to do that it seems to a lot of us it makes sense to re-propose the regulation at the same time

you are proposing the class exemption so people can see how they work together and then come up with a final solution for both. To do one before the other I don't think makes—makes sense as the way to go.

Mrs. BIGGERT. And thank you. My time is expired.

Chairman ROE. Mr. Andrews?

Mr. ANDREWS. Mr. Chairman, I would like to thank you, our colleagues, and the members of the panel for what I anticipated and hoped would be a very edifying discussion, and I have not been disappointed.

This really has been an oasis of rationality in a sea of chaos around here, so we appreciate that.

Ken, it is great to have you back. We miss you here and appreciate your contribution as a public servant and now in your new iteration.

The rest of the panel, predictably, was great.

Mr. Myers, obviously your stellar legal education helped you give very trenchant testimony, but I hear two broad points of consensus and one area of reason disagreement here.

The first is that I think there is broad consensus that the law should protect investors and workers against conflicted advice and that people should have a good, solid advice when they make decisions. Secondly, I hear people saying that there will no doubt be some unintended consequences of this rule that could do real harm in the marketplace, and we have to address that.

Where there is disagreement is the procedure by which we might avoid those unintended consequences, and I would like to focus, Mr. Mason, on your example of the swaps transactions.

Now, if I understand the fact pattern now correctly, I agree with you that sponsors and others who involve in swaps transactions should be outside the parameters of this rule.

They are really not, in my view, interacting with the participants in a way that would impose fiduciary responsibilities, and in fact, they are providing liquidity and risk management for plan sponsors in a way that benefits everyone. I think you are correct in that conclusion.

You suggested that the Secretary's letter to the CFTC was encouraging but what you wanted, I think I got the phrasing right, was authoritative guidance that would have the force of law. Did I get that right? And if I did, what would that be? In what legal iteration would that manifest itself?

Mr. MASON. Yes, and let me sort of just back up for one second. One of the things that we did after the secretary wrote the letter to Chairman Gensler was I actually worked with a group of about eight or nine of the largest pension plans in the country and I said to them, "Are you going to be able to rely on this letter?"

And the answer from them and their legal teams was a unanimous no.

Mr. ANDREWS. So what would they like instead?

Mr. MASON. Excuse me?

Mr. ANDREWS. What would they want instead of the letter?

Mr. MASON. And that was exactly what, when we met with the department, they said that is what we need to know. And we gave them precise language and it is actually language. It is a system

that is actually very common in the Department of Labor working with the IRS because they sort of do so many things together. It is not as common DOL and other agencies because they are rarely working in conjunction.

Mr. ANDREWS. Right.

Mr. MASON. And we gave them this preamble language stating in the preamble to the CFTCs final business conduct standards to say the Department of Labor has informed us that its final regulations will state that no action taken by a swap dealer solely to comply with the business conduct standards will make that swap dealer a fiduciary.

Mr. ANDREWS. So they are really asking for two things, if I understand this correctly. The first would be the preamble language at CFTC would have this—incorporate the point you just made.

Mr. MASON. Correct.

Mr. ANDREWS. Then secondly, that the final rule promulgated by DOL would in fact reflect that preamble.

Mr. MASON. Correct.

Mr. ANDREWS. I understand that is not the only issue you have, but I understand.

Now, let me come back to something Mr. Myers said, because he makes the argument that modification of class exemptions or the creation of new class exemptions is a process that is too timely and cumbersome, and marketplace participants cannot rely upon it; therefore, it would still have the problems that we talked about before.

Did I correctly state your view?

Mr. MYERS. Let me just modify. It is a complicated, time consuming process but it can be a solution if there is no regulation that is already in effect. If the regulation is in effect, then people have to live with the regulation and you can at that time propose exemptions.

But if the regulation is re-proposed at the same time, Department of Labor could propose class exemptions to deal with lots of these issues.

Mr. ANDREWS. Is there a middle course here? In other words, if the new regulation went into effect, hypothetically, and there were discussions of these modifications, is there some instrument like a guidance letter that would serve the same function in the marketplace? In other words, an enforcement policy that would be consistent with your views?

Mr. MYERS. That wouldn't work, in fact—works at the SEC. The problem with prohibited transactions, if one engages in a prohibited transaction it is automatically a violation of the law. It automatically gives rise to an excise tax and there is nothing that the Department of Labor could do absent of an exemption.

Mr. ANDREWS. Does the department have any discretion to define what that prohibitive transaction is?

Mr. MYERS. Well, it has the ability, it has interpretive——

Mr. MYERS. I am sorry?

Mr. ANDREWS. In terms of its prosecutorial decisions?

Mr. MYERS. Well, see, it doesn't impose the excise tax so it is imposed by the IRS and so the Department of Labor has no authority to control what the IRS is going to do.

The Department of Labor could take an interpretive position that something is not prohibited or grant a class exemption.

Mr. ANDREWS. I see my time has expired.

Mr. Chairman, I do think there is a fruitful area here for us mutually to talk about about some procedure. I know the witnesses, many of them want the rule withdrawn, and I understand that.

But in the eventuality that doesn't happen, I am not saying it won't, but in the eventuality it doesn't happen, I don't think we should abandon our mutual effort to find responses to these unintended consequences that I have made reference to.

I thank the witnesses for their testimony.

Chairman ROE. I thank the gentleman for yielding.

Dr. Holt?

Mr. HOLT. Thank you, Mr. Chairman.

Forgive me for having to duck out. I got word that several dozen people had occupied my office. They were all concerned citizens, but I am pleased to report they were friendly. [Laughter.]

But I did get to hear——

Mr. ANDREWS. Could you send them to my office, then? [Laughter.]

Mr. HOLT. I did get to hear all of the testimony and it was very helpful.

Mr. Bentsen, again, good to see you. You have been a good friend to many of us for a long time.

One sentence in your testimony caught my attention. "That firms must operate their business on the rules as written not based on the possibility of exemptions to come in the future." Sseveral people have told me that in their conversations with the Department of Labor, the Department has said that, well, after the regulation is finalized, we surely can work out a lot of the problems about prohibited transactions.

It seems to me a little bit backwards, and I just wanted to ask you to elaborate a little bit on your statement.

Mr. BENTSEN. Thank you, Congressman. And I think this fits in as well with what Mr. Andrews was talking about also.

What our members have told us is regardless of what the implementation time period is once there is a final rule, the firms will have to organize based upon that final rule.

So even given the comments by the secretary today and many of us have talked to the secretary and her staff about where we think there would need to be prohibitive transaction exemptions made. In our second comment letter we listed a number of areas. We have been in to meet with the staff on this issue; I know others have as well.

But because of the points that Don raised, our firms can't take the risk. First of all, as he points out the law is very explicit and there is no exception except through a PTE structure that can be done.

So our firms have to operate under the rule as written, not as the rule that may be modified by a PTE later. If the PTE comes out later, then they can make the adjustment but they have to organize their compliance operations, their training of their people, their communications with their clients and it takes time.

So they can't wait if there is a long, you know, say there is a year implementation period, they can't wait 6 months, 8 months, and think that this PTE will be promulgated. Hence the reason why we suggested re-propose, put the PTEs out now, and take all the comments at this point in time. What is the rush?

Mr. HOLT. Okay. Thank you.

Earlier I tried to put to the Secretary some comments or actions to ask whether they might run afoul of the regulation being considered.

Can any of the witnesses give me examples of comments or actions that might run afoul that you think would be desirable comments or actions but would run afoul of the way you see the regulations going now?

There won't be time, but I would like to hear from any of you whether you see a model that is somewhere between the personal financial advisor that we would all like to have and the impersonal so-called conflicted dealer salesperson model.

Two different questions, but the first one first, please.

Mr. MASON. I think one of the questions, and this goes back to something that I think Norman raised a little bit ago which is the question of what does this regulation do to investment education?

And there have been very disparate sort of views on that point. Here is the concern of the industry is that under the prior law, or current law, there is sort of investment advice in one place and there is sort of a principally different investment education and people have felt comfortable, their over here in the investment education world.

This regulation actually takes a different tact. It takes, technically, it takes a tact that says that sort of everything is investment advice, you know, implicitly, including investment education. And then carves out investment education——

Mr. HOLT. You know, what I was hoping was for something more specific. Something that a simple thinker like me could say——

Mr. MASON. Well, I guess what I am saying is investment education, for example, people asking a question, can I get, as a sort of 32-year-old, can I get information about what sort of asset allocation I should do.

Should I be heavily in bonds or should I be heavily in equities? And the answer, unfortunately, from the industry at this point under this regulation is I can't answer your question because of the lack of clarity that I was just describing.

Current law, they can say to you, yes, for someone at your age with your risk tolerance you should be 60 percent in equities, 30 percent in bonds, and 10 percent in cash or whatever sort of, they can give you sort of a breakdown.

Under this, because of the way it is structured, and I do think it is not hard to fix, but it needs to be fixed, the professionals that I have talked to would be very hesitant to even answer that question, which is a critical question and an important question they need answers to.

Mr. HOLT. I thought the Secretary was saying that was not a problem, but thank you.

Chairman ROE. I thank the gentleman for yielding back.

And, again, would like to thank all the witnesses. It has been a great panel. Thank you for being here.

And I will recognize the Ranking Member for any closing comments.

Mr. ANDREWS. Well, first, Mr. Chairman, I would ask consent for three letters to be entered into the record pertaining to today's discussion.

[The information follows:]

Prepared Statement of Matthew D. Hutcheson, Professional Independent Fiduciary

My name is Matthew Hutcheson. I am a professional fiduciary (professional decision maker) for over 900 employers, consisting of 401(k), profit sharing, and traditional pension plans. Over 2.5 million American workers collectively participate in those plans.

The fiduciary duty debate is an important one. The debate is about when fiduciary duty applies, to whom it applies, and whether individuals saving for retirement are entitled to those protections (or not), and why. It is also about which type of professional is entitled to exemptions, and which ones are not.

Having pondered this matter deeply for several years, I have come to several conclusions. First, our retirement system is severely under served. There are over 30 million American workers without access to a quality retirement plan. Second, many of those might never have access unless more professionals are willing to enter into the qualified retirement plan profession. Third, those barriers must be removed without injuring vulnerable plan participants.

That challenge may be easier to solve than one might think.

It is understood that independent SEC registered advice givers (Registered Investment Advisors) are not more honorable than representatives of a broker-dealer or insurance company. Both can be equally honorable, educated, astute, etc.

Registered Investment Advisors by law must place the interests of their clients above their own. Representatives of financial institutions are expected to place the interests of their employer above their own. If we look at this too narrowly, we may incorrectly presume that with respect to interacting with plan participants, one is good, and the other is bad. I've come to the conclusion that it's not either or; but rather both are good and both have their place.

The challenge before us is not about who should or should not be able to interact with participants. Rather, the answer to the challenge is providing participants with an easy way to discern whether he or she needs general information, needs advice, or wants/needs plan decisions to be made for them by a discretionary fiduciary on their behalf.

A plan could actually be sufficiently diverse that all three (general information, advice, decisions made automatically) are needed by plan participants at one point or other. In such a scenario, a Registered Investment Advisor, a Registered Representative, and a discretional fiduciary could work side-by-side on the same plan, harmoniously, each providing a specific needed service. Thus, this debate should not be viewed as one approach is better than the other. Each might be required at some point for a given need.

Therefore, this debate should be about encouraging more individuals to enter the retirement plan profession; thus contributing to the greater good of society, coupled with a simple way to help a participant (or plan sponsor) know when one approach is needed over another. Professional understanding and courtesy between plan sponsors, plan participants, and professional service providers is required to make it easy for the transition to occur from one approach to another.

Defining when a retirement plan professional is treated explicitly or implicitly as a fiduciary is difficult to do, and hence exemptions have been proposed to clarify the role of one that simply sells retirement plans and provides the accompanying information necessary for a participant to understand. The challenge with such exemptions is that participants find it difficult to discern between advice and information, and are usually unable to tell when that line has been crossed.

The line is frequently crossed as a registered representative becomes a trusted "advisor" to the plan participants; frequently discussing personal matters about finances, retirement, etc., even though the representative believes he or she is not giving "advice" as defined in ERISA.

When that line is crossed, the plan participant becomes vulnerable because a relationship of trust exists. The participant begins to personally rely on the information

shared by the registered representative, with the expectation of favorable outcomes. Vulnerability, Reliance, and Expectation together create a fiduciary relationship.

For example, a plan participant may share personal financial information with a non-fiduciary registered representative. Sharing personal information usually conveys or creates vulnerability on the part of the participant.

Perhaps a feeling of vulnerability exists that he or she will not be able to retire when they had hoped and are sharing that vulnerability with the representative in the hope information will be shared he or she can rely upon.

If the information is acted upon, it is because he or she relied upon it because of the trust that exists between the parties, and the expectation that something good will occur as a result of that reliance.

If a participant is unable to discern that they are personally vulnerable, the registered representative has a professional obligation to point it out, and to refer him or her to a fiduciary for specific advice.

If a non-fiduciary professional will adhere to that professional standard of care, it is reasonable to conclude they are not acting as a fiduciary, but rather a professor of information, not advice.

The following model disclosure would solve virtually every element of this debate:

Disclosure of professional duty

My name is Jane Representative. My employer is ABC Broker Dealer, and I am obligated to be loyal them just as you are to your current employer. In other words, my first responsibility is to help my firm succeed.

In accordance with that responsibility, I have a professional duty to provide you with accurate and relevant information. It is your responsibility to consider that information in light of your experience, knowledge, understanding, and objectives.

During our interaction, it will be your responsibility to inform me immediately if you ever feel vulnerable because you do not understand the information I have shared with you, or you are unsure how to implement it. In such an instance, you may require advice specifically suited to your personal circumstances. We will then introduce you to one or more independent SEC register investment advice givers.

We will always be here to serve, and we also understand that there are times where specific, reliable advice is required to meet specific individual needs or expectations.

If at any time you feel vulnerable due to a lack of understanding about how information shared applies to you personally, and you need customized information upon which you can trust and rely with the expectation of specific outcomes, we will immediately introduce you to a Registered Investment Advisors.

It is your responsibility to tell us and your employer (or its designated fiduciary) when you are experiencing those feelings so we can involve another professional to provide the advice you require.

If you do not request individualized advice in writing, we will presume you understand the information conveyed, and that no further clarification or elaboration is required.

In conclusion, there is a great need for many more individuals to enter the retirement plan profession. It is an honorable profession that has greatly improved the lives of tens of millions.

There are different roles professionals can play, including:

- Conveyors of general information (non-fiduciary)
- Advice givers (fiduciary)
- Decision makers (fiduciary)

If a conveyor of general information is approached by a participant that has questions about their personal situation, and feels vulnerable, needs to rely on specific information, and will expect a favorable outcome for having relied on that information, then a fiduciary advice giver should be brought in.

Exemptions that permit a general conveyor of information to cross over into the life-impacting realm of advice giving without being held to the high level responsibility that accompanies that advice (that of fiduciary), should be against public policy.

There's enough room at the table for all of the different types of service providers. It may not be "either/or," but it could be "both." In other words, a plan may need two or more types of service providers to serve the needs of the participants and beneficiaries. This can easily be done without increasing the overall cost of the plan. In fact, it could decrease total costs, and I have participated in just that scenario hundreds of times.

Registered Representatives or agents should not be expected to be mind-readers. If a conventional 401(k) plan requires a participant to choose individual funds from a complex and diverse menu, then the participant should also be responsible for knowing when they need fiduciary assistance. If fiduciary advice is not immediately available, the registered representative or agent should facilitate that advice to clearly delineate between their services and that of a fiduciary advice giver.

This simple solution does not impugn a non-fiduciary representative, nor does it impair their ability to compete. Such a representative can continue in their client relationship management role just as they have in the past. They need only to explain that given the participant's vulnerability, need for reliance, and expectation of a favorable outcome, a fiduciary advice giver is required in that specific instance. There are many Registered Investment Advisors that will provide such advice on an as-needed basis.

That solution solves the dilemma without adding complexity that is difficult to understand, remember, or implement.

Prepared Statement of the Profit Sharing/401k Council of America (PSCA)

The Profit Sharing / 401k Council of America (PSCA) supports the Department of Labor's proposed rule amending the definition of a fiduciary adviser, with some recommendations for changes and clarifications.

For more than sixty years, PSCA, a national non-profit association of 1,000 companies and their six million employees, has advocated increased retirement security through profit sharing, 401(k), and 403(b) defined contribution programs to federal policymakers. PSCA provides practical assistance to our members on plan design, administration, investment, compliance, and communication. PSCA is based on the principle that "defined contribution partnership in the workplace fits today's reality." PSCA's services are tailored to meet the needs of both large and small companies with members ranging in size from Fortune 100 firms to small entrepreneurial businesses.

The elimination of the subjective "regular basis" and "primary basis" tests in the proposed rule will reduce uncertainty for plan sponsors, participants and beneficiaries, and service providers. Today, the potential exists for plan fiduciaries and participants to believe that they are receiving impartial advice while the advice provider believes that ERISA's fiduciary standards are not applicable. PSCA believes that removing this misunderstanding by applying the fiduciary standard regardless of the regularity of the advice or to what degree the recipient will consider it is a very positive development.

In the preamble to the proposed rule, the Department of Labor requested comments on whether it should reexamine its current position that a recommendation to take a distribution, even when combined with a recommendation as to how the distribution should be invested, may not constitute investment advice.

PSCA, in its formal comments on the proposed rule, urged the Department to reverse its position. The decision by a participant or beneficiary to request a distribution of their account assets, and how to subsequently invest those assets, can profoundly affect an individual's retirement. We believe the public policy benefit of our position is self-evident and that a recommendation to take a distribution constitutes a recommendation to sell a particular plan investment.

The expansion of activities that will be considered advice under the proposed rule raises concerns that the provision of marketing, informational, and educational materials will be constrained by new liability concerns. PSCA believes that the Department shares our concerns, as evidenced by provisions in the proposed rule relating to limitations for selling activities, educational activities pursuant to Interpretive Bulletin 96-1, and marketing and assistance provided under a platform arrangement. We made several suggestions in this regard.

- The Department should clarify in the preamble and the body of the final rule that educating participants about distribution options, including discussions of the advantages and disadvantages of seeking a distribution and managing retirement assets outside the plan, does not constitute advice. As long as these communications do not include a clear recommendation to seek a distribution, they should not be treated as advice.
- Education, information, and advice regarding the tax effects of taking a distribution should not constitute the provision of advice under the proposed rule. This important information is frequently sought by or provided to plan participants that are contemplating taking a distribution of their plan assets.
- In the course of the Department's joint inquiry with the Department of the Treasury on lifetime income products, the agencies requested comments regarding

the provision of information to help participants make choices regarding management and spend down of retirement benefits. PSCA and several other organizations identified the expansion and clarification of Interpretive Bulletin 96—1 to explicitly apply to the provision of information to help participants and beneficiaries make better-informed retirement income decisions. We urged the Department to take this action in conjunction with the development of this rule.

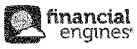
• The proposed rule specifies in subparagraph (c)(2)(ii)(B) that marketing or making available securities or other property from which a plan fiduciary may designate investment alternatives under a fund platform or similar arrangement does not constitute the provision of advice if certain disclosures are made. Subparagraph (c)(2)(ii)(C) provides that general financial information and data to assist a plan fiduciary's selection or monitoring of such securities or property does not constitute the provision of advice if certain disclosures are made. PSCA strongly supports these provisions and urged the Department to retain and expand them in the final rule. The relief provided for the provision of general financial information and data is currently limited to information provided in conjunction with a platform arrangement. It should be available for all plans, regardless of whether or not it is offered in conjunction with a platform arrangement.

• It is common for a fund investment manager to provide newsletters, economic market analyses, and forecasts to plan fiduciaries. For example, the recent worldwide debt crisis and its effect on capital markets, the economic impact of political crises in the Middle East and Africa, or reports about emerging markets such as China or Brazil might be discussed in these reports. Another common topic of analysis is the Washington political environment and its potential impact on industries and markets. These reports and analyses may influence a plan fiduciary's decision about the selection and monitoring of plan investments. PSCA believes that the Department does not intend that these activities constitute the provision of advice. We requested that the final rule include specific provisions that clarify our interpretation.

Under the proposed rule, the provision of advice, or an appraisal or fairness opinion, concerning the value of securities or other property of an employee benefit plan constitutes the provision of advice. The Department simultaneously announced that the proposed rule supersedes its position in Advisory Opinion 76-65A, where it held that making valuations to be used in establishing an ESOP does not establish a fiduciary relationship because a plan did not yet exist; and that advice provided to an existing ESOP regarding the value of employer securities does not constitute the provision of advice.

These changes will result in creating a new fiduciary relationship for a large group of service providers that provide valuation and appraisal services for all types of retirement plans. According to the preamble of the proposed rule, "The Department would expect a fiduciary appraiser's determination of value to be unbiased, fair, and objective, and to be made in good faith and based on a prudent investigation under the prevailing circumstances then known to the appraiser." PSCA supports this standard of conduct and generally supports the assumption of fiduciary status by plan service providers that deal with plan investments. However, we also share the significant concerns in the retirement plan community about the increased costs that may result from the proposed changes. For example, questions have been raised if the Department's standard of impartiality is consistent with a fiduciary duty of loyalty. The magnitude of the costs and the willingness of providers to provide valuation services under the proposed rule are, we believe, undetermined. PSCA urged the Department to carefully consider these issues when formulating a final rule.

At a minimum, valuations, fairness opinions, and appraisals of assets traded on "generally recognized markets" should never be considered the provision of advice. Additionally, the Department's position in Advisory Opinion 76-65A that "Where a plan is not yet in existence, a fiduciary relationship within the meaning of section 3(21)(A) cannot be established" is widely recognized as established law that applies to all retirement plans subject to ERISA. We urged the Department to clarify that it is not superseding this particular finding in the Advisory Opinion.



July 25, 2011

Via E-mail

U.S. House Committee on Education and the Workforce
Subcommittee on Health, Employment, Labor and Pensions
2181 Rayburn House Office Building
Washington, D.C. 20515

Re: Redefining 'Fiduciary': Assessing the Impact of the Labor Department's Proposal on Workers and Retirees

Ladies and Gentlemen:

Financial Engines respectfully submits the following comments in response to the Department of Labor's proposed regulation entitled *Definition of the Term "Fiduciary,"* published in the October 22, 2010 Federal Register. Financial Engines Advisors L.L.C., a wholly owned subsidiary of Financial Engines, Inc., is a registered investment adviser that provides personalized investment advice and management services to participants in 401(k) and similar plans. Financial Engines provides such services as a fiduciary under ERISA. Financial Engines is the leading provider of independent advisory services to large plan sponsors, working with many of the nation's largest employers and retirement service providers.

We applaud the Department's proposal to update the definition of fiduciary under 29 CFR 2510.3-21(c), and support the objective of improving protections for participants and beneficiaries by seeking to ensure that persons providing investment advice are subject to ERISA's standards of fiduciary conduct. We share the concern that the current regulation may not adequately protect the interests of participants and may limit unnecessarily the scope of ERISA's fiduciary protections. ERISA's fiduciary standards provide important protections against conflicts of interest and self-dealing and, particularly in light of changes in the financial industry, it is crucial now more than ever to re-examine the types of relationships that should give rise to fiduciary duties under ERISA and to apply these protections broadly.

The current proposal represents good progress towards achieving the Department's objective of enhancing fiduciary protections. However, we respectfully submit that the Department should expand and clarify the proposed definition to better protect the interests of participants and beneficiaries and to reflect more closely statutory intent and the broad fiduciary definition set forth in ERISA.

I. Investment Education exclusion should not encompass specific investment advice

A. Investment Education

Paragraph (c)(2)(ii)(A) of the proposed regulation provides that investment education information and materials as described in Interpretive Bulletin 29 CFR 2509.96-1(d) (the "Interpretive Bulletin") will not constitute investment advice under ERISA section 3(21)(A)(ii). Investment education is a valuable way to offer help to participants. However, as the preamble to the proposed regulation notes, the information

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and materials described in the Interpretive Bulletin merely represent *examples* of the type of information and materials that may be furnished to a participant or beneficiary without being considered the rendering of fiduciary investment advice under the proposed regulation.

Thus, we are concerned that a broad exclusion for investment education may not account for certain industry practices and the expectations of participants and beneficiaries when they are provided information and materials that are not generic in nature. For example, asset class recommendations may properly be considered investment education, but if the asset classes are mapped to specific funds available within the participant's plan, the participant now has specific, actionable investment advice. Using the label "model portfolio" to describe allocations to specific funds within a plan may align with the Interpretive Bulletin in form, but in substance investment advice is being rendered. Because participants who receive specific and tailored recommendations likely perceive those recommendations as advice rather than general education, providers of such specific recommendations should be treated as fiduciaries under ERISA.

B. Recommendation

The Department should specify that the exclusion for investment education will not apply where specific investment recommendations are provided, such as where asset class models are mapped to specific investment alternatives within a plan. Similarly, interactive investment materials should not be non-fiduciary investment education under circumstances in which an individual receives tailored, actionable recommendations. These modifications would help to provide clarity about what constitutes investment education, and help to ensure participants and beneficiaries who take action based on customized recommendations are not left without ERISA's fiduciary protections.

II. Seller-Purchaser exemption should be limited to advice recipients other than plan participants

A. Seller-Purchaser exemption

Section 2510.3(21)(c)(2)(1) of the proposed regulation provides that a person will not be considered a fiduciary with respect to the provision of advice or recommendations if such person can demonstrate that the advice recipient knows, or under the circumstances reasonably should know, that the person is providing advice in the capacity of a seller or purchaser whose interests are adverse to that of the plan or participants, and that the person is not undertaking to provide impartial advice. Individual plan participants should not be expected to know that advice is not impartial.[1]

[1] Congress and regulators have been focused on investor confusion regarding the roles and standards of conduct applicable to financial professionals. See, for example, the *Study on Investment Advisers and Broker-Dealers,* issued by the Securities and Exchange Commission on January 22, 2011 and mandated by Section 913 of the Dodd-Frank Act (the "Study"), which describes the confusion of retail customers, who do not understand the roles of investment advisers and broker-dealers or the standards of care applicable when they provide personalized advice about securities. As the Study notes, "[m]any find the standards of care confusing, and are uncertain about the meaning of the various titles and designations used by investment advisers and broker-dealers. Many expect that both investment advisers and broker-dealers are obligated to act in the investors' best interests." (Executive Summary at page v).

B. Recommendation

We recommend that the Department modify the proposed limitation so that the exception does not apply where an advice recipient is an individual plan participant. Alternatively, the limitation should more precisely describe the burden that must be met by a seller who seeks to avoid fiduciary status by claiming that an advice recipient should have known that advice is not impartial.

III. Additional Comments

A. Clarify treatment of discretionary managed accounts as covered advice

Additionally, from a more technical perspective, we are concerned that there is a gap in the proposed definition with respect to the treatment of discretionary managed accounts. Status as an investment manager under ERISA Section 3(38) would satisfy Section (c)(1)(ii)(B), thus satisfying the second prong of the proposed definition. However, paragraph (c)(1)(i) of the proposed definition may only capture discretionary managed accounts to the extent investment transactions are actually implemented. For example, Paragraph (c)(1)(i)(A)(3) includes a person who "[p]rovides advice or makes recommendations as to the management of securities or other property". One could argue that making recommendations is inherent in the activities of a discretionary investment manager, but there may also be no formal process of recommending a specific transaction to the participant and receiving an affirmative or negative consent to its execution. Paragraph (c)(1)(ii)(B) of the proposed regulation includes persons who are fiduciaries within the meaning of section 3(21)(A)(i) of ERISA. Under section 3(21)(A)(i), a person is a fiduciary with respect to a plan to the extent it **exercises** any discretionary authority or discretionary control with respect to the management or disposition of its assets, leaving open the question of whether a person is a fiduciary if the authority is granted, but not exercised.

B. Clarify standard for determining whether an understanding exists as to whether the advice is being considered in making investment decisions

Section 2510.3(21)(c)(1)(ii)(D) of the proposed regulation includes within the meaning of "investment advice" the provision of advice or recommendations described in paragraph (c)(1)(i) pursuant to an agreement, arrangement or understanding, written or otherwise, between such person and the plan, a plan fiduciary, or a plan participant or beneficiary that such advice may be considered in connection with making investment or management decisions with respect to plan assets, if individualized to the needs of the plan, plan fiduciary, participant, or beneficiary. The preamble to the regulation also refers to the understanding "of the parties." Although the proposed definition, unlike the existing definition, does not explicitly require that the understanding be mutual, it may be difficult to determine whether a participant's reasonable reliance on advice, or use of advice in reaching an investment decision, is sufficient to constitute an agreement, arrangement or understanding if the advice is rendered on a non-discretionary basis, where the participant may be asked to approve an investment strategy, proposed portfolio, or proposed transaction.

C. Advice on Plan Distributions

The Department also requested comment on whether the final regulation should define the provision of investment advice to encompass recommendations related to taking a plan distribution. If such recommendations are addressed, it is critical to maintain the availability of high-quality independent advice for all plan participants at a reasonable cost, especially those with lower balances who may not otherwise have access to advice. If such independent advisors are precluded from reaching participants through the workplace, participants may lose a valuable source of advice.

D. Recommendation

We recommend that the Department clarify that a person is a covered fiduciary where exercise of authority over assets has been granted, regardless of whether the authority is actually exercised, and that such status not be avoidable by requiring participant approval of an investment strategy, proposed portfolio, or proposed transaction.

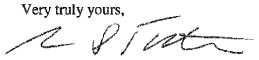
IV. Provision of fiduciary investment advice is not cost prohibitive

Finally, in the Regulatory Impact Analysis, the Department notes uncertainty both as to the potential costs of the proposal, such as whether service provider costs would increase and whether the service provider market could shrink because of concerns about higher costs. Financial Engines believes that our history and growth support the conclusion that it is neither onerous nor impossible for service providers to provide high quality services in a fiduciary capacity to large numbers of plans and participants. Financial Engines launched its first advice service in October 1998 as it set out to accomplish the vision of its co-founder and Nobel Prize winner Bill Sharpe: To provide high-quality independent investment advice to everyone. With the subsequent introduction of a discretionary managed accounts service, Financial Engines works with more than 765 large employers (including 129 of the FORTUNE 500) and 8 of the largest retirement plan providers serving the defined contribution market[2]. As a result, over one million people have used Financial Engines Online Advice or have their retirement account professionally managed by the company.

Conclusion

Financial Engines appreciates the opportunity to comment on the proposed regulation, and we support the Department's actions in seeking to better protect participants and beneficiaries. We welcome the opportunity to provide any further assistance that may be required.

Very truly yours,



Anne S. Tuttle
Executive Vice President and General Counsel

[2] As of December 31, 2010

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Chairman ROE. Without objection, so ordered.

Mr. ANDREWS. Second, I, again, would like to thank you, our colleagues, and the witnesses for a really well, and Secretary Borzi as well, for really well-reasoned information which lets us approach this problem. Again, it is refreshing to hear people actually speak about solving a problem instead of reading their talking points. So, not that any of us would ever do that. [Laughter.]

Thank you very much.

Chairman ROE. Just as I close I want to make one closing comment, I would like to make. I want to thank all of you all for the education process you have done here.

And, quite frankly, just listening for a long time I guess I will use a medical metaphor, it sounds like we are doing a heart transplant when all you need to do is get up off the couch and walk around the block. [Laughter.]

And, I mean we want to protect people from bad advice, Professor Stein, as you pointed out. No question that we want to do that. And yet, we want to make this system as efficient for people like me that have been out there trying to run a pension plan to maximize, and I can assure you no one had more interest in making it work than me because my retirement savings was also invested there.

So, thank you for this information. I think we do need to step back and re-look this rule. I appreciate you being here.

Being no further business, this meeting is adjourned.

[Additional submissions of Dr. Roe follow:]

Prepared Statement of the American Council of Life Insurers (ACLI)

The American Council of Life Insurers (ACLI) commends this subcommittee for holding this hearing on the Department of Labor's (DoL) proposed rule on the definition of "fiduciary" for purposes of offering investment advice. We applaud Chairman Phil Roe (R-TN) and Ranking Member Rob Andrews (D-NJ) for holding this hearing to receive testimony from the Assistant Secretary of the Employee Benefit Security Administration, DoL, Phyllis Borzi, and various stakeholders on the impact this proposal would have on individuals saving for retirement and small businesses ability to provide investment education to their plan participants. Members on this subcommittee from both parties have already urged DoL to re-propose the rule to address a substantial number of revisions that need to be made to it to ensure the rule does not negatively impact these savers or businesses. We thank these members for their efforts and urge them to reach out to the Administration to share these concerns.

The American Council of Life Insurers is a national trade organization with over 300 members that represent more than 90% of the assets and premiums of the U.S. life insurance and annuity industry. ACLI member companies offer insurance contracts and investment products and services to qualified retirement plans, including defined benefit pension, 401(k), 403(b) and 457 arrangements and to individuals through individual retirement arrangements (IRAs) or on a non-qualified basis. ACLI member companies' also are employer sponsors of retirement plans for their employees.

Consistent with the comments submitted by stakeholders and concerns raised by Members of Congress, we have urged the DoL to re-propose the rule so that stakeholders have an opportunity to review and comment on the DoL revisions to address these comments and concerns. A re- proposal will provide an opportunity to ensure that plan sponsors, plan participants and IRA owners continue to have affordable access to investment education and investment choices. We have urged the DoL to address prohibited transaction exemptions (PTEs) in conjunction with its development of a new rule. Lastly, we also urge the DoL to re-propose the rule so that stakeholders will be able to review and provide comment on DoL's economic analysis of the impact the proposal would have on IRA holders, plans and plan participants.

Background

On October 22, 2010, the DoL proposed a new rule to expand the definition of fiduciary with respect to the provision of investment advice. The proposed rule broadens the definition, for example, by removing the "regular" and "primary" basis conditions necessary for advice to be considered fiduciary advice. The DoL received over 200 public comment letters in response to the proposal.

There have been over 25 bipartisan, bicameral letters sent to the Administration outlining Members of Congress concerns about the impact the proposal would have on their constituents. These letters represent over 80 Members. Most notably, the Chairman and Ranking Member of the following Committees have sent letters to the agency heads expressing their concern about the proposal: Senate HELP, House Education and Workforce, Senate Banking, House Financial Services, Senate Agriculture, House Agriculture, Senate Finance and the House Ways and Means Committee.

DoL Should Re-propose the Rule so that Stakeholders Can Have an Opportunity to Review How It Plans to Address Comments and Concerns Raised

We recognize the DoL's authority to review its rules, especially in light of the responsibilities individuals have to plan for their retirement. We also appreciate the DoL's willingness to listen to stakeholders concerns about the proposal. However, the rule's expansion of who would be considered a fiduciary will interfere with employers and their management of plans and investment sales and distribution practices that are customary in the marketplace, well understood, and commonly relied upon by financial services providers, plans and participants alike. We are concerned that these changes will result in plans, plan participants, and IRA owners having less access to investment information and investment choices. We want to make sure that this result does not occur. We have offered comments to the DoL that seek to preserve the DoL's enforcement objective and avoid unnecessary disruption and negative impacts to plans, participants and individuals. Despite these efforts, we are unsure of whether and, if so, how the DoL will address these comments, and therefore seek to review its efforts once again to make sure the rule does not negatively impact individuals or small businesses.

Additionally, the DoL has acknowledged that it will need to revise a number of existing prohibited transaction exemptions (PTEs) which financial providers currently rely upon. ACLI has asked the DoL to issue a new proposal together with any proposed changes to or confirmations of exemptive relief. ACLI believes it is important to review and comment on these together. Absent a re-proposal, these revisions will be presented in conjunction with a final rule which may or may not address the concerns raised by ACLI, other organizations and companies. Stakeholders need an opportunity to review any proposed PTEs in conjunction with a proposed rule and provide comment as to whether they are workable within the newly revised rule.

DoL Should Re-propose the Rule so that Stakeholders Can Review and Provide Comment on DoL's New Economic Analysis

Assistant Secretary Borzi has recently announced that she will include a complete economic analysis on the impact of the rule on IRA holders, plans and plan participants in the final rule. Unfortunately, if issued as a final rule, stakeholders would not be able to comment upon the DoL's analysis. Given the rule's potential impact, such regulatory action should not occur without stakeholder review and comment.

A recent report issued by Oliver Wyman outlined the tremendous negative impact this proposed rule would have on IRA owners, especially those with smaller balances. Nearly 40% of IRAs in the study sample had less than $10,000 in their accounts. 98% of investor accounts with less than $25,000 were in brokerage relationships. This proposed rule would lead IRA providers to offer these small account owners either a higher fee-based advisory account or a no service account in order to comply with the proposal. Many low to middle income IRA owners would not be able to afford the estimated 75—195% increase in cost to pay for the advisory account. The DoL failed to include a similar analysis in its proposal, and needs to fully consider such analysis before initiating a rulemaking.

As an addenda to this statement, ACLI has attached a copy of its initial comment letter on this issue to the DoL dated February 3, 2011, its statement that it provided at DoL's public hearing on March 1, 2011, and additional comments in response to hearing questions dated April 12, 2011.

We look forward to working with this subcommittee, the larger committee, and DoL to address the concerns raised in this statement and to ensure Americans have abundant access to investment education and appropriate investment advice. (See attached addenda.)

ACLI Comment Letter to DOL February 3, 2011

On behalf of the American Council of Life Insurers ("ACLI"), we are writing to comment on the proposed rule promulgated under Section 3(21)(A)(ii) of the Employee Retirement Income Security Act ("ERISA"), which was published at 75 Fed. Reg. 65263 (October 22, 2010) ("Proposed Rule" or "Rule"). The Proposed Rule would dramatically enlarge the universe of persons who owe duties of undivided loyalty to ERISA plans and to whom the prohibited transaction restrictions of ERISA and the Internal Revenue Code would apply1, by re-defining and substantially broadening the concept of rendering "investment advice for a fee" within the meaning of ERISA Section 3(21)(a)(ii).

The American Council of Life Insurers is a national trade organization with more than 300 members that represent more than 90% of the assets and premiums of the U.S. life insurance and annuity industry. ACLI member companies offer insurance

contracts and other investment products and services to qualified retirement plans, including defined benefit pension, 401(k) and 403(b) arrangements, and to individuals through individual retirement arrangements (IRAs) or on a non-qualified basis. ACLI member companies also are employer sponsors of retirement plans for their own employees.

1. Although not covered under Title I of ERISA, individual retirement accounts and annuities ("IRAs") fall within the scope of the prohibited transaction excise tax provisions of Code Section 4975. The Proposed Rule would similarly enlarge the universe of persons defined as fiduciaries for purposes of applying Section 4975 to transactions involving IRAs.

2. Subject, of course, to any limitations on marketing and promotional practices imposed on sales of financial products generally.

3. ERISA §3(21)(A)(ii)

ACLI appreciates the Department's concern that under some circumstances the current rule impinges the Department's ability to bring enforcement actions in situations that are clearly abusive. We share the Department's interest in seeing that plans and participants who seek out and are promised advice that is impartial and disinterested ultimately receive advice that adheres to the rigorous standards imposed by ERISA. At the same time, we are concerned that the Proposed Rule's pursuit of this objective interferes with investment sales and distribution practices that are customary in the marketplace, well understood, and commonly relied upon by financial services providers, plans and participants alike. We are concerned that these changes will result in plans, plan participants, and IRA owners having less access to investment information. Our comments seek to preserve the Department's enforcement objective while avoiding unnecessary disruption and negative impacts to plans, participants and individuals.

Persons engaged in the sale and distribution of investment product and services need to have confidence that ordinary course sales recommendations will not, in hindsight, be subjected to a fiduciary standard that disallows the payment of sales commissions and other traditional forms of distribution-related compensation. Please note that regulatory efforts are underway by the Securities and Exchange Commission ("SEC") regarding the standard of care under the securities laws for broker-dealers and investment advisers that provide investment advice about securities to retail customers. On January 21, 2011, the SEC issued a study on broker-dealers and investment advisers. We are reviewing this study which may lead to additional comments on the Proposed Rule. We urge the Department to provide the public sufficient opportunity to consider the SEC's regulatory efforts and offer additional comments on the Proposed Rule.

Parties engaged in transactions with ERISA plans and IRAs need clear, unambiguous rules by which to determine their duties and obligations in order for the marketplace to function efficiently and to ensure that plans, plan participants and IRA owners continue to have a broad range of investment products and services available to them, including investment advice and educational services. We offer these comments to assist in the development of such rules.

1. Recommendations Made by Sellers

Firms seeking to sell investments and investment products to plans and plan participants should be able to both (1) promote their products and recommend them to prospective purchasers,2 and (2) benefit financially from the successful sale of those products. Without a financial interest, economic activity is stifled and opportunities for buyers and sellers to meet and transact are lost.

Sales activities naturally include recommendations to purchase and invest in products and services offered by the seller. For that reason, the seller's limitation provided by paragraph (c)(2)(i) (the "seller's limitation") recognizes financial institutions such as life insurers and their sales representatives should not be categorized as fiduciaries under ERISA or Code section 4975(e)(3)(B) when they are engaged in selling activities and are clear that they are acting in a sales capacity. The seller's limitation is a critical component of the Department's Proposed Rule.

Sales Activites. We believe it is absolutely critical to make sure that the wording of the seller's limitation be sufficiently inclusive to encompass the full scope of ordinary course selling and distribution activity. As written, the wording of the seller's limitation, which describes sellers and their agents, raises some uncertainties about the availability of the seller's limitation for other distribution channels, such as independent insurance agents, insurance affiliated and unaffiliated broker-dealers and registered investment advisers that offer life insurer products, whether exclusively or as one of many other products from a variety of different product manufacturers.

Impartial, not "Adverse." Our membership is deeply troubled by the wording of the paragraph requiring that the recipient of the advice know or have a basis for knowing that the interests of the selling firm and its distributors are "adverse" to the interests of the plan and its participants. While the seller of a financial product has a financial interest in the outcome of a transaction, we think it is inappropriate to describe that financial interest as necessarily entailing broad adversity of interest. As responsible providers, we have an interest in seeing that our customers are well served, are happy with our products and services, and that our customers found those products and services useful to the attainment of their financial goals.

The process whereby purchasers and sellers bargain for and agree upon the terms of a proposed transaction is fundamental to the efficient operation of a market transaction. Adversity of interests exists in the area of price negotiation, where the seller of a product or service has an interest in maximizing profit and the purchaser has in interest in minimizing cost.

We believe the seller's limitation needs to parse this key distinction. It should make the point that a seller of an investment or an investment product has a financial interest in the transaction it is recommending and, if applicable, that less costly versions of an investment product may be available. So long as purchasers are provided with that information, they will have the requisite basis for evaluating the recommended transaction in light of the seller's financial interest, and will be in a position to understand that the selling firm's recommendation is not impartial.

Illustrate with Examples. The rule should provide an example or examples of circumstances in which a person would reasonably demonstrate that the recipient of information knows that a recommendation is being made by someone in a capacity as a seller. For example, a written representation would suffice if it clearly notes that the person is a seller of products and services, that the person and, if applicable, its affiliates, will receive compensation in the event the plan, plan fiduciary or participant/individual selects the product and services, and that such compensation may vary depending upon which product is purchased or which investments under a product or products are selected. This type of representation would provide a clear indication to the plan, plan fiduciary or participant/individual that the person is a non-impartial seller of products and services. It would also address the Department's stated concern about undisclosed conflicts of interest. Again, ACLI urges the Department to adopt a rule that leaves the nature of the relationship unambiguous to all parties.

Ongoing Sales Relationship. The Department should clarify that the seller's limitation covers all aspects of both an initial sale and the subsequent ongoing relationship between a plan, plan fiduciary or individual and an investment provider or any agent, broker, and/or registered investment adviser involved with the sale of the investment provider's products and services. This would include information and recommendations regarding the use of a product, e.g., advice regarding the choice of investments available under a product's menu of investments. It is common for defined contribution plans to request of potential investment providers a sample menu of investments from among a provider's available investments which, in the opinion of the provider, best match the plan's current investment options. There should be no expectation that any such recommendation is impartial or that the plan seeks advice upon which it will rely for its investment decisions. The nature of this relationship should not change after a sale. A product provider, agent, broker, and/or registered investment adviser may continue to make recommendations regarding products and services. There should be no expectation that these recommendations differ in nature following the initial sale.

2. Representations of ERISA Fiduciary Status Should be Written

In its preamble, the Department expresses the belief that explicitly claiming ERISA fiduciary status, orally or in writing, enhances the adviser's influence and forms a basis for the advice recipient's expectation that the advice rendered will be impartial. The Proposed Rule reflects that view by applying fiduciary status to all persons affording those acknowledgments and disallowing the availability of the paragraph (c)(2)(i) seller's limitation to such persons.

We are concerned about the potential proof issues inherent in claims that an adviser provided oral representations of fiduciary status. Advisers may be hard put to dispute erroneous or otherwise fictitious claims by plans that oral assurances of fiduciary status were provided. At the same time we think prudence dictates that where a plan, plan participant or individual seeks out impartial, disinterested advice delivered in a manner consistent with ERISA's fiduciary standard of conduct, then the plan, plan participant or individual should obtain the appropriate acknowledgment in writing in order to secure the acknowledgement in a permanent form.

For these reasons, we strongly suggest that paragraph (c)(1)(ii)(A) be modified to apply only to persons who represent or acknowledge in writing (electronic or otherwise) that they are acting as a fiduciary within the meaning of ERISA with respect to the advice they are providing to the person or persons for whom they are so acting. This concept is consistent with the recently promulgated section 408(b)(2) regulations which require that a service provider acting in a fiduciary capacity acknowledge such in writing.

3. Separately Consider a Rule for Individual Retirement Arrangements

ACLI requests that the Department take additional time to study the IRA and Keogh/one-participant plan markets and carefully consider the economic impact of the Proposed Rule on both individuals and providers of products and services. We ask the Department to consider IRAs and these Keogh plans apart from the scope of a final rule for time to consider the IRA and Keogh market place, changes in its regulatory environment, the economic impact of a change to the current rules to the non-ERISA marketplace, a meaningful investment education safe harbor tailored to this marketplace, and to clarify the application of existing exemptions and/or issued new exemptions tailored to this marketplace. We believe that this would be similar to the Department's decision to separately consider welfare benefit plans under the recently issued 408(b)(2) regulations. The Department has held hearings and is close to issuing newly proposed regulations governing fee disclosure for welfare benefit plans. We urge the Department to consider a similar approach for IRAs and Keogh plans.

Unlike employer sponsored 401(k) plans that generally provide a limited number of investment options selected by a plan fiduciary, IRAs and Keogh plans offer individuals a practically unlimited number of options. Brokers and registered investment advisers who prefer to offer a wide range of options find it impossible to create a level sales compensation structure. Because that universe of investments is virtually unlimited, it is nearly impossible to design a computer model to take into the account every possible option. The rights of IRA owners are protected by way of their individual agreements and direct relationships with financial institutions.

Seller's limitation. We believe that the Department should confirm that the seller's limitation applies to IRAs. It is common for advisors and agents to engage clients and prospective client on their particular goals and objectives to better understand their product and service needs. Based on these conversations, an advisor might explain the pros and cons of various investment vehicles including variable annuities, mutual funds, brokerage accounts, banking products, fixed annuities, alternative investments and several types of advisory accounts. Within each of these types of securities and property, advisors/agents can usually recommend several different specific securities that may have different features. It is extremely difficult to design different product types so that the product pays the advisor the same compensation regardless of the investment allocation within the product. It is virtually impossible to do so across product types. For instance, compensation charged for executing a stock trade will differ from compensation received for selling a variable annuity. Absent a seller's limitation, it would be next to impossible to provide recommendations as to products and services because generally fees are not level.

For example, a broker may receive 50 bps if the individual invests in Product A (a large cap growth fund), 25 bps if the individual invests in Product B (a bond fund) or 0 bps if the individual invests in Product C (a money market account). For an individual with $10,000 in her account, a recommendation to put all assets into Product A would result in compensation of $50. A recommendation to use two products, 60% to Product A and 40% to Product B would result in compensation of $40. If the seller's limitation is too narrow, a broker may avoid making a recommendation, thereby leaving the individual without any professional assistance. The individual could instead pay a fee-only advisor (typically $500) to get the recommendations that may well be identical to the recommendations the broker would otherwise have provided at a far lower cost. The economics of small plans and small accounts make it so that the only advice available is often the incidental advice provided by brokers. Absent a broad seller's limitation, the average individual may receive no advice at all.

Other Limitations—The limitations provided at Section 2510.3-21(c)(2)(ii) should be available to IRAs. The Proposed Rule carves out from the definition specific acts related to the dissemination of investment information and defined contribution plan "platforms." However, these carve outs are limited to individual account plans as defined in ERISA §3(34). ACLI urges the Department to explicitly extend these carve outs to include IRAs.

Insurers issue variable IRAs (IRC § 408(b) Individual Retirement Annuities) that invest in insurance company separate accounts. These accounts may offer a variety

of investment options in different asset classes to address a range of possible investment objectives or asset allocations of different annuity owners all within a single separate account. The limited number of the funds in the separate account is similar to the "platform" of funds available to a defined contribution plan participant. The principal of the "platform" limitations described in 2510.3-21(c)(2)(ii)(B) & (C) should be equally applicable to IRAs.

Regarding education, the Department has provided considerable guidance regarding the line between activities that would result in fiduciary investment advice as opposed to activities that would be deemed non-fiduciary investment education. The Proposed Rule specifically references Interpretive Bulletin 96-1 (29 CFR 2509.96-1) to preserve this guidance for ERISA individual account plans, but does not provide a limitation for these activities to IRAs. Interpretive Bulletin 96-1 assumes that the investment education being provided relates to an ERISA individual account plan with a limited number of investment options. It addresses asset allocation models, but does not address the range of choices available for IRAs or Keogh plans such as annuity products, mutual funds, REITs, brokerage accounts, or an advisory wrap program to name just a few. Information that models the use of these various arrangements by hypothetical individuals should be viewed as "investment education" rather than investment advice.

Furthermore, the educational activities that apply to individual account plans are even more important with regard to IRAs. As indicated above, the investment options available to IRA owners could almost be limitless, as compared to employer sponsored plans which generally have limited options. The typical IRA owner needs help in picking the investment options needed to achieve their retirement goals and the concepts of IB 96-1 are therefore very important to IRA owners. We request that prior to issuing a final rule applicable to the IRA and Keogh plan marketplace, the Department issue a Field Bulletin that addresses investment education in IRAs and Keogh plans and make it clear that the "education limitation" applies to model information regarding the use of these various types of investment arrangements and asset allocation models for IRAs and Keogh plans.

Consumer Impacts—ACLI is extremely concerned that the Rule, if adopted as proposed, will negatively impact the very people the Department seeks to protect. We believe that the Rule may lead to less choice, reduced access and increased costs for products and services. Compensation structures vary by investment products for a variety of reasons, for example, to account for the increased time needed to explain a product that is not well understood or more complex than another. Sales agents must be able to address the needs of their customers. The Rule must permit this or, we fear, there will be fewer opportunities for IRA customers to learn about and consider a range of products and services.

We are not aware of a computer model that would advise an individual as to choices among different IRA product types. If typical sales activities, including recommendations regarding one or more IRA products under varied compensation structures, are not permitted by the final rule, IRA customers may find that advice is only available under a "wrap program." Under these arrangements, a set fee, either on a dollar or percentage formula basis, is paid for advice on the assets within the arrangement. Wrap programs are generally not available to individuals with small accounts. In many instances, wrap programs are more expensive than commission-based accounts, yet may be appropriate for certain IRA account holders. However, they are not necessarily as suitable a choice for other IRA account holders, such as buy and hold investors. Guaranteed lifetime income products are a "buy and hold" investment on which an ongoing wrap fee would not be a good fit. As annuities are sold on a commission basis, they are generally not available under a wrap program.

Individuals should not be limited in making IRA rollover decisions. A provider should be able to sell and an individual should be able to purchase an IRA insurance product even when the provider's products are used to fund the plan from which a rollover will be made. Fiduciary status should not be applied in a way that would restrict the options available to the participant seeking to purchase a rollover product. As we noted in section 1 above, so long as it is clear that the provider seeks to sell products, the seller's limitation in the Proposed Rule must apply here.

4. Recommendations to Take Distributions Not Investment Advice

The Department has requested comment on whether and to what extent the final rule should define "investment advice" to include recommendations related to the taking of a plan distribution. A decision by the participant to effect a distribution cannot be assumed to be an investment decision with respect to the plan as the Department noted in Advisory Opinion 2005-23A. A recommendation regarding whether to take a distribution from a plan might include advice which results in a new

investment outside the plan (e.g., "you should rollover your benefit to your new employer's plan) or on what such distribution should be spent (e.g., "you may be eligible to take a hardship distribution to cover our repair to your home"), but it should not be construed to be advice "with respect to any moneys or other property of the plan."3 While a plan may need to liquidate various investments to make the distribution, liquidation of plan assets is merely incidental to the primary transaction which is a distribution from the plan. In addition, a distribution will not necessarily result in a liquidation of assets if the plan distributes cash or other investments in-kind, i.e., no change in investment. To the extent that a recommendation to effect a distribution is also accompanied by specific advice regarding the plan's investments (e.g., to liquidate certain plan investments but retain others), the provision of such investment advice would be subject to the Proposed Rule. However, a recommendation regarding whether to contribute to or take a distribution from a plan is not investment advice and should not be considered investment advice regardless of the fiduciary status of the financial professional making the contribution or distribution recommendation.

Fiduciary Responsibilities can be Limited by Agreement

In the preamble, the Department cited Advisory Opinion 2005-23A and noted its position that a recommendation to a participant to take a distribution does not constitute investment advice within the meaning of the regulation. We urge the Department to use the preamble to the final regulation to clarify an important issue raised by question 2 of the advisory opinion, i.e., the extent to which responses by a party who is "already a fiduciary" to participant questions regarding distributions are the exercise of discretionary authority regarding management of the plan which is subject to ERISA fiduciary restrictions. Specifically, we ask the Department to clarify that responding to a participant's question regarding plan distribution is not subject to fiduciary standards merely because the party responding to the question or its affiliate provides fiduciary services under a written agreement with the plan that are separate and unrelated to participant distributions. Such a clarification would be consistent with the understanding that fiduciary responsibilities can be limited by agreement and that no party is an all-purpose fiduciary merely because it or its affiliate has entered into an agreement to perform specific fiduciary services. More specifically, ERISA uses a functional definition of fiduciary. Therefore a person is only a fiduciary to the extent the person performs a specific fiduciary function. For example, an agent is a fiduciary due to an arrangement to provide plan participants with investment advice regarding designated plan investments. If that agent recommends that a participant take a distribution from the plan, this action is separate and apart from the scope of the fiduciary's duties under the arrangement. We urge the Department to confirm this functional definition of fiduciary and clarify that activities such as a recommendation to contribute to a plan or take a distribution from the plan, whether directly or via an IRA roll-over, do not fall within the scope of a fiduciary's duties merely because the person is a fiduciary for other purposes, e.g., participant level investment advice. We also urge the Department to confirm that the seller's limitation is available to persons recommending IRA arrangements to a plan participant or individual to receive a rollover from a plan or another IRA.

5. Status as RIA Alone Should Not Give Rise to Fiduciary Duty

Absent the application of the limitations in paragraph (2), section 2510.3-21(c)(1)(ii)(C) of the Proposed Rule provides that all registered investment advisors ("RIA") are ERISA fiduciaries. ACLI believes that this provision is both unnecessary and unworkable. We find the provision unnecessary as paragraph (D) of that subsection already includes any person that provides advice or makes recommendations to plans and plan participants as described. The provision is unworkable as its application in conjunction with the affiliate rule leads to fiduciary status even when no advice or recommendations have been made to the plan or plan participants.

Should the final rule include the provisions of section 2510.3-21(c)(1)(ii)(C), ACLI requests that the rule limit the application of the affiliate provision to only those instances in which an affiliate engages in actions or has authority with respect to the plan that is sufficient to cause a reasonable plan fiduciary to believe it is receiving fiduciary-level investment advice. Under the Proposed Rule, the mere affiliation with an RIA would result in fiduciary status. Specifically, the Proposed Rule says that a person may attain this status "directly or indirectly (e.g., through or together with any affiliate)." Affiliation with an RIA should not trigger ERISA fiduciary status unless the RIA is providing advice services to the plan. If the RIA is not providing advice services to the plan, the affiliate should be able to rely on the multi-

factor test in section 2510.3-21(c)(1)(ii)(D) of the Proposed Rule in determining its fiduciary status.

Similarly, affiliation with, or even direct status as, an ERISA fiduciary other than by providing investment advice should not trigger the presumption that a person is an investment advice fiduciary unless such status would give plans and participants a reasonable expectation of impartial investment advice and the person is in a position to influence investment decisions. Thus, for example, status as an ERISA fiduciary for a limited purpose unrelated to investment decisions (e.g., directed trustee, investment manager of a "plan asset" investment vehicle in which a plan invests such as an insurance company separate account or collective trust), either directly or through an affiliate, should not trigger the presumption of investment advice fiduciary status because the fiduciary's limited status alone would not give rise to a reasonable expectation that the fiduciary should provide impartial investment advice and does not put the fiduciary in a position to influence investment decisions. To impose investment advice fiduciary status on these persons solely because of these other limited and unrelated functions would be contrary to the functional nature of fiduciary status under ERISA, which generally only imposes fiduciary responsibility on persons to the extent of their fiduciary activities with respect to the plan.

ACLI understands that the language assigning fiduciary status through an affiliate relationship is in the existing rule today so it may seem reasonable to continue this concept in the Proposed Rule. However, the difference between the existing rule and the Proposed Rule is that the existing rule is primarily focused on activity, not status. For example, under the current rule, the mere affiliation of a person with an RIA or a directed trustee would not trigger fiduciary status. Instead, the affiliate would have to engage in actions or have authority with respect to the plan that is sufficient to cause a reasonable plan fiduciary to believe it is receiving fiduciary-level investment advice. Because the Proposed Rule would presume fiduciary status based on status alone in some cases, extending that presumption based solely on the status of an affiliate is inappropriate.

6. Reasonable Expectations for Fiduciary Status

The Department should revise section 2510.3-21(c)(1)(ii)(D) to provide greater clarity as to which arrangements lead to fiduciary status. ACLI believes that fiduciary status should not apply when advice merely "may be considered." The current rule provides that a person will be a fiduciary when the person and the plan agree that the advice "will serve as a primary basis" for investment decisions with respect to plan assets. ACLI believes that this is reasonable and in keeping with the intent of ERISA. The fiduciary standards of ERISA should only apply when the parties reasonably expect that the advice given and received will serve as a basis for a decision. That reasonable expectation should be evidenced by a written agreement between the parties or a written disclosure from the provider. Due to the nature of such a relationship, this advice should be subject to the fiduciary duties and responsibilities of ERISA. However, the Proposed Rule would subject such duties and responsibilities to persons whose advice or opinions hold no such import. A plan may solicit advice from a number of persons without engaging any one to serve as an advisor. When a plan's interest in the advice is cursory at best, there is clearly not a relationship which would warrant the extension of ERISA obligations to the advisor.

7. Platform Provider Limitation

The Department should provide greater clarity on the "platform provider" limitation in section 2510.3-21(c)(2)(ii)(B) as it pertains to "individualization" in the context of the sales, marketing and retention activities of platform providers. In particular, we believe the platform provider limitation should be clear that platform providers are not providing investment advice for a fee when they suggest to plans sample menus, or otherwise, when the platform provider (1) does not hold itself out as a plan fiduciary, (2) discloses that its recommendations are not intended to be impartial advice, and (3) discloses that it has a financial interest in the transaction, which may include indirect compensation paid to the platform provider or its affiliates from investment fund complexes.

This is important to platform providers because in the ordinary course of selecting a platform provider, or determining whether to continue a contract with a platform provider, plan sponsors often require, either through a formal request for proposal or by means of an informal request by an intermediary acting for the plan such as a broker or consultant, that a platform provider supply a sample menu of investment funds (e.g., a subset of funds available from the provider's investment platform) for consideration by the plan sponsor and its advisers. Platform providers that

fail to respond to such requests are often excluded from the sales opportunity, or fail to retain an existing plan customer.

In some cases, such requests may be accompanied by certain criteria or parameters supplied by the plan sponsor or its intermediary, to guide the platform provider such as the plan's investment policy, fund performance history requirements, Morningstar classifications and other similar criteria. Often, however, the plan sponsor's (or its intermediary's) request may be simply that the platform provider supply a suggested list of funds from the provider's platform that are substantially identical or closely comparable to the plan's existing designated investment funds.

In responding to these requests, platform providers engage in non-fiduciary sales activity. Platform providers strive to suggest sample menus that are consistent with the goals and objectives communicated to the platform provider by the plan sponsor, and consistent with the economic needs of the platform provider's non-fiduciary business model. Therefore, similar to the activity described in the seller's limitation at section 2510.3-21(c)(2)(i), the platform provider will typically attempt to respond to these requests by suggesting a sample menu or suggested list of funds that both (1) attempts to reasonably satisfy any criteria accompanying the request and (2) meets the platform provider's target revenue needs. Accordingly, we believe it is important that the limitation in section 2510.3-21(c)(2)(ii)(B) be clarified to include these types of sales activities.

8. Investment Product Offerings are not Investment Advice

The Department should clarify in a final rule or its preamble that the development and offer of an investment product with a limited investment menu, e.g., a bond fund, a stock fund and a balanced fund, is not a provision of investment advice. Investment providers such as insurers should have the flexibility to offer a range of products with varied investment menus.

9. Confirm Status of Existing Exemptions

The last time a new fiduciary standard was created to govern sales of products by brokers and other investment advisers, the Department responded immediately issuing a number of exemptions applicable to broker-dealer activity to protect certain activities. Creating a bright-line test to determine who is an advice fiduciary is a laudable goal. However, the bright-line test should not end at the determination of who is a fiduciary, but rather extend to the determination as to whether such advice creates a prohibited transaction when the broker or other financial professional receives fully disclosed direct or indirect compensation from such sale or service.

It is difficult to assess the impact of the Proposed Rule without a clear understanding of whether prior exemptions would continue to apply and whether new exemptions are contemplated. The Department has provided a broad exemption for the sale of annuities (PTE 84-24). We would appreciate the Department's confirmation that this exemption is still available and would cover sales of affiliated and unaffiliated annuities as well as any compensation, direct or indirect, received by an affiliated insurance company, affiliated money managers of variable annuity subaccounts, and any revenue sharing paid to the broker. Further, we seek the Department's confirmation that if the requirements of PTE 84-24 are met that the exemption covers the provision of investment advice. The Department should also confirm the status of exemptions such as PTE 75-1 and 86-128. In particular, it should confirm that these exemptions apply to the provision of investment advice. Product providers, agents and brokers need to know that these exemptions still apply, and cover advisory programs which meet the requirements of the exemption.

Finally, the Department has issued Advisory Opinions to investment providers that also provide investment advice to ERISA plan participants on whether the receipt of compensation under the arrangements in question result in prohibited transactions. In both Advisory Opinion 97-15A (the "Frost" letter) and Advisory Opinion 2001-09A ("the SunAmerica" letter), the Department concluded that, based upon the facts, the receipt of compensation described under these arrangements did not result in a prohibited transaction under ERISA §406(b). ACLI members agree with the Department's conclusions in these Opinions. We ask that Department continue to support these conclusions and leave no doubt as to the status of these Opinions under a final rule.

10. Valuations are not Investment Advice

ACLI requests that the Department remove the provision of appraisal services from the rule. ERISA section 3(21)(A)(ii) provides that a person is a fiduciary if he or she "renders investment advice for a fee * * *" The determination of the current price of an asset is not "investment advice," i.e., it is not a recommendation to purchase or sell property or securities nor an opinion regarding the merits or value of

investing in such property or security. The Department elaborated on the matter shortly after it issued the current rule in Advisory Opinion 76—65A, clarifying that the provision of valuation services is not "investment advice." The Department noted, absent an opinion as to the relative merits of purchasing a particular asset as opposed to some other asset or assets, the valuation of securities is neither investment advice, nor advice as to the value of securities.

There are good reasons for not treating appraisal services as investment advice. When a plan fiduciary directly engages an appraiser to obtain current prices on property or securities that are under consideration for purchase or sale or for assets already held by the plan, the fiduciary must act prudently in selecting and monitoring the appraiser. A plan's service arrangement with an appraiser is subject to the provisions of ERISA §408(b)(2). As for the Department's concerns regarding undisclosed conflicts of interests, the interim final rule under ERISA §408(b)(2) makes clear that to satisfy the prohibited transaction exemption under ERISA §408(b)(2), an appraiser who provides services for indirect compensation must disclose to the fiduciary any and all indirect compensation it expects to receive for services rendered to the plan. Thus, with respect to appraisals, there already is a plan fiduciary to ensure that appraisal activities are performed under an arrangement and in a manner that protects the interests of the plan and its participants and beneficiaries.

Extending fiduciary status to appraisers under this Proposed Rule would, at the very least, substantially raise the costs of what are already objective independent valuations for no discernible purpose. For appraisal work performed for insurance company separate accounts, it would make such appraisers fiduciaries to all ERISA covered plans that invest in these separate accounts. In general, these appraisers would have no direct relationship with or knowledge of these ERISA plans. ACLI members expect many appraisers to avoid ERISA plans and investment vehicles in which plans invest altogether if this Proposed Rule take effect. In that event, there would be severe market disruption for both plans seeking to invest in separate accounts and other non-publicly traded securities. At best, we anticipate fewer appraisers and increased valuation fees due to the reduction in the number of willing appraisers and the need for willing appraisers to insure against potential law suits, all of which are costs that will ultimately be borne by plans and their participants.

If the Department extends the definition to include appraisal services, we note that the limitation on the application of the Proposed Rule at (c)(2)(iii) raises two key concerns. First, the scope of the exclusion for "general reports * * * provided for purposes of compliance with the reporting and disclosure requirements" is too narrow. It is common for insurers to prepare and provide reports and statements more frequently than ERISA's minimum reporting requirements. For example, it is common to provide access to daily online account values to plan participants. It is also common for interim reports to be prepared for a plan's investment committee. Second, and more importantly to insurers, the rule's exclusion for reports on assets for which there is "not a generally recognized market" is quite problematic.

Both a plan's equity investment in an insurer's separate account (units of the separate account) and an undivided interest in the separate account's investment in other vehicles (e.g., units of the separate accounts investments in real estate funds, hedge funds, private equity funds) are "plan assets." Accordingly, any party passing along information to the separate account investment manager (the insurer or its affiliate) on the value of the separate account's investment in the underlying investment vehicles (units in the underlying fund) or on assets of that vehicle that are used in computing unit values of that vehicle is potentially a fiduciary under the Proposed Rule because it is giving advice on the value of securities or other property owned or to be purchased by a plan. This would be true whether the underlying investment vehicle invests in publicly offered securities or in non-public assets (with values determined by appraisal). The parties swept into the fiduciary definition include investment managers of underlying investment vehicles, custodians or subcustodians and appraisers.

Many insurers offer real estate separate accounts and hire appraisers to determine the values of separate account holdings. Those values are used for client reporting purposes and to set unit values used for a plan's purchase or sale of separate account units. The Proposed Rule would impose fiduciary status and liability on real estate appraisers to separate accounts in which ERISA plans invest. By valuing the underlying properties of a real estate fund, an appraiser would be advising the real estate fund manager on the value of fund units, an ERISA "plan asset," because the appraisal is for an underlying asset of the insurer's separate account.

Units of a non-registered separate account are not publicly offered securities. This is true even when the underlying assets of the separate accounts are registered securities. Under the Proposed Rule, establishing separate account unit values would be a fiduciary act of "advice," leading an insurer to become a fiduciary for purposes

of the valuation. Insurers typically hire sub-custodians who have no direct contact with any plan investor to handle recordkeeping as well as the calculation of separate account unit values. The Proposed Rule would make these sub-custodians ERISA fiduciaries.

The Department should not use this proposed rule to attempt to extend the definition of fiduciary under ERISA 3(21)(A)(ii) to persons providing appraisal services because such services do not constitute the rendering of investment advice. This portion of the proposal along with the "limitation" in the Proposed Rule at (c)(2)(iii) should be dropped. If the Department finds it necessary to study valuation issues more broadly, ACLI suggests that Department issue a Request for Information.

11. Effective Date

ACLI believes that an effective date of at least one year following the publication of a final rule is necessary and reasonable. The Proposed Rule states that final rule would be effective 180 days following publication. As indicated in our comments above, the implications of the new rule would require significant changes. Our members will need sufficient time to fully understand and address a new regulatory regime, particularly given that any violations would result in a prohibited transaction. Should the Rule be implemented as proposed, in addition to time required for compliance review, there may be significant changes required to information technology infrastructure, sales processes and compensation arrangements and other agreements.

On behalf of the ACLI member companies, thank you for consideration of these comments. We welcome the opportunity to discuss these comments and engage in a productive dialogue with the Department on these important issues.

Sincerely yours,

WALTER C. WELSH,
Executive Vice President, Taxes & Retirement Security.

JAMES H. SZOSTEK,
Vice President, Taxes & Retirement Security.

SHANNON SALINAS,
Counsel, Taxes & Retirement Security.

Prepared Statement of Tom Roberts, on Behalf of the American Council of Life Insurers

Good morning. My name is Tom Roberts and I am Chief Counsel at ING Insurance U.S., testifying on behalf of the American Council of Life Insurers. ACLI member companies represent more than 90% of the assets and premiums of the US life insurance and annuity industry, and offer insurance contracts and other investment products and services to qualified retirement plans, including defined benefit pension and 401(k) arrangements, and to individuals through individual retirement arrangements (IRAs) or on a nonqualified basis. ACLI member companies also are employer sponsors of retirement plans for their own employees.

We appreciate this opportunity to offer our views of the proposed rule with the Department. ACLI submitted written comments describing eleven key concerns. Today, I focus on three of them: the importance of the seller's limitation; our suggestions to ensure all interested parties clearly understand when advice is subject to ERISA; and our concerns regarding the proposed rule's applicability to IRAs and the need for further inquiry on the nature of these programs and the products and services offered to support them.

The Proposed Rule would dramatically enlarge the universe of persons who owe duties of undivided loyalty to ERISA plans and to whom the prohibited transaction restrictions of ERISA and the Internal Revenue Code would apply. It substantially broadens the concept of rendering "investment advice for a fee."

ACLI appreciates the Department's concern that under some circumstances the current rule impinges the Department's ability to bring enforcement actions in situations that are clearly abusive. We share the Department's interest in seeing that plans and participants who seek out and are promised advice that is impartial ultimately receive advice that adheres to the rigorous standards imposed by ERISA. At the same time, we are concerned that the Proposed Rule's pursuit of this objective interferes with investment sales and distribution practices that are customary in the marketplace, well understood, and commonly relied upon by financial services providers, plans and participants alike. We are concerned that these changes will

result in plans, plan participants, and IRA owners having less access to investment information and or increased costs. Our comments seek to preserve the Department's enforcement objective while avoiding unnecessary disruption and negative impacts to plans, participants and individuals.

Seller's Limitation on fiduciary status

In the preamble to the proposed rule, the Department notes that, in the context of selling to a purchaser, communications with the purchaser may involve advice or recommendations and that such communications ordinarily should not result in fiduciary status. This point is critical to the development of a workable rule. Persons engaged in the sale and distribution of investment product and services need to have confidence that ordinary course sales recommendations will not, in hindsight, be subjected to a fiduciary standard that disallows the payment of sales commissions and other traditional forms of distribution-related compensation. Parties engaged in transactions with ERISA plans and IRAs need clear, unambiguous rules by which to determine their duties and obligations.

Financial institutions such as life insurers and their sales representatives should not be treated as fiduciaries under ERISA when they are engaged in selling activities and are clear that they are acting in a sales capacity.

As written, the wording of the seller's limitation, which describes sellers and their agents, raises some uncertainties about the availability of the seller's limitation for other distribution channels, such as independent insurance agents, insurance affiliated and unaffiliated broker-dealers and registered investment advisers that offer life insurer products, whether exclusively or as one of many other products from a variety of different product manufacturers. These parties must be covered by the limitation.

The seller's limitation is only available when the recipient of the advice knows or has a basis for knowing that the interests of the selling firm and its distributors are "adverse" to the interests of the plan and its participants. We think that the word "adverse" is not right word to explain that a seller is not impartial. While the seller of a financial product has a financial interest in the outcome of a transaction, we think it is inappropriate to describe that financial interest as necessarily entailing broad adversity of interest. As responsible providers, we have an interest in seeing that our customers are well served, are happy with our products and services, and that our customers find them useful to the attainment of their financial goals.

We believe the seller's limitation should make the point that a seller of an investment or an investment product has a financial interest in the transaction it is recommending. So long as purchasers are provided with that information, they will have the requisite basis for evaluating the recommended transaction in light of the seller's financial interest, and will be in a position to understand that the selling firm's recommendation is not impartial.

The rule should provide an example or examples of circumstances in which a person reasonably demonstrates that the recipient of information knows that a recommendation is being made by a "seller." For example, a written representation would suffice if it clearly notes that the person is a seller of products and services, that the person and, if applicable, its affiliates, will receive compensation for the selection of the product and services, and that such compensation may vary depending upon which product is purchased or which investments under a product or products are selected. This type of representation would provide a clear indication to the plan, plan fiduciary or participant that the person is a non-impartial seller of products and services. It would also address the Department's stated concern about undisclosed conflicts of interest.

The Department should clarify that the seller's limitation covers all aspects of both an initial sale and the subsequent ongoing relationship between a plan, plan fiduciary or individual and an investment provider or any agent, broker, and/or registered investment adviser involved with the sale of the investment provider's products and services. This would include information and recommendations regarding the use of a product, for example, advice regarding the choice of investments available under a product's menu of investments. It is common for defined contribution plans to request of potential investment providers a sample menu of investments from among a provider's available investments which, in the opinion of the provider, best match the plan's current investment options. There should be no expectation that any such recommendation is impartial or that the plan seeks advice upon which it will rely for its investment decisions. The nature of this relationship should not change after a sale. A product provider, agent, broker, and/or registered investment adviser may continue to make recommendations regarding products and services. There should be no expectation that these recommendations differ in nature following the initial sale.

Written Representations

In its preamble, the Department expresses the belief that explicitly claiming ERISA fiduciary status, orally or in writing, enhances the adviser's influence and forms a basis for the advice recipient's expectation that the advice rendered will be impartial. The Proposed Rule reflects that view by applying fiduciary status to all persons affording those acknowledgments and disallowing the availability of the seller's limitation to such persons.

We think prudence dictates that where a plan, plan participant or individual seeks out impartial, disinterested advice delivered in a manner consistent with ERISA's fiduciary standard of conduct, then the plan, plan participant or individual should obtain the appropriate acknowledgment in writing in order to secure the acknowledgement in a permanent form. We are concerned about the potential proof issues inherent in claims that an adviser provided oral representations of fiduciary status. Advisers may be hard put to dispute erroneous or otherwise fictitious claims that oral assurances of fiduciary status were provided.

For these reasons, we request that the rule be modified to apply only to persons who represent or acknowledge in writing, electronic or otherwise, that they are acting as a fiduciary within the meaning of ERISA with respect to the advice they are providing to the person or persons for whom they are so acting. This concept is consistent with the recently promulgated section 408(b)(2) regulations that require that a service provider acting in a fiduciary capacity acknowledge such in writing.

Separately Consider Rule for IRAs

ACLI requests that the Department take additional time to study the IRA and self-employed plan markets and carefully consider the economic impact of the Proposed Rule on both individuals and providers of products and services. The Department is separately considering welfare benefit plans under the recently issued 408(b)(2) regulations. We ask the Department to do likewise for IRAs and self-employed plans and hold them apart from the scope of a final rule. The Department should take time to consider the IRA and Keogh market place, and the economic impact a change to the current rules would have on this retail marketplace.

In addition, the Department should consider changes in the regulatory environment affecting retail products. In particular, there are regulatory efforts are underway by the Securities and Exchange Commission regarding the standard of care under the securities laws for broker-dealers and investment advisers that provide personalized investment advice about securities to retail customers. On January 21, 2011, the SEC issued a study on broker-dealers and investment advisers. It is important that the SEC and DOL efforts lead to rules that are complimentary in nature. We urge the Department to provide the public sufficient opportunity to consider the SEC's regulatory efforts and offer additional comments on the Proposed Rule.

The Department should consider a meaningful investment education safe harbor tailored to this marketplace. The Department should also clarify the application of existing exemptions and/or issued new exemptions tailored to this marketplace.

As we read the proposed regulation, the seller's limitation applies to IRAs. It is common for advisors and agents to engage customers and prospective customers on their particular goals and objectives to better understand their product and service needs. Based on these conversations, an advisor might explain the pros and cons of various investment vehicles including variable annuities, mutual funds, brokerage accounts, banking products, fixed annuities, alternative investments and several types of advisory accounts. Within each of these types of securities and property, advisors/agents can usually recommend several different specific securities that may have different features. The compensation paid by product and service will vary. For instance, compensation charged for executing a stock trade will differ from compensation received for selling an annuity. The seller's limitation, with an appropriate indication of the seller's interest, makes it possible to recommend products and services to customers.

I want to thank the Department again for holding this hearing, and for inviting ACLI to testify. I am happy to answer any questions you may have.

ACLI Clarification of Earlier Testimony

On behalf of the American Council of Life Insurers[1] ("ACLI"), we write to you today on the proposed rule promulgated under Section 3(21)(A)(ii) of the Employee Retirement Income Security Act ("ERISA"), which was published at 75 Fed. Reg. 65263 (October 22, 2010) ("Proposed Rule" or "Rule") and to offer a response to questions raised at the March 1st hearing by DOL staff to our witness Thomas Roberts.

Clarification of Seller's Limitation

In our February 3rd comment letter and in our testimony, we asked that the proposal be modified to provide examples of circumstances that would reasonably demonstrate that the recipient of information knows that a recommendation is being made by a "seller." One example would be a representation that:

The person is a seller of products and services, that the person and, if applicable, its affiliates, will receive compensation in the event the plan, plan fiduciary or participant/individual selects the products and services, and that such compensation may vary depending upon which product is purchased or which investments under a product or products are selected.

The proposed regulation provides that the seller's limitation is not applicable to a person "who represents or acknowledges that it is an ERISA Fiduciary." Our letter states that this constraint on the seller's limitation should only apply if the seller has represented or acknowledged in writing (electronic or otherwise) that it was a fiduciary.

During our testimony it was suggested that the seller's limitation might be protected by some form of disclosure stating that the seller was not an ERISA Fiduciary. Such a disclosure could be added to the representation (described above) that the "person is a seller * * *."

In addition to examples, the rule could include one or more safe harbor model notices. For example:

I, (Name), am a representative of (Agency/Company). I would like to be of assistance to you. Before we proceed, I need to be clear with you that my firm and I may have a financial interest in the sale of any product or transaction that we might recommend to you. Our financial incentive to recommend a particular product or investment may vary by asset class, investment choices or product type, or according to the particular investments available within a given asset class or product type. My firm and I do not agree to act as your ERISA fiduciary investment advice provider. An ERISA fiduciary is not permitted to take its own financial interests into account when making a recommendation.

In certain circumstances, it may be appropriate to bifurcate this disclosure to make clear that, while the selling firm does not agree to serve as an ERISA fiduciary investment advice provider in connection with recommendations made by the particular representative making the disclosure, it may agree to serve as an ERISA fiduciary investment advice provider in connection with recommendations made outside of the scope of the relationship between the representative and the plan, plan fiduciary or participant/individual to whom the disclosure is made. In such cases, the disclosure should be revised to remove all references to the selling firm and add the following:

I also need to be clear with you that my firm may have a financial interest in the sale of any product or transaction that I might recommend to you and my firm does not agree to act as your ERISA fiduciary investment advisor in connection with any of my recommendations.

This type of representation would provide a clear indication to the plan, plan fiduciary or participant that the person is a non-impartial seller of products and services. It would also address the Department's stated concern about undisclosed conflicts of interest.

As you are aware, regulatory efforts are underway by the Securities and Exchange Commission ("SEC") regarding the standard of care for broker-dealers and investment advisers that provide investment advice about securities to retail customers. Depending upon the SEC's actions, there may be a need to expand this "seller's" disclosure to describe the seller's status and obligations under federal securities law including whether the seller is a fiduciary under federal securities law.

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[1] The American Council of Life Insurers is a national trade organization with more than 300 members that represent more than 90% of the assets and premiums of the U.S. life insurance and annuity industry. ACLI member companies offer insurance contracts and other investment products and services to qualified retirement plans, including defined benefit pension, 401(k) and 403(b) arrangements, and to individuals through individual retirement arrangements (IRAs) or on a non-qualified basis. ACLI member companies also are employer sponsors of retirement plans for their own employees.

Finally, the Department should clarify that, for purposes of the seller's limitation, the "recipient" of advice or recommendations may be the plan, the plan's sponsor or other plan fiduciary, plan participant, plan beneficiary or an individual (in the case of an individual retirement arrangement).

Proposed Rule and Exemptive Relief

In light of the substantive comment letters and testimony at the hearing, we expect that the Department will make a number of useful revisions to the Proposed Rule. With substantive revisions, the Department should provide the public with an opportunity to review and comment on the next iteration of the rule before a final rule is promulgated. The current Proposed Rule would dramatically enlarge the universe of persons who owe duties of undivided loyalty to ERISA plans and to whom the prohibited transaction restrictions of ERISA and the Internal Revenue Code would apply, by re-defining and substantially broadening the concept of rendering "investment advice for a fee" within the meaning of ERISA Section 3(21)(a)(ii).

At the hearing, we were asked about compensation disclosure and noted that the Prohibited Transaction Exemption 84-24 requires such disclosure. We note this exchange to emphasize the need for the Department to confirm the status of current exemptions and solicit public input on whether amendments are needed to existing exemptions and/or whether new exemptions are in order.

We ask that the Department issue a new proposal together with any proposed changes to or confirmations of exemptive relief. We believe it is important to review and comment on these together. We remain committed to offering comments that seek to preserve the Department's enforcement objective while avoiding unnecessary disruption and negative impacts to plans, participants and individuals.

On behalf of the ACLI member companies, thank you for consideration of these comments. We welcome the opportunity to discuss these comments and engage in a productive dialogue with the Department on these important issues.

July 25, 2011.

Hon. PHIL ROE, *Chairman;* Hon. ROBERT ANDREWS, *Ranking Member,*
Subcommittee on Health, Employment, Labor and Pensions, Committee on Education and the Workforce, U.S. House of Representatives, Washington, DC 20515.

DEAR CHAIRMAN ROE AND RANKING MEMBER ANDREWS: Tomorrow, the House Subcommittee on Health, Employment, Labor and Pensions is holding a hearing entitled "Redefining 'Fiduciary': Assessing the Impact of the Labor Department's Proposal on Workers and Retirees." On behalf of the American Institute of Certified Public Accountants (AICPA) Forensic and Valuation Services Executive Committee, I am writing to express significant concern and reiterate our position regarding the approach being taken by the Department of Labor (DOL) in its Proposed Rule ("Proposal")[1] that would broaden the DOL's interpretation of a "fiduciary" under the Employee Retirement Income and Security Act (ERISA). Specifically, the Proposal would significantly expand the circumstances under which a person would be considered a "fiduciary" under ERISA by reason of providing an appraisal or fairness opinion concerning the value of securities or other property. As currently drafted, certified public accountants (CPAs) and others who perform appraisal services for Employee Stock Option Plans (ESOPs) would be included in this new definition of fiduciary. While we appreciate the concerns which have been expressed by the DOL regarding the quality of some appraisals performed for ESOPs, we believe that the Proposal raises significant legal issues, which are set forth below.

The AICPA believes that the Proposal's treatment of appraisers as fiduciaries would create a clear conflict between an ERISA fiduciary's strict duty of loyalty to plan participants and beneficiaries, and an appraiser's obligation, pursuant to professional appraisal standards and the Internal Revenue Code (IRC), to perform assignments with impartiality, objectivity and independence. ERISA requires plan fiduciaries to act "solely in the interest" of, and for the "exclusive purpose of" providing plan benefits to plan participants and beneficiaries. Thus, the capacity in which a fiduciary is bound to act cannot be described as independent.

During public hearings on the Proposal, DOL officials asserted that there is no conflict between an appraiser's obligation to act with independence and fiduciary status because ERISA does not require a fiduciary to serve as an advocate. We disagree. Fiduciaries have a clear obligation to constantly and single-mindedly consider

[1] 75 Federal Register 65,263 (October 22, 2010)

and represent the interests of the plan participants and beneficiaries. One cannot adequately represent—or act for the exclusive benefit of—the interests of a party without, in some way, being an advocate.

DOL officials also stated during recent hearings that appraiser independence and fiduciary status are not mutually exclusive because an "independent appraiser" and "fiduciary appraiser" have the same goal: to ascertain the correct valuation of ESOP securities. While such a conclusion may be warranted in circumstances where there is only one "right" answer (e.g., single figure), valuations are typically stated in terms of a reasonable range. Notwithstanding that a great deal of judgment is involved, the valuation analyst must be able to fully support and document any number within that range.

To illustrate this point, consider an ESOP's first purchase of stock from an employer. ERISA would require a "fiduciary appraiser" to assist the plan fiduciary negotiating the purchase by generating an appraisal that resolves each and every judgment call in favor of the plan participants and beneficiaries (within a reasonable range) rather than steer a middle course. In comparison, an independent appraiser/valuation analyst would not necessarily take into consideration best interests of the plan participants and beneficiaries but would, instead, consider the best objective criteria regarding the value of the stock. We do not see how a fiduciary appraiser can reconcile his or her duty to act for the exclusive benefit of one party with the requirement that he or she make independent and disinterested judgment calls at various stages in the appraisal process.

The AICPA further believes that the elevation of an appraiser to fiduciary status under ERISA, a consequence of the DOL's Proposal if approved, is incompatible with Section 401(a)(28)(C) of the Internal Revenue Code, which requires ESOPs to obtain valuations from an "independent appraiser" for employer securities that are not readily tradable on an established market.[2] For purposes of IRC Section 401(a)(28)(C), the term "independent appraiser" is defined as "any appraiser meeting requirements similar to the requirements prescribed under IRC Section 170(a)(1)." Under Section 170, as interpreted by the IRS, we believe it is reasonably clear that a fiduciary could not serve as "qualified appraiser." IRS regulations3 which set forth guidance on the definition of "qualified appraiser" specify that one is disqualified as serving as a "qualified appraiser" if he or she has prohibited relationships with parties who have a direct interest in the property being valued. In the context of a valuation of an ESOP's securities that are not readily tradable, the interested parties include the ESOP and the plan's participants and beneficiaries. We believe that being a fiduciary to an interested party disqualifies a person from being a "qualified appraiser."

The clear and significant conflicts raised by this Proposal also go against Executive Order 13563 which directs regulators to promote coordination across agencies, consider the combined effect of their regulations on particular sectors and industries and reduce the burdens, redundancies and conflict created by such requirements. This Proposal would put appraisers in an untenable position with respect to valuations performed for all employee benefit plans, and ESOPs in particular because of a clear conflict between the DOL Proposal and the IRS Rules.

Importantly, we believe that this change would have a direct adverse effect on CPAs and other appraisers and, more significantly, on the employees covered by the employee benefit plans. By defining valuation preparers as fiduciaries, preparers would face increased insurance rates and risk premiums resulting from increased liability risk. Such increases would necessarily be passed on to employers requiring the valuations and ultimately to plan participants.

Finally, the AICPA also believes that the DOL's proposed change does not address the underlying issue: sponsor company valuations can currently be performed by any individual, regardless of qualifications. The AICPA believes a better solution would be for the DOL to mirror other regulatory agencies regarding regulation of appraisers and require proper qualifications and standards for performing valuation services. Specifically, we recommend that the DOL implement rules that would require appraisers to meet minimum specialized training requirements, hold relevant credentials, and comply with applicable professional standards.

We understand that the DOL anticipates completing its Final Rule soon. We hope that our concerns regarding the inconsistency between the requirement to remain independent under the Internal Revenue Code and the duties owed as a fiduciary as contemplated by the DOL's proposed rule can be resolved. Please contact Diana

[2] 26 U.S.C. §401(a)(28)(C) 3 Section 1.170A-13(c)(5)(iv) of the Income Tax Regulations.

Huntress Deem at 202.434.9276 in our Washington office if you have any questions regarding our concerns.

Sincerely,

THOMAS BURRAGE, CPA/ABV/CFF, *CVA Chair,*
AICPA Forensic and Valuation Services Executive Committee.

Hon. PHIL ROE, *Chairman;* Hon. ROBERT ANDREWS, *Ranking Member,*
Subcommittee on Health, Employment, Labor and Pensions, Committee on Education and the Workforce, U.S. House of Representatives, Washington, DC 20515.

DEAR CHAIRMAN ROE AND RANKING MEMBER ANDREWS: The American Society of Appraisers (ASA)[1] is writing to express its appreciation to the Subcommittee for today's hearing into the Labor Department's proposed fiduciary rule; and, to express our profound concerns over that portion of the rule which mandates the inclusion of appraisers who perform ESOP valuations within the definition of "fiduciary".

ASA, many of whose credentialed business appraisers provide ESOP valuation services, has worked closely and successfully with many federal agencies to establish regulatory requirements that improve their ability to ensure the integrity of appraisals they oversee and sanction appraisers for abusive or unprofessional valuations. We mention our record of support for strengthened federal agency oversight of valuations in the hope it will demonstrate to Subcommittee members our organization's unwavering commitment to federal appraisal reforms that hold out the promise of effectiveness. Regrettably, we do not believe DOL's proposed rule holds out that promise. Instead, its inevitable effect will be to greatly increase the costs of ESOP valuations without doing anything to improve the competency of appraisers practicing before the agency or the reliability of their valuations.

ASA's reasons for strongly opposing the appraiser-as-fiduciary provisions of the proposed rule are summarized below:

First, making appraisers fiduciaries is fundamentally irrelevant to DOL's stated public policy objective, which is to improve the reliability and integrity of appraisals performed in connection with ESOPs or other pension plans. While making appraisers fiduciaries will expose them to the likelihood of endless law suits, it will do nothing to improve their valuation skills or the quality of the appraisals themselves;

Second, DOL's proposal is totally out-of-sync with the appraisal enforcement programs of every other federal agency. These agencies—including IRS which shares ERISA enforcement authority with DOL—have improved the reliability of appraisals they oversee by requiring appraisers to meet rigorous qualification requirements (e.g., experience, training, education and testing in connection with specific categories of property) and by mandating that they adhere to uniform appraisal standards (i.e., the Uniform Standards of Professional Appraisal Practice or USPAP) . The appraisal reform requirements adopted throughout the federal government are consistent with the appraiser qualifications and appraisal standards promulgated by the Congressionally-recognized Appraisal Foundation. As stated above, ASA has played an active role with many federal agencies to modernize and reform their appraisal regulatory programs. We would like to continue that role with DOL and have so advised them;

Third, a DOL rule making appraisers fiduciaries would directly violate the Ethics obligation of all professional appraisers under the Uniform Standards of Professional Appraisal Practice to be completely independent of all parties and interests to a transaction for which a valuation is performed. An appraiser cannot be a fiduciary and, simultaneously, be independent of all parties. DOL's proposed rule, if finalized, would cause a severe breach in an independence requirement that goes to the essence of professional appraisal practice. This is not only the opinion of ASA, it is the conclusion of the Appraisal Standards Board of The Appraisal Foundation—the Congressionally recognized arbiter of appraisal standards in federally-related transactions. The Foundation has written DOL and urged the agency not to adopt the appraiseras-fiduciary proposal. It would be ironic if DOL, which is deeply committed to preventing conflicts of interest by those involved in ESOPs, were to adopt a rule that undermines the ethical obligation of every professional appraiser to avoid any and all conflicts of interest.

Moreover, if DOL's proposal were to become law, it would put an agency of the federal government—for the first time—in direct conflict with the enforcement re-

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[1] ASA is a multidiscipline professional appraisal society which teaches, tests and credentials its members for professional appraisal practice in the areas of business valuation, commercial and residential real property and the valuation of tangible and intangible personal property, such as fine art and machinery and technical equipment.

sponsibilities of the real estate appraiser licensing boards in the 50 states and territories; and, with the Ethics Committees of the professional appraisal organizations, like ours, which credential professional appraisers. Both the state appraiser licensing agencies (pursuant to state laws) and the professional appraisal organizations (pursuant to contractual agreement with their credentialed members) are obligated to take disciplinary action against appraisers who violate USPAP's independence provision;

Fourth, if a central purpose of DOL's proposed rule is to make appraisers accountable for abusive valuations, that purpose has already been accomplished. Appraisers are already subject to serious sanctions for ethical lapses or improper appraisals under a wide variety of federal and state laws, as well as under the Ethics agreements they enter into with professional credentialing organizations. State real estate appraiser licensing boards regularly bring enforcement actions against their licensees for such infractions, as do the professional credentialing organizations, such as ours. Even without an appraiser-as-fiduciary rule, there are numerous ways DOL could seek sanctions against appraisers for improper ESOP valuations: They could refer such cases to IRS which shares ERISA authority with DOL and has effective sanctioning authority against appraisers; to state appraiser licensing agencies (for improper real estate appraisals) and to professional appraisal credentialing organizations when infractions are committed by their members;

Fifth, the proposed DOL rule would require appraisers to obtain fiduciary errors and omissions insurance—a product which does not even currently exist and which, if it were developed, would be prohibitively expensive. The inevitable result would be a large increase in the cost of ESOP and other pension plan appraisals—a cost which would have to be borne by the ESOP plans and their beneficiaries. It would be ironic indeed if the federal agency responsible for safeguarding the financial interests of pension plan beneficiaries were to adopt a rule which would greatly—and unnecessarily—raise the costs of operating and administering the plans.

In order to avoid the negative consequences of the proposed appraiser-as-fiduciary rule, ASA has urged DOL to adopt the proven and successful appraisal reform blueprint which exists at many federal agencies (and referenced in item "Two" above). Adopting that blueprint would effectively address DOL concerns about the reliability of ESOP appraisals but without the dramatic increase in appraisal costs that the proposed rule would cause; and, without the other disruptions to the ESOP valuation process that would result.

ASA respectfully requests that this letter be made part of the hearing record. If the Subcommittee has any questions or seeks additional information, please call me at my Philadelphia office (1-484-270-1240) or email me at jfishman@finresearch.com. Alternatively, please contact ASA's Government Relations Consultant in Washington, D.C., Peter Barash, at 202-466-2221 or peter@barashassociates.com, or John Russell, ASA's Director of Government Relations at 703-733-2103 or jrussell@appraisers.org.

JAY FISHMAN, CHAIRMAN,
Government Relations Committee.

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Statement of the Investment Company Institute

Hearing on Redefining "Fiduciary": Assessing the Impact of the Labor Department's Proposal
House Subcommittee on Health, Employment, Labor and Pensions

July 26, 2011

The Investment Company Institute[1] is pleased to submit this statement in connection with the Hearing of the House Subcommittee on Health, Employment, Labor and Pensions on the proposal by the Department of Labor to revise the definition of investment advisory activities that trigger fiduciary status under ERISA.

Fiduciary status entails one of the highest obligations, and liabilities, known to the law. Fiduciary status underpins the entire ERISA compliance structure. An ERISA fiduciary not only must act prudently and for the benefit of participants – as virtually all fiduciaries must do – but is subject to additional limitations on conduct under the prohibited transaction rules, including restrictions on compensation that apply only to ERISA fiduciaries. Thus, rules defining who is a fiduciary under ERISA must provide certainty and avoid over-breadth. They should not impede commonplace financial interactions.

The system by which Americans save for retirement in individual accounts on a tax-favored basis has been a huge success. As of 2011:Q1, Americans have accumulated $4.7 trillion in defined contribution plans and another $4.9 trillion in IRAs.[2] (Estimates suggest that approximately half of IRA assets originate from 401(k) and other employer-sponsored retirement plans.) About half of the assets in defined contribution plans and IRAs are invested in mutual funds.

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[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors and advisers. Members of ICI manage total assets of $13.1 trillion and serve over 90 million shareholders.

[2] For the complete report on the U.S. retirement market in 2011:Q1, *see* Investment Company Institute, "The U.S. Retirement Market, First Quarter 2011" (June 2011), available at http://www.ici.org/info/ret_11_q1_data.xls.

Congress made clear when it enacted ERISA that it did not intend to disrupt the functioning of the securities markets, prevent employee benefit plans from accessing investments, or turn "the ordinary functions of consultants and advisers" into fiduciary functions.[3] In 1975 DOL adopted a rule drawing an important legal boundary – the line between *commonplace financial market interactions* in which plan sponsors and participants of ERISA-governed plans can freely obtain information or suggestions to consider in making their investment decisions, on the one hand, and *advisory relationships* in which those plan sponsors or participants engage providers to act on their behalf in evaluating or making investment decisions, on the other. The rule adopted in 1975 did not "narrow" the definition of investment advice, but rather implemented Congress' intent that ERISA not disrupt established business practices of financial institutions in interacting with employee benefit plans.

The rule adopted in 1975 is 35 years old and it is understandable that the Department may want to review it. What has not changed in 35 years, however, is the need to make very clear the line between commonplace financial market interactions and true advisory relationships.

As proposed, the Department's revisions represent a major rewrite of the rule that could result in fiduciary status for ordinary business interactions, discourage basic educational materials like newsletters and phone contacts with investment firms that do not undertake to provide personalized investment advice, and make it difficult for firms to help workers preserve their savings through an IRA rollover when they change jobs or retire.

In comment letters and testimony at the administrative hearing the Department held on the proposal, we have recommended that the Department redraft its proposal so that fiduciary status only attaches to genuine advisory relationships where a position of trust and confidence exists, so that simply selling a product is not a fiduciary act. We emphasize the importance of not discouraging the assistance that recordkeepers provide to help fiduciaries prudently select and monitor plan menu investments, and not impeding the ability of workers to preserve their savings at job change through an IRA rollover.[4] Adopting a revised rule that provides this clarity will require careful analysis and redrafting. Given the importance of the issues and the need for the Department to assure that the next draft is clear and not

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[3] *See* ERISA Conference Report, P.L. 93-406, at 323 ("...the ordinary functions of consultants and advisers (other than investment advisers) may not be considered as fiduciary functions..."), *id.* at 309 (some otherwise prohibited transactions "nevertheless should be allowed in order not to disrupt the established business practices of financial institutions" and directing the Secretaries of Labor and Treasury to grant an administrative exemption for brokerage services).

[4] The Institute's comment letters and testimony to the Department of Labor provide a full discussion of these recommendations. *See* letters from Mary Podesta, Senior Counsel - Pension Regulation, Investment Company Institute, to Office of Regulations and Interpretations, Employee Benefits Security Administration, Department of Labor (February 3, 2011), available at http://www.ici.org/pdf/24941.pdf and (April 12, 2011), available at http://www.ici.org/pdf/25084.pdf; Testimony of Paul Stevens before Department of Labor Hearing on Fiduciary Definitions Proposal (March 1, 2011), available at http://www.ici.org/401k/statements/11_dol_fiduciary_tmny; ICI Letter to The Honorable Phyllis Borzi,

unnecessarily broad, the Department should give the regulated community opportunity to simultaneously review and comment on both a reproposed rule and any necessary prohibited transaction exemptions. We discuss each of these points below.

1. Fiduciary status should attach only to genuine advisory relationships where a position of trust and confidence exists.

To assure the sound functioning of the ERISA statutory framework, it is essential that persons who deal with plans, participants and IRA savers be able to distinguish with clarity between those activities and functions that confer ERISA fiduciary status and those that do not. Unfortunately, the Department's proposed rule blurs the line and captures ordinary course communications and activities that no reasonable person would consider to be fiduciary in nature.

A person's conduct satisfies the proposed test if the person provides advice to a plan or participant about the value of securities or makes a recommendation as to the advisability of investing in purchasing, holding, or selling securities. As proposed, the advice need not be individualized to the needs of the plan participant or even *aimed* at a particular plan or participant. This over-breadth will impact and likely chill commonplace market interactions in which retirement savers seek information and ideas on investing. For example, any investment newsletter or expression of opinion and any column in a newspaper or financial publication, including one making general statements about classes of investments, could qualify. Mutual fund companies commonly receive calls from individuals interested in opening an IRA and investing either contributions or rollover amounts in the firm's funds. The call center representative may state that while he or she cannot provide specific individualized advice, X fund is designed to meet a particular investment objective, or Y fund is a target date fund designed for individuals who expect to retire around a certain date. This routine market and basic interaction could be caught by the rule.

The Department should redraft the rule so that recommendations and advice that could trigger fiduciary status must be personalized to the plan or participant. This will assure the rule only applies where a reasonable person would believe a fiduciary relationship exists. It also makes sense in light of the Wall Street Reform and Consumer Protection Act of 2010 (Dodd-Frank), which directs the SEC to study the standards of care applicable to broker-dealers and investment advisers giving personalized advice. The SEC is authorized to adopt any needed standard of care rules, including rules making the standard of conduct for all broker-dealers and investment advisers providing personalized investment advice identical to the standard of care under the Advisers Act.

Assistant Secretary, Employee Benefits Security Administration, Department of Labor (May 20, 2011), available at http://www.ici.org/pdf/25210.pdf.

The redraft needs to make clear that fiduciary status is not triggered merely because an affiliate or employee of a firm meets the definition of "investment adviser" in the Advisers Act or serves as a directed trustee. This would be consistent with a long-settled ERISA principle that a person is a fiduciary only to the extent that he or she functions as one. The mere fact that somewhere in a financial enterprise someone is an investment adviser or fiduciary should not operate to transform any interaction between a plan and another part of that organization into a fiduciary relationship.

The redraft also needs to revise the test to apply only to situations where there is a mutual agreement, arrangement or understanding that a true advisory relationship exists. This will distinguish education, or advice that is incidental to selling activities, from a fiduciary relationship of trust.

2. Simply selling an investment product cannot be a fiduciary act.

The proposed regulation contains an exemption for transactions that might entail advice if the seller can show that the recipient knows, or under the circumstances should know, that the person is providing the advice "in its capacity as a seller of a security or other property, or as an agent for, such a purchaser or seller, whose interests are adverse to the interests of the plan or its participants and that the person is not undertaking to provide impartial investment advice."

Under an expansive definition, selling an investment almost always involves some sort of a *recommendation* that the seller believes the buyer should purchase the product. Investment firms offer a product to the market believing that the investment is a good one and that it should be purchased where it meets the investor's needs.

The proposed regulation's "seller's exception" should not require the seller to demonstrate that the recipient of the advice knows that the seller has interests that are adverse to those of the plan. It is unrealistic and unnecessary for the rule to assume that any non-fiduciary interaction with a plan, participant or IRA saver is "adverse." The relevant question to ask is not whether the parties' interests are "adverse" but rather, whether in the context of the transaction, it would be clear to a reasonable person that the seller is acting as or on behalf of a seller and is not holding itself out as providing impartial investment advice.

3. The rule should not discourage the assistance that recordkeepers engaged to administer plans provide in order to help fiduciaries prudently select and monitor plan investments.

The proposed rule raises questions about whether the information and assistance recordkeepers commonly provide to fiduciaries to help manage their decision-making process might be re-characterized as fiduciary investment advice. Recordkeepers commonly provide assistance to plan fiduciaries, including a sample fund line-up, in response to a plan's Request for Proposal to demonstrate an overall sense of plan cost or suggestions for commonly used objective screens or criteria *(e.g.*, peer

performance in top quartile, manager tenure over a certain number of years, a minimum Morningstar or similar rating) to narrow the universe of available funds for initial selection and to monitor investments over time. Fiduciaries often look to the plan recordkeeper for screening assistance because the recordkeeper has experience in what other clients use and has all the necessary data about platform investments. Recordkeepers also may assist with mapping decisions by suggesting funds that are similar to one that the plan's fiduciary has decided to remove.

The decision to select or monitor the plan line-up, to replace a fund or how to map assets remains with the plan fiduciaries. Yet many fiduciaries do not have ready access to the information to perform this function by themselves. If recordkeepers were to withdraw from providing assistance because of uncertainty over the nature of the assistance they provide, plans might face the burden and considerable expense of hiring an independent consultant willing to provide fiduciary advice.

4. The Department should carefully consider how the rule would relate to IRAs and to rollovers so firms can help workers preserve their savings at job change through an IRA rollover.

The Department should maintain its current position as expressed in the 2005 Deseret Advisory Opinion[5] that a recommendation to take an otherwise permissible distribution is not investment advice. Changing this position will chill the routine process in which a worker leaves a job, contacts a financial services firm for help rolling over a 401(k) balance, and the firm explains the investments it offers and the benefits of a rollover. As the Department agreed in 2005, this simply is not investment advice with respect to the old 401(k) plan, even if the result is a liquidation of the 401(k) account with the prior employer.

In addition, the Department should complete and publish an analysis of the costs of the proposal on IRA investors and providers. While the proposed rule applies to non-employer based IRAs, the Department's economic analysis, which derives from Form 5500 data, does not consider the costs of the proposal to IRA investors and providers. The proposal will generate costs for IRA savers in that the prohibited transaction rules prohibit commission compensation to fiduciaries in many instances. If financial advisers must move from a commission structure to a wrap fee in the IRA market to comply with the prohibited transaction rules, this may, in many cases, result in higher fees to IRA investors, especially given the long-term nature of IRA investments. In addition, there are costs to IRA savers if financial advisers must curtail the information and services they offer to avoid crossing into ERISA fiduciary status.

5. To provide clarity in a final rule, the Department should draft and issue a reproposed rule along with guidance on and proposed changes to prohibited transaction class exemptions.

[5] DOL Adv. Op. 2005-23A (Dec. 7, 2005).

Department officials have stated that if a final revised rule re-classifies various service providers as investment advice fiduciaries, those providers may be able to avoid restructuring their businesses and compensation arrangements by relying on existing class exemptions or new exemptions that the Department contemplates proposing. We believe that the preferred outcome first should be to write a rule that correctly draws the line between true advisory relationships and incidental market transactions in which plans, plan participants and IRA savers obtain input for their decision-making process. Second, in those situations where a true advisory relationship of trust and confidence exists, the Department appropriately should ameliorate any unfortunate consequences of turning parties in interest under the old rule into fiduciaries under a revised rule by proposing and adopting appropriate exemptions *before finalizing a revised rule.* One of the Department's first tasks after ERISA was enacted was proposing (and finalizing) *at the same time* both the rule now under reconsideration and PTE 75-1, which ameliorated some of the effects of the current investment advice regulation. The Department should follow this precedent and propose comprehensive PTE changes along with a redraft of the rule in order to vet fully the solutions to these complex and interrelated issues.

The Department has reproposed rules in the past to get them right.[6] The record before the Department on the proposed rule supports both the need for significant changes – even in places where the Department may revise only to clarify its intent – and the need for another round of comments. The Institute strongly urges that the Department repropose this important rule. We share the interest of the Department, this Subcommittee, and the Congress for a final rule that is clear and workable and will serve plans and participants well for the next 35 years.

[6] In 1991, the Department appropriately used the reproposal process with the 404(c) regulation, concluding that because of the "significance of the changes" made to its first proposal, interested parties should be afforded an opportunity to comment on them prior to adoption of a final regulation. *See* 56 Fed. Reg. 10724 (Mar. 13, 1991) (reproposal); 57 Fed. Reg. 46906 (Oct. 13, 1992) (final).

Prepared Statement of the American Bankers Association; the Financial Services Roundtable; the Financial Services Institute; the Insured Retirement Institute; the National Black Chamber of Commerce; and the National Association of Insurance and Financial Advisors

I. We support retirement security

The undersigned organizations[1] share the Congress' and the Obama Administration's goal of increasing opportunities for Americans to save and plan for their retirement. We support increased incentives and opportunities for Americans to save and invest. It is our belief that providing these opportunities for Americans is important because savings increase domestic investment, encourage economic growth, and result in higher wages, financial freedom, and a better standard of living. We believe that most Americans should approach retirement with a comprehensive strategy that incorporates a number of retirement vehicles. Consumer education

about retirement savings products can help consumers make sound investment decisions and allow them to maximize their retirement savings.[2] Further gains can be achieved through better use of investment advice, and by promoting policies that provide for more diversified, dynamic asset allocation, and exploration of new and innovative methods to help individuals make better investment decisions.

As a partner with the Congress and the Obama Administration in our collective efforts to protect Americans' retirement security, we strongly believe that one of the largest challenges currently confronting pension plans, plan sponsors, small business owners, individual retirement account owners, employees, and retirees is the Department of Labor's (the "Department") proposed rule that would expand the definition of the term fiduciary[3] under Title I of the Employee Retirement Income Security Act of 1974 ("ERISA").[4] In our view, the Department's Proposal will negatively impact the ability of hard-working Americans to save and plan for their retirement. Moreover, the Department's Proposal would substantially increase the categories of service providers who would be deemed fiduciaries for purposes of ERISA,[5] and thereby decrease the availability of retirement planning options for all Americans.[6] We respectfully request the Department formally withdraw its proposed definition of fiduciary[7] and re-propose a more narrow definition of fiduciary that targets specific abuses.

II. We believe that the proposed expansion of the definition of fiduciary would jeopardize the retirement security of millions of Americans

Most Americans rely on retirement plans to supplement Social Security and private savings.[8] For instance, Americans have increased their participation in 401(k) plans by 250 percent over the last twenty-five years.[9] In addition, a 2009 study showed that over two-thirds of "U.S. households had retirement plans through their employers or individual retirement accounts ("IRAs")."[10]

IRAs are the fastest growing retirement savings accounts.[11] IRAs are widely held by small investors[12] who seek to maximize return by minimizing overhead on their accounts. According to the OLIVER WYMAN REPORT, smaller investors overwhelmingly prefer to use a brokerage account for their IRAs (rather than an advisory account)[13] because of the lower operating costs associated with brokerage accounts. In fact, 98% of IRAs with less than $25,000 in assets are serviced by securities brokers.[14]

We believe that the sheer breadth of the proposed expansion of the definition of fiduciary would have the unintended—but entirely foreseeable—consequence of reducing alternatives available to hard-working Americans to help them save for retirement, and increasing the costs of remaining retirement savings alternatives. The resulting increase in the number of persons who could be subject to fiduciary duties, increased costs, and increased uncertainty for retirement services providers will very likely reduce the level and types of services available to benefit plan participants and IRA investors by making benefit plans and IRAs more costly and less efficient.[15]

Thus, if the Department were to adopt the expanded definition of fiduciary in its present form,[16] we believe it is clear that fewer Americans would have access to the advice they need to help them make prudent investment decisions that reflect their financial goals and tolerance for risk as they prepare for their retirement because of their reluctance to pay the increased costs that will likely be associated with professional investment advice.[17]

We also are concerned that the Department's Proposal could lead to lower investment returns, and ultimately, a reduced amount of savings for retirement.[18] Moreover, if the Department were to adopt its expanded definition of fiduciary in its present form, millions of hard-working Americans are likely to have reduced access to meaningful investment services or help from an investment professional,[19] and likely would incur greater expense to access the broad range of product types associated with brokerage accounts.[20] We find the potentially adverse consequences that the Department's proposed expanded definition of fiduciary would have on our nation's retirement system and the retirement security of all Americans to be untenable.

In summary, our specific concerns with the Department's proposed expansion of the definition of fiduciary are:

The Department has not demonstrated that the current definition needs to be completely re-written.

The proposed expansion of the fiduciary definition to encompass IRAs is ineffective and counterproductive.

The Department's rule could result in significantly fewer retirement accounts and less retirement savings.

The Department has not evaluated the economic impact on small business owners.

Consultation and coordination with each of the relevant regulatory authorities is needed, including without limitation the Securities and Exchange Commission and the Commodity Futures Trading Commission.

The Department provided insufficient regulatory analyses.

Given the substantive concerns raised in the public comment record concerning the adverse impact of the rule, the Department should publish notice of its proposed revisions to the definition of fiduciary, and solicit public comment on the proposed revisions.

1. The Department has not demonstrated that the current definition needs to be completely re-written.

Despite 35 years of experience with the current definition of fiduciary,[21] the Department has not provided adequate justification for its wholesale revisions to the current definition.

The Department's stated rationale is to pursue bad actors (i.e., pension consultants and appraisers) who allegedly have provided substandard services and who failed to recognize or disclose conflicts of interest.[22] If this is the goal, then the Department should more narrowly tailor the proposed changes to reach those particular bad actors.

The Department also should consider whether other regulations (including those enforced by other authorities) already provide adequate safeguards. For example, the Department's recent disclosure regulations will require pension consultants to disclose all direct and indirect compensation they receive before entering into a service arrangement with a plan.[23] This may address the Department's concerns.

2. The proposed expansion of the fiduciary definition to encompass IRAs is ineffective and counterproductive.

The proposed expansion of the definition of fiduciary would constrain the availability of lower-cost commission-based IRAs, which would increase costs for IRA owners and reduce retirement savings.[24]

The Department previously expressed the view that regulatory initiatives designed for ERISA employee benefit plans were neither necessary nor appropriate for IRAs.[25]

Sales practices for IRAs currently are subject to oversight by the Securities and Exchange Commission and FINRA. If the Department is concerned about oversight of sales practices, it should work together with those regulators to address those concerns, as opposed to overhauling a much broader regulatory regime.

Service providers to IRAs should be expressly excluded from any definition of fiduciary for purposes of Title I of ERISA.

3. The Department's rule could result in significantly fewer retirement accounts and less retirement savings.

The Department issued the Proposal without having done any study or survey—or providing any data—on the Proposal's projected impact or effect on IRA owners or IRA service providers.[26]

According to the OLIVER WYMAN REPORT, the effect of the Department's rule "could well result in hundreds of thousands of fewer IRAs opened per year." [27]

"Nearly 90% of IRA investors will be impacted by the proposed rule." [28]

The Department's Proposal would make service providers fiduciaries when merely providing a valuation of a security or other asset held in the account. This may lead service providers to withdraw from providing valuation services for real estate, venture capital interests, swaps, or other hard to value assets. As a consequence, investors will have far fewer investment choices available to diversify assets in their accounts as they seek to increase their retirement savings.

4. The Department has not evaluated the economic impact on small business owners.

Small plan sponsors are not likely to be able to absorb the potentially substantial increase in costs arising from the expanded definition of fiduciary.[29]

Small business owners are struggling to recover in the U.S. economy.[30]

We urge the Department to ensure that its regulations not only protect retirement plan participants and beneficiaries, but also remove undue burdens that constrain the feasibility for small business owners to provide retirement plans for their employees.

5. Consultation and coordination with each of the relevant regulatory authorities are needed, including without limitation the Securities and Exchange Commission,[31] FINRA, and the Commodity Futures Trading Commission.

Investors and retirement services providers need a regulatory regime that provides clarity and certainty.

Regulations that establish conflicting rules create confusion, increase costs to service providers, and tend to lessen the availability of retirement services overall.

6. The Department provided insufficient regulatory analyses.

The Department was obligated under Executive Order 12866[32] to determine whether its proposed expansion of the definition of fiduciary was a "significant" regulatory action.[33] Even though the Office of Management and Budget determined the Department's proposed definition was economically significant,[34] the Department performed an insufficient Regulatory Impact Analysis of the Proposal.[35]

The Department stated "it is uncertain about the magnitude of [the] benefits and potential costs" of its regulatory action.[36] Yet, the Department failed to provide any data whatsoever in support of its Regulatory Impact Analysis, in which the Department "tentatively conclude[d] that the proposed regulation's benefits would justify its costs."[37]

The Department's Initial Regulatory Flexibility Analysis failed to provide either an estimate of the number of affected small entities[38] or the increased business costs small entities would incur if they were determined to be fiduciaries under the proposal as required by the Regulatory Flexibility Act.[39] As a consequence, it appears that the Department of Labor performed an insufficient analysis under the Regulatory Flexibility Act when it estimated the impact of its rule proposal on small businesses, a segment of the market also impacted by the proposed expansion of the definition of fiduciary.

On January 18, 2011, President Barack Obama issued Executive Order 13563 "Improving Regulation and Regulatory Review."[40] The Order explains the Administration's goal of creating a regulatory system that protects the "public health, welfare, safety, and our environment while promoting economic growth, innovation, competitiveness, and job creation,"[41] while using "the best, most innovative, and least burdensome tools for achieving regulatory ends."[42]

The Department's Proposal contravenes the Obama Administration's publicly articulated goal to "identify and consider regulatory approaches that reduce burdens and maintain flexibility and freedom of choice for the public."[43]

7. Given the substantive concerns raised in the public comment record concerning the adverse impact of the rule, the Department should publish notice of its proposed revisions to the definition of fiduciary, and solicit public comment on the proposed revisions.

The definition as proposed would require substantial changes to address concerns identified in the public comment file.[44]

It is likely that class exemptions will be necessary and should be part of the rule itself, so that hard-working Americans do not lose access to investment products they need to fund their retirement while the financial services markets wait for the Department to adopt the required prohibited transaction class exemptions.

The current definition of fiduciary[45] has informed almost 35 years of Department guidance on investment advice for ERISA retirement plans and IRAs. Revisions to such a mature rule ordinarily should not require ancillary exemptions in order for the final rule to work in the real world.

III. In light of the substantive concerns raised by the public, we believe the department should withdraw its proposed expansion of the definition of fiduciary, and re-propose a defintion of fiduciary that addresses deficiences noted in the public comment file

We and other parties have filed comments and supplemental materials with the Department that generally have raised these and other concerns about the adverse impact of the Proposal.[46] At present, it is our understanding that the Department is considering substantial revisions to its Proposal in response to the views expressed during the public comment period.[47]

It is in the interest of the millions of hard-working Americans who are saving for retirement that the Obama Administration and the Congress collaborate actively with the private sector—in particular, the small business community and the retirement security community—to develop a regulatory regime that will benefit consumers and expand Americans' retirement savings.

IV. Conclusion

In closing, strengthening the retirement security of all Americans is our priority. Strong and vibrant retirement programs benefit employees and their beneficiaries. As well, it strengthens the financial health and well-being of our nation. We, therefore, reiterate our request that the Department withdraw and re-propose a definition of the term fiduciary.

While we support policies that encourage safeguards in retirement savings programs to protect consumers and our markets from fraudulent practices, we vigor-

ously oppose regulations that would discourage participation by employers and employees in retirement programs or would imperil retirement security for millions of hard-working Americans.

We urge policymakers to work with us to preserve a retirement system that helps strengthen retirement security for all Americans. We encourage the Congress to support policies that help promote retirement savings and enable the financial services industry to better meet the long-term retirement needs of hard-working Americans.

We stand ready to work with you and the Department on this important issue.

ENDNOTES

[1] The American Bankers Association represents banks of all sizes and charters and is the voice for the nation's $13 trillion banking industry and its two million employees. Many of these banks are plan service providers, providing trust, custody, and other services for institutional clients, including employee benefit plans covered by the Employee Retirement Income Security Act of 1974. As of year-end 2010, banks held over $8 trillion in defined benefit, defined contribution, and retirement-related accounts (Source: FDIC Quarterly Banking Profile, Table VIII-A (Dec. 2010)).

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Among the Roundtable's Core Values are fairness ("We will engage in practices that provide a benefit and promote fairness to our customers, employees or other partners."); integrity ("[E]verything we do [as an industry] is built on trust. That trust is earned and renewed based on every customer relationship."); and respect ("We will treat the people on whom our businesses depend with the respect they deserve in each and every interaction."). See Roundtable Statement of Core Values, available at *http://www.fsround.org/*. Roundtable member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $92.7 trillion in managed assets, $1.2 trillion in revenue, and 2.3 million jobs.

The Financial Services Institute, which was founded in 2004, is the only advocacy organization working on behalf of independent broker-dealers and independent financial advisors. Our vision is that all individuals have access to competent and affordable financial advice, products, and services delivered by a growing network of independent financial advisors affiliated with independent financial services firms. Our mission is to create a healthier regulatory environment for independent broker-dealers and their affiliated independent financial advisors through aggressive and effective advocacy, education, and public awareness. Our strategy supports our vision and mission through robust involvement in FINRA governance, constructive engagement in the regulatory process, and effective influence on the legislative process.

The Insured Retirement Institute has been called the "primary trade association for annuities" by U.S. News and World Report and is the only association that represents the entire supply chain of insured retirement strategies. Our members are the major insurers, asset managers, broker dealers and financial advisors. IRI is a not-for-profit organization that brings together the interests of the industry, financial advisors and consumers under one umbrella. Our official mission is to: encourage industry adherence to highest ethical principles; promote better understanding of the insured retirement value proposition; develop and promote best practice standards to improve value delivery; and to advocate before public policy makers on critical issues affecting insured retirement strategies. We currently have over 500 member companies which include more than 70,000 financial advisors and 10,000 home office financial professionals.

National Association of Insurance and Financial Advisors ("NAIFA") comprises more than 700 state and local associations representing the interests of approximately 200,000 agents and their associates nationwide. NAIFA is one of the only insurance organizations with members from every Congressional district in the United States. Members focus their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. According to a Fall 2010 survey, nearly two-thirds of NAIFA members are licensed to sell securities, and 89% of NAIFA member clients are "main street" investors who have less than $250,000 in household income. The Association's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members.

The National Black Chamber of Commerce The NBCC is a nonprofit, nonpartisan, nonsectarian organization dedicated to the economic empowerment of African American communities. 140 affiliated chapters are locally based throughout the nation as well as international affiliate chapters based in Bahamas, Brazil, Colombia, Ghana and Jamaica and Businesses as well as individuals who may have chose to be direct members with the national office. In essence, the NBCC is a 501(c)3 corporation that is on the leading edge of educating and training Black communities on the need to participate vigorously in this great capitalistic society known as America. The NBCC reaches 100,000 Black owned businesses. There are 1.9 million Black owned businesses in the United States. Black businesses account for over $1 trillion in expendable income each year according to the US Bureau of Census. The National Black Chamber of Commerce(r) is dedicated to economically empowering and sustaining African American communities through entrepreneurship and capitalistic activity within the United States.

[2] The financial services industry has developed numerous financial literacy initiatives, including initiatives directed toward elementary and high school students and programs presented to investors in the local community. See The Financial Services Roundtable, COMMUNITY SERV-

ICE IMPACT REPORT at 64-69 (2010), available at *http://www.fsround.org/publications/pdfs/CS10-ImpactReport.pdf;* Insured Retirement Institute, Retirement Planning Resources for Consumers, available at *http://www.irionline.org/consumers/retirementPlanningResources;* Securities Industry and Financial Markets Association Foundation, available at *http://www.sifma.org/Education/SIFMA-Foundation/About-the-SIFMA-Foundation/;* Investment Company Institute, available at *http://ici.org/#investor—education;* and FINRA, available at *http://www.finra.org/Investors/*.

[3] Definition of the Term "Fiduciary" [RIN: 1210—AB32], 75 Fed. Reg. 65263 (Oct. 22, 2010) (the "Proposal").

[4] 29 U.S.C. § 1001, et seq.

[5] See Oliver Wyman, Inc., OLIVER WYMAN REPORT: ASSESSMENT OF THE IMPACT OF THE DEPARTMENT OF LABOR'S PROPOSED "FIDUCIARY" DEFINITION RULE ON IRA CONSUMERS at 13 (Apr. 12, 2011) (the "OLIVER WYMAN REPORT"), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-PH060.pdf* (noting that "practically every investment-related conversation or interaction with a client [could become] subject to [a] fiduciary duty"). "Even * * * discussions with call center and branch staff[ ] could be curtailed (so as to avoid inadvertently establishing a fiduciary duty." Id. at 15. The OLIVER WYMAN REPORT is based on aggregate proprietary data furnished by "[twelve] financial services firms that offer services to retail investors." Id. at 1. These firms "represent over 19 million IRA holders who hold $1.79 trillion in assets through 25.3 million IRA accounts [or roughly forty percent (40%) of IRAs in the United States and forty percent (40%) of IRA assets]." Id.

[6] OLIVER WYMAN REPORT, supra note 5 at 19-20. If the Department were to adopt the Proposal, the likely result would be a "[r]educed choice of investment professional, level of investment guidance, and investment products," according to the OLIVER WYMAN REPORT. Id. at 19.

[7] It also would afford the Department an opportunity to receive further information and analyses from the public on the effectiveness of the proposed revisions. See Natural Resources Defense Council v. Environmental Protection Agency, 279 F.3d 1180, 1186 (9th Cir. 2002) (reviewing the "notice and comment" requirements, the court stated that "one of the salient questions is 'whether a new round of notice and comment would provide the first opportunity for interested parties to offer comments that could persuade the agency to modify its rule'").

[8] Insurance Information Institute and The Financial Services Roundtable, THE FINANCIAL SERVICES FACT BOOK at 37 (2011) ("THE FINANCIAL SERVICES FACT BOOK"), available at *http://www.fsround.org/publications/pdfs/2011/Financial—Services—Factbook—2011[1].pdf.*

[9] Retirement Security: 401(k)s (Sept. 23, 2010) ("Retirement Security"), available at *http://www.fsround.org/fsr/pdfs/fast-facts/2010-09-23-RetirementSecurity.pdf.* In 2009, $2,121 billion of retirement assets were held in defined benefit plans compared to $3,336 billion of assets in defined contribution plans. THE FINANCIAL SERVICES FACT BOOK, supra note 8 at 43 (2011) (Source: Securities Industry and Financial Markets Association).

[10] THE FINANCIAL SERVICES FACT BOOK, supra note 8 at 37.

[11] OLIVER WYMAN REPORT, supra note 5 at 4.

[12] Id. at 10 ("[A]pproximately half of IRA investors in the report sample have less than $25,000 in IRA assets, and over a third have less than $10,000.").

[13] Id. at 12. Investors who hold IRA assets in a brokerage account pay commissions to the brokers who buy or sell securities for their IRAs. In the alternative, investors can hold IRA assets in an "advisory" account and pay a fee that is a percentage of the assets held in the IRA. A study of 7,800 households conducted by Cerulli Associates found that more affluent investors also "prefer paying commissions." See Fee vs. commission: No doubt which investors prefer, BLOOMBERG (June 8, 2011), *http://www.investmentnews.com/apps/pbcs.dll/article?AID=/20110608/FREE/110609950* (reporting that the survey examined "households with more than $50,000 in annual income or more than $250,000 in * * * assets").

[14] OLIVER WYMAN REPORT, supra note 5 at 2.

[15] Id. at 19-22.

[16] Proposal, supra note 3 at 65277-78.

[17] See OLIVER WYMAN REPORT, supra note 5 at 2; Fee vs. commission, supra note 13.

[18] OLIVER WYMAN REPORT, supra note 5 at 22 ("These increased investment costs would serve as a drag on long-term investment gains, and therefore on the ultimate retirement savings available to impacted [IRA] holders.").

[19] Id. at 19.

[20] Id. at 20.

[21] 40 Fed. Reg. 50842 (Oct. 31, 1975). See also, Mercer Bullard, DOL's Fiduciary Proposal Misses the Mark (June 14, 2011), available at *http://news.morningstar.com/articlenet/article.aspx?id=384065* ("It is unfair to the industry because it disregards decades of administrative law and practice under ERISA. It is bad for investors because it strips them of fiduciary protections when they are needed most.").

[22] Proposal, supra note 3 at 65271 (citing a Securities and Exchange Commission staff report that found a majority of the 24 pension consultants examined in 2002-2003 "had business relationships with broker-dealers that raised a number of concerns about potential harm to pension plans"); GAO, Conflicts of Interest Can Affect Defined Benefit and Defined Contribution Plans, GAO-09-503T, Testimony Before the Subcommittee on Health, Employment, Labor and Pensions, Education and Labor Committee, House of Representatives at 4 (Mar. 24, 2009), available at *http://www.gao.gov/new.items/d09503t.pdf* (noting that 13 of the 24 pension consultants examined by the Securities and Exchange Commission's staff "had failed to disclose significant ongoing conflicts of interest to their pension fund clients").

[23] Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans; Final Rule [RIN: 1210—AB07], 75 Fed. Reg. 64910 at 64937 (Oct. 20, 2010).

[24] OLIVER WYMAN REPORT, supra note 5 at 2 (noting that "estimated direct costs would increase by approximately 75% to 195% for these investors").

[25] See Preamble to Interim Final 408(b)(2) Regulations, 75 Fed. Reg. 136 (July 16, 2010).

"The Department does not believe that IRAs should be subject to the final rule, which is designed with fiduciaries of employee benefit plans in mind. An IRA account-holder is responsible only for his or her own plan's security and asset accumulation. They should not be held to the same fiduciary duties to scrutinize and monitor plan service providers and their total compensation as are plan sponsors and other fiduciaries of pension plans under Title I of ERISA, who are responsible for protecting the retirement security of greater numbers of plan participants. Moreover, IRAs generally are marketed alongside other personal investment vehicles. Imposing the regulation's disclosure regime on IRAs could increase the costs associated with IRAs relative to similar vehicles that are not covered by the regulation. Therefore, although the final rule cross references the parallel provisions of section 4975 of the [Internal Revenue] Code, paragraph (c)(1)(ii) provides explicitly that IRAs and certain other accounts and plans are not covered plans for purposes of the rule." Id.

[26] Proposal, supra note 3 at 65274-76.

[27] OLIVER WYMAN REPORT, supra note 5 at 2.

[28] Id. at 19-20 (IRA holders who cannot qualify for an "advisory account" would be "forced to migrate to a purely 'low support' brokerage model * * * and have little access to investment services, research and tools" to support their IRA savings goals.). See also, Most Americans Haven't Planned for Retirement and Other Areas of Concern, WALL ST. J., June 6, 2011, available at *http://blogs.wsj.com/economics/2011/06/06/most-americans-havent-planned-for-retirement-and-other-areas-of-concern/* ("Efforts to make people essentially their own money managers may also be futile. Only 21% to 25% of respondents said they have used information sent to them from Social Security.")

[29] While the costs associated with providing various employee benefits (including retirement plans) impact all employers, smaller companies typically are more sensitive to the costs associated with these programs. To the extent that service providers' expenses increase, those costs are passed through to their clientele. An example of expenses associated with the Department's Proposal is the legal cost associated with the initial "compliance review." According to the Department, the cost of legal review would average sixteen (16) hours of time at a rate of $119 per hour. Proposal, supra note 3 at 65274. This rate, however, is significantly lower than the average billing rate of $295 per hour for 10,913 lawyers surveyed by the National Law Journal. SURVEY OF LAW FIRM ECONOMICS, NAT'L L. J. (2010) ("LAW FIRM SURVEY"), available at *http://www.alm.com/pressroom/2011/02/10/alm-legal-intelligence-releases-2011-survey-of-billing-and-practices-for-small-and-midsize-law-firms/*.

[30] See, Kelly Greene, Retirement Plans Make Comeback, With Limits, WALL ST. J., June 14, 2011, available at *http://professional.wsj.com/article/SB10001424052702303714704576384072497942338.html* (reporting that in the face of a "slowly improving job market, [many companies] seek to balance the need to retain highly skilled workers with the need to limit costs").

[31] The Securities and Exchange Commission released a study evaluating the regulatory regimes applicable to investment advisers and broker-dealers who provide advice to retail customers, as required by section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act [Pub. L. No. 111-203, § 913, 124 Stat. 1824 (2010) (the "Dodd-Frank Act")]. STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS AS REQUIRED BY SECTION 913 OF THE DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT (Jan. 21, 2011), available at *http://sec.gov/news/studies/2011/913studyfinal.pdf.* Section 913(f) authorized the Commission to engage in rulemaking to address the legal or regulatory standards of care applicable to investment professionals who provide "personalized investment advice about securities" to retail customers. Section 913(f) of the Dodd-Frank Act, 124 Stat.1827-28.

[32] 58 Fed. Reg. 51735.

[33] 75 Fed. Reg. at 65269.

[34] Id. (According to the Office of Management and Budget, the Department's proposed rule "is likely to have an effect on the economy of $100 million in any one year.").

[35] For example, the Department estimated that service providers would incur about sixteen (16) hours of legal review at a rate of $119 per hour. While the complexity of the compliance review likely would far exceed the Department's estimate of sixteen (16) hours, an allocation of just $119 per hour for legal services vastly understates the cost of legal services in the United States. See LAW FIRM SURVEY, supra note 29 and accompanying text.

[36] 75 Fed. Reg. at 65275 ("[The Department's] estimates of the effects of this proposed rule are subject to uncertainty.").

[37] Id.

[38] Id. at 65276.

[39] Id.

[40] Improving Regulation and Regulatory Review—Executive Order 13563 (Jan. 18, 2011), available at *http://www.whitehouse.gov/the-press-office/2011/01/18/improving-regulation-and-regulatory-review-executive-order.*

[41] Id. at Section 1.

[42] Id.

[43] Id. at Section 4.

[44] See infra note 46.

[45] 29 C.F.R. § 2510.3-21(c).

[46] See, e.g., Employee-Owned S Corporations of America (Jan. 12, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-040.pdf;* American Council of Engineering Companies (Jan. 19, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-048.pdf;* American Institute of CPAs (Jan. 19, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-050.pdf;* National Association of Realtors (Jan. 20, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-*

052.pdf; Glass Lewis & Co. (Jan. 20, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-053.pdf;* Securities Law Committee of Business Law Section of the State Bar of Texas (Jan. 11, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-039.pdf;* Retirement Industry Trust Association (Jan. 26, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-064.pdf;* International Corporate Governance Network (Jan. 21, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-065.pdf;* New York City Bar Committee on Employee Benefits & Executive Compensation (Jan. 28, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-070.pdf;* Investment Adviser Association (Feb. 2, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-082.pdf;* International Data Pricing and Reference Data, Inc. (Feb. 2, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-082.pdf;* The ERISA Industry Committee (Feb. 2, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-090.pdf;* Institutional Shareholder Services Inc. (Feb. 2, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-104.pdf;* U.S. Chamber of Commerce (Feb. 3, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-111.pdf;* CFA Institute (Feb. 2, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-128.pdf;* Business Roundtable (Feb. 3, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-139.pdf;* and Committee of Federal Regulation of Securities of the Section of Business Law of the American Bar Association (Feb. 3, 2011), available at *http://www.dol.gov/ebsa/pdf/1210-AB32-152.pdf*

[47] Definition of the term "Fiduciary" Proposed Rule Public Comments, available at *http://www.dol.gov/ebsa/regs/cmt-1210-AB32.html.*

July 29, 2011.

Hon. PHIL ROE, *Chairman;* Hon. ROBERT ANDREWS, *Ranking Member, Subcommittee on Health, Employment, Labor and Pensions, Committee on Education and the Workforce, U.S. House of Representatives, Washington, DC 20515.*

DEAR CHAIRMAN ROE AND RANKING MEMBER ANDREWS: We are writing today to personally thank you for holding a hearing on July 26, 2011 that focused entirely on the U.S. Department of Labor's proposed rule defining the term "fiduciary." Tuesday's hearing was critically important because the public gained firsthand insight to the Department's approach to redefining the term fiduciary. We think the hearing made it abundantly clear that the Department should withdraw its fatally flawed proposal and re-propose a definition that corrects the numerous deficiencies in the current proposal.

Our members share the Department's laudable goal to protect and promote retirement savings. Unfortunately, the long-term consequences of the proposed rule will jeopardize the retirement security of millions of hard-working Americans. The hearing highlighted the fact that the Department is unable to clearly present its rationale for why its proposal is necessary. More specifically, Secretary Phyllis Borzi never directly addressed the following critical issues:

- What specific harm is the Department trying to prevent?
- What data is currently available that quantifies the Department's concerns?
- Why is the definition of "fiduciary" being extended to IRAs?
- Why were essential exemptions not introduced with the proposed rule?
- A holders historically have used commission-based brokerage accounts or advisory (or wrap-fee) accounts. What other feasible business models exist for IRA holders?
- Why is the proposed rule the least restrictive way to address the Department's concerns under ERISA?

After Tuesday's hearing, we are more convinced than ever that the Department should withdraw and re-propose a more effective definition of fiduciary. In summary, the Department has not demonstrated that the current definition needs to be completely re-written. Our members share the overwhelming, bi-partisan concern that American consumers will suffer harm over the long-term, because the proposed rule will reduce customer access to investment education.

As leaders of the subcommittee, you are uniquely positioned to address the negative impact of the Department's proposed rule. Your leadership is needed to make sure that the Department takes the appropriate, measured steps to reach the right result for American consumers and our markets. The Roundtable stands ready to work with you and the Department on this important issue.

If you have any questions, please have your staff contact Brian Tate at 202.589.2417 or Ryan Caruso at 202.393.0022.

Best Regards,

STEVE BARTLETT, *President and CEO, The Financial Services Roundtable.*

DALE BROWN, *President and CEO, Financial Services Institute.*

Prepared Statement of the ESOP Association
(Employee Stock Ownership Plan)

The ESOP Association's statement for the record will cover several topics concerning the Department of Labor's (DOL) proposed regulation on the definition of a fiduciary including:

Part I. Association's Education Mission Focuses on ERISA Compliance

Part I explains why education is an important tool in helping to create well-managed, high performing ESOP companies.

Part II. Concerns Regarding the Definition of a Fiduciary

The ESOP community address its concerns with the appropriateness of converting ESOP appraisers into ERISA fiduciaries.

Part III. Legal Precedent and ERISA Legal Regime Overlooked by Proposed Regulation

Part III will address the following concerns:

- The Proposed Regulation Exceeds the DOL's Authority
- The Proposed Regulation Interferes with the Trustee's Traditional Oversight Role over the Appraiser

Part IV. Negative Impacts on Pension Benefits

In Part IV, how making an ESOP appraiser an ERISA fiduciary will create a negative impact on retirement benefits.

Part V. Alternative Approaches

Two alternative approaches will be discussed:

- Provide Guidance
- Appraiser Credentials

Part VI. Conclusion

Final thoughts on the negative impact the DOL's proposed regulation on the definition of a fiduciary will have on the ESOP community.

The ESOP Association's statement for the record

The following information will give you an understanding of the Association and its membership. These statistics are intended to provide an understanding of the natural pride and passion ESOP companies, and ESOP beneficiaries, have in their ownership structure.

Of our 1,400 corporate members, 91.2% have fewer than 500 employees and 53.9% have fewer than 100 employees. Membership in the Association is dominated by small privately—held businesses.

In each year since 1975, between 80% and 95% of ESOPs were created when an exiting shareholder(s) of a private company sold his or her stock to an ESOP. ? The Association's 2010 survey of its members showed 22.1% are manufacturing companies, by far the dominant category, followed by construction companies at 13.2%. ? On average, the Association's corporate members have sponsored their ESOPs for 15 years. ? ESOPs sponsored by Association corporate members owned an average of 77% of the stock of the sponsoring corporation.

The average individual ESOP account balance of corporate members, according to the Association's survey, is $192,223. Among Association corporate members, 78% also sponsor a 401(k) plan.

When creating their ESOPs, 96.7% of the corporations did not reduce wages or other benefits, and 70.35% did not utilize another plan's assets, to fund their ESOPs.

Approximately 900 professionals are secondary members of the Association. Approximately 100 members provide valuation services to privately-held ESOP companies, which are required by law to obtain an independent valuation of ESOP shares annually. Other professional members include lawyers, plan administrators, lenders, trustees, and ownership culture management consultants.

Privately-held small businesses that sponsor ESOPs, businesses considering ESOPs, and professionals that provide services to ESOP trustees and companies would be directly impacted by the Proposed Regulation "Definition of the Term Fiduciary," (Federal Register, Volume 75, Number 204, Pages 65263-6578, October 22, 2010, Proposed Regulation).

On behalf of our membership, the Association appreciates the opportunity to express its views in regard to redefining of the term fiduciary.

Part I. Association's Education Mission Focuses on ERISA Compliance

The mission of the Association is "To educate and advocate about employee ownership with emphasis on ESOPs." The leaders of the Association purposely listed "education" first, as a basic tenet of the Association is that well-managed, high performing ESOP companies, visible in local communities, are the best and most effective way to execute the advocacy mission.

Over 50% of the Association's annual resources are spent on education. In 2010, 8,089 individuals attended Association educational programs. Education of ESOP company fiduciaries, focusing on their obligations to retain competent valuation firms, understand the valuation report, and decide whether to accept a valuation report, is a major topic at Association national and Chapter meetings. Other conference and meeting attendees had exposure to the topics related to ERISA compliant valuation of ESOP shares of private companies.

The members of the Association's Advisory Committee on Valuation (VAC) are key to the quality of fiduciary education on valuation matters. They lead discussions involving thousands of attendees and write articles for the Association's monthly newsletter on valuation "hot" issues, produce white papers on best practices, prepare booklets and handbooks on valuing ESOP shares, and contribute the chapter in the "ESOP Fiduciary Handbook" on reviewing, and rejecting or accepting a valuation report. VAC members educate companies, fiduciaries, and other professional members, and ensure that the latest information on valuation best practices is available.

VAC members are volunteers. They agree with the basic premise that the best way to maintain current laws permitting and encouraging employee ownership via the ESOP model—the advocacy mission—is to have excellent ESOP practices, and ensure that ESOP trustees and fiduciaries, internal and institutional, understand and comply with ERISA. Compliance with ERISA law is the best path to a high performing company that will provide adequate retirement security to its ESOP participants.

Part II. Concerns Regarding the Definition of a Fiduciary

In proposing the expansion of the definition of investment advice for purposes of the definition of a fiduciary under Section 3(21) of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), the Department of Labor (DOL) has identified three areas of concern: (i) a significant shift in the marketplace for employee benefit plan services since the DOL last provided fiduciary rules in 1975, (ii) avoidance of conflicts of interest that may exist with service providers, and (iii) incorrect valuations of employer securities. The proposal states that these concerns were identified in the DOL's Consultant/Advisor Project (CAP), recent testimony before the Government Accountability Office (GAO) and in the Employee Benefits Security Administration (EBSA) national enforcement project relating to ESOPs.

The Association believes the marketplace for ESOP transaction services generally has not changed since 1975, with the overwhelming majority of ESOPs created when a shareholder(s) of a privately-held company sells her/his shares to an ESOP.

With regard to conflicts of interest, it is not apparent to the Association that ESOP appraisers regularly have conflicts of interest with respect to the plans for which they work. This would, of course, be contrary to Section 401(a)(28) of the Internal Revenue Code which requires appraisers be independent. Moreover, the DOL proposed regulation setting forth the definition of adequate consideration (Prop. Reg. Sec. 2510.3-18, referred to herein as the 1988 Proposed Regulation) also requires the independence of an appraiser as a condition to a prohibited transaction exemption.

With regard to incorrect valuations of private company ESOP stock, the Association acknowledges and shares the DOL's concern but questions whether the problem is as widespread as the DOL implies. The Association has not heard significant numbers of complaints from its corporate or fiduciary members about incorrect ESOP valuations. The Association provides seminars and educational sessions on the valuation of employer securities at conferences, and publishes written material on valuation.

If the DOL is correct in its assessment, the Association also questions the effectiveness and appropriateness of converting ESOP appraisers into ERISA fiduciaries as means of reducing the number of incorrect ESOP appraisals. The Association believes there are other means of addressing the DOL's concern short of a wholesale change to over thirty five (35) years of statutory guidance, and respectfully requests the opportunity to engage in a dialogue with the DOL to assist in fashioning an appropriate and effective means for addressing such concerns.

Part III. Legal Precedent and ERISA Legal Regime Overlooked by Proposed Regulation

The Proposed Regulation Exceeds the DOL's Authority

Section 3(21)(ii) of ERISA creates fiduciary status for a person who "* * * renders investment advice for a fee * * *" The preparation of an appraisal of an asset, whether employer securities, real estate or otherwise, was not intended by Congress to create an ERISA fiduciary status. Neither an appraisal, nor a fairness opinion rendered in a transaction, makes a recommendation to the trustee of a course of action. In either instance, it remains the trustee's ERISA fiduciary responsibility to make an investment decision, with the appraisal or fairness report a tool in that process.

Federal courts have correctly instructed ESOP trustees that an independent appraisal does not automatically establish a transaction price for employer securities. Rather, the trustee is responsible to prudently review and then utilize the report in making an investment decision. In order to add asset valuations and fairness opinions to the list of items that constitute "investment advice" we believe the DOL would need Congress to add a new subsection to Section 3(21) of ERISA to this effect.

The Proposed Regulation Interferes with the Trustee's Traditional Oversight Role over the Appraiser

We assume the DOL believes that making the ESOP appraiser a fiduciary will create a system of oversight over the ESOP appraiser which has somehow been absent. This belief would be an incorrect understanding of the role that has developed between the ESOP appraiser and the ESOP trustee under current law and regulatory guidance. It is important to understand that an oversight system already exists. As the plan fiduciary, the ESOP trustee is responsible for determining the fair market value of the employer securities to be acquired by or held under the ESOP. The ESOP trustee retains and works closely with the ESOP appraiser as its financial advisor, to assist the ESOP trustee with undertaking the financial review and ultimate valuation determination. If the ESOP appraiser's skill, or analysis, is lacking under applicable professional standards, then it is the ESOP trustee's responsibility to investigate the relevant issues and make a determination regarding whether the ESOP appraiser can continue to provide the ESOP trustee with the necessary financial assistance on behalf of the plan. This relationship allows the ESOP appraiser to focus on the specific task of providing advice to the ESOP trustee who is the party responsible for decisions regarding transactions and the related fair market value of the employer securities. (See Chapter 6.C, "Review of Valuation Report", ESOP Fiduciary Handbook, The ESOP Association, 2010, pages 36-42.) Further, the current structure already provides the DOL with adequate redress for an incorrect valuation, but such redress rests with the ESOP trustee the plan fiduciary charged with making the fair market value determination and ensuring a correct valuation.

Part IV. Negative Impacts on Pension Benefits

The DOL's stated goal in expanding the definition of investment advice is to create a bright line identifying who is a fiduciary. The DOL states that its limited resources are stretched by the task of assessing who is a plan fiduciary, impacting its ability to assess whether a breach occurred. This reasoning is not justified, and is short sighted, because this sweeping shift in the fiduciary rules will have significant negative consequences for ESOP companies and the ESOP participants that the DOL seeks to protect. Further, because the ESOP trustee is always a plan fiduciary and acts in a fiduciary capacity in determining fair market value and adequate consideration, in each and every instance where the perceived ill is the incorrect valuation, the DOL's argument that it is unable to establish the ESOP trustee as the fiduciary is unfounded.

In the Regulatory Impact analysis section of the proposal, the DOL submits a list of three benefits the proposed regulation will provide, but states that "* * * the Department is unable to quantify these benefits, [but] the Department tentatively concludes they would justify their cost." The DOL then estimates the service provider community would incur a cost of $10.1 million to assess its fiduciary status under ERISA. Setting aside any disagreement over this initial cost, the Association's view is that the larger costs of the proposal will be felt by plan participants through: (i) a shrinking of the marketplace for competent appraisers (ii) higher costs to ESOP sponsors to retain competent appraisers and (iii) greater costs of protecting against litigation (i.e. additional involvement of counsel and greater documentation). The overarching cost however, is not so easily quantified and will be seen when business owners, instead of pursuing a transaction with burdensome regulation as well as

cost, business owners choose to pursue other means of ownership transition, such as sales to third parties, which may result in less wealth in qualified plans.

Many of the best appraisers currently work for large or mid-sized multi-disciplinary financial service organizations. Such firms have resources, depth of expertise, breadth of experience, and work on a variety of types of non ESOP assignments and bring this experience to their ESOP appraisals. Generally, none of the professionals in these organizations are ERISA fiduciaries, or fiduciaries under any set of Federal or state laws. The Association believes these firms will not have a financial incentive to accept fiduciary status related to ERISA appraisals and may cease providing services to ESOP sponsors and trustees. ESOP companies and trustees will lose the expertise that these firms bring to their clients when performing an ESOP valuation engagement. The ESOP community, including peer firms, will also lose the benefit of these firms' knowledge.

For those firms that choose to continue to perform ESOP appraisals, significant costs will be incurred beyond the initial compliance assessment cost detailed by the DOL. First, firms will need to obtain fiduciary liability insurance, a more complex and expensive product than the current errors and omissions insurance most hold; second, valuation firms will need ERISA legal counsel for each engagement to advise on their fiduciary duties and responsibilities in a particular transaction or valuation; third, valuation firms will likely change their interactions and business relationships with ESOP trustees in order to manage their own ERISA fiduciary risks; fourth, ongoing compliance costs may increase; and fifth, instances of litigation will increase.

For ESOP sponsors, this means: (i) higher costs of valuation services, (ii) fewer qualified appraisers, and the need to replace appraisers who leave the market; (iii) confusion as to who is responsible for certain fiduciary functions; and (iv) loss in the industry of the benefits of working with multi-disciplinary organizations.

The DOL has identified "incorrect valuations" as the principal concern in the Proposed Regulation. The Association disagrees that the Proposed Regulation will, in and of itself, result in more accurate appraisals when fewer qualified appraisers will perform ESOP valuations, and the remaining firms may be less well capitalized entities that may not have the resources to defend their opinions. Further the Association fails to see how making more parties fiduciaries solves the problem when a clearly identified plan fiduciary, the ESOP trustee, is already responsible for the ESOP valuation and its accuracy.

Part V. Alternative Approaches

Provide Guidance

We are not aware, and do not acknowledge, there is a widespread problem with ESOP valuations among our membership.

However, to the extent the DOL perceives a problem, the Association believes it is more effective to focus regulatory efforts on prevention rather than punishment. Valuation standards already exist in a variety of professional organizations such as the American Society of Appraisers (ASA), American Institute of Certified Public Accountants (AICPA), as well as guidance used by the IRS, and could be easily adopted by the DOL. Hard-to-value securities held on companies' and ERISA plans balance sheets have been a significant focus of accounting standards. It would be very reasonable for the DOL to adopt general operating principles of valuation that are already generally accepted and well understood in the valuation profession.

DOL's 1988 Proposed Regulation defining "adequate consideration" provides guidance on valuing employer securities. Though not issued as final, and therefore not binding. many appraisers choose to rely on the 1988 Proposed Regulation as if it were final. With better guidance, the ESOP trustee's task of reviewing and approving valuations before accepting them would be improved because it would know the standard against which to measure the appraisal

We respectfully suggest the DOL finalize the 1988 Proposed Regulation, and amend it to include a more detailed description of the trustee's role in assessing a valuation or the valuation report.

Appraiser Credentials

The Association's Valuation Advisory Committee, whose members consist of the most prominent ESOP valuation advisors in the United States, was formed to bring professionals together to discuss ESOP valuation issues. The Association also provides forums for the interaction among various ESOP professionals to address ESOP issues, including a recently formed Interdisciplinary Committee. ESOP valuations have, for the most part, been self regulated by those professionals who have endeavored to build solid ESOP valuation practices based on generally accepted valuation

methods and procedures. These experienced ESOP professionals have worked together to develop consensus on many ESOP valuation issues.

Most ESOP appraisers are well educated, informed, and credentialed and continue their education by reading industry materials and scholarly journals, and attend conferences and seminars to keep abreast of financial theory, regulatory changes, and other factors affecting business appraisals. Many have advanced degrees in finance and maintain appraisal-related credentials such as the ASA, Chartered Financial Analyst, or AICPA designations. One of the duties of an ESOP trustee is to choose a qualified appraiser, and various credentials can help an ESOP trustee discern who is qualified.

In light of the fact that most ESOP appraisers are already credentialed, the Association believes that the DOL's resources would be best served by engaging in a dialogue with ESOP professionals, including the Association, to identify the DOL's specific concerns about appraiser competence so the ESOP community can self-regulate. For example, the DOL may find that those ESOP appraisals that it believes are "incorrect" are performed by appraisers without appropriate valuation credentials, or who are not part of the various professional organizations that provide training and education related to ESOP valuation. Further discussion and guidance may help the Association's members choose the most qualified appraisers.

Part VI. Conclusion

The valuation of privately held stock is an imprecise science. This is the very nature of advanced finance theory. There is often no single "correct" answer to the question of valuation. Imposing fiduciary standards on ESOP appraisers would expose ESOP appraisers to increased liability, without addressing the DOL's perceived need for improved financial advice regarding valuation.

On behalf of our 1,400 corporate members, we believe the proposal to mandate appraisers of privately-held ESOP company stock be ERISA fiduciaries will increase the cost of the valuation substantially. We also believe there are more efficient, less economically burdensome ways to ensure valuations are done properly without reducing ESOP companies' profits (and the accounts of ESOP participants). The Proposed Regulation will confuse and blur responsibilities between the trustee and the valuation firm. The Proposed Regulation will confuse interpretation of the law about ESOP trustee decisions and will be very expensive for ESOP companies if more private parties sue ESOP companies and ESOP trustees in cases that Federal courts currently dismisses.

Finally, ESOP companies provide locally controlled jobs, many in the manufacturing sector, that provide average pay employees with significant retirement savings. In fact, DOL's Office of the American Workplace under former Secretary of Labor Robert Reich labeled ESOP companies as examples of high performing companies, and highlighted quotes from The ESOP Association's then leader, the late Charles Edmunson.

We respect and support the important and difficult job of DOL investigators in uncovering improper valuation work and agree that those responsible should be held accountable. We would welcome the opportunity to work with you to discover an approach that will help the DOL achieve that goal.

GREG WALDEN
SECOND DISTRICT, OREGON
DEPUTY WHIP

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August 5, 2011

The Honorable Phil Roe
Chairman
Subcommittee on Health,
Employment, Labor, and Pensions
Committee on Education
and the Workforce
2181 Rayburn HOB
Washington, DC 20515

The Honorable Robert Andrews
Ranking Member
Subcommittee on Health,
Employment, Labor, and Pensions
Committee on Education
and the Workforce
2101 Rayburn HOB
Washington, DC 20515

Dear Chairman Roe and Ranking Member Andrews:

I am pleased that your subcommittee recently held a hearing to discuss bipartisan concerns with the Department of Labor's (DOL) proposal to alter the long-standing definition of fiduciary, and I write today to join those expressing concern with this controversial proposal.

As I travel throughout my district in southern, central, and eastern Oregon, I've heard from small businesses about how new government regulations will result in higher costs and more uncertainty for job-creators, and I have heard particular concern about this new proposal from DOL. Recently, I met with an investment advisor from Pendleton who told me how harmful it would be to his business and the clients he serves.

I think we all share the same objective: we want Americans to be able to invest responsibly for their retirement. However, if this new regulation is implemented, it could have the opposite effect and cut off millions of middle-income Americans from access to investment services. The current proposal could deny investment opportunities and drive up costs to those it aims to protect.

Despite these concerns—that have been expressed by Republicans and Democrats alike—the Department has failed to carefully examine all the potential costs of this proposed regulation.

Therefore, I join a bipartisan group in Congress in urging DOL to reconsider this proposal. I hope that Congress will continue to work in a bipartisan manner to carefully examine regulations that could increase uncertainty for small businesses and stand in the way of job creation.

Thank you for your attention to this important matter.

Best regards,

Greg Walden
Member of Congress

[Questions submitted for the record and their responses follow:]

U.S. CONGRESS,
Washington, DC, August 31, 2011.

Hon. PHYLLIS BORZI, *Assistant Secretary,*
Employee Benefits Security Administration, 200 Constitution Avenue, NW, Washington, DC 20210.

DEAR ASSISTANT SECRETARY BORZI: Thank you for testifying at the July 26, 2011, Subcommittee on Health, Employment, Labor, and Pensions hearing entitled, "Redefining 'Fiduciary': Assessing the Impact of the Labor Department's Proposal on Workers and Retirees." I appreciate your participation.

Enclosed are additional questions submitted by Committee members following the hearing. Please provide written responses no later than September 14, 2011, for in-

clusion in the official hearing record. Responses should be sent to Benjamin Hoog of the Committee staff, who may be contacted at (202) 225-4527.

Thank you again for your contribution to the work of the Committee.

Sincerely,

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

QUESTIONS FROM REPRESENTATIVE ROKITA

1. Can you provide the Committee with your reasoning for why it is unnecessary to reopen the comment period on this rule following the many changes that DOL is planning to make?

2. Following up an earlier question I had regarding the comments DOL received during the open comment period, please explain how DOL weighted the comments?

- Were all the comments treated equally?
- If not, how was a formula derived to weigh the comments?

3. Would you please provide the Committee with the studies DOL used as the basis of this proposed rulemaking?

4. DOL has indicated that if the proposed regulation is finalized, it will likely release a series of prohibited transaction exemptions (PTEs) to remedy the negative consequences of the proposal. What actors and transactions are you considering for exemptive relief? Why were these actors and transactions covered by the initial proposed regulation?

QUESTIONS FROM REPRESENTATIVE MCCARTHY

1. In your testimony, you indicated that the proposed regulation would not disrupt the broker-dealer model, suggesting that existing class exemptions enable commissions to be paid without violating prohibited transaction rules. Would you explain how existing exemptions will enable fully disclosed revenue-sharing to continue under the terms of the proposed regulation?

2. At the hearing, you assured Members that the Department would complete a robust economic analysis by the time that a final rule is proposed. You stated: "We are looking to have the most solid cost information we can to justify the rule * * * We are in the process of a doing a much more thorough economic analysis." Could you please describe in detail the steps the Department is taking to ensure a robust economic analysis? Have you commissioned any outside experts to consider the issue? Will your analysis carefully evaluate the indirect costs to participants who lose access to information they need to make savings and investment decisions? In your view, how much uncertainty surrounding costs to participants, plan sponsors, and providers is acceptable?

3. In addition to its impact on individual retirement accounts, I am also very concerned about the proposed regulation's impact on qualified plans. Under current regulations, a financial institution is able to provide extensive guidance—including model portfolios—to the owner of a small business who is considering establishing a plan. But as I understand, under the proposed regulation, helping the owner identify investment options would make the financial institution a fiduciary, which could make such guidance a prohibited transaction. Is my understanding correct? If so, how can we guard against considerable adverse consequences for plan sponsors?

U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210

NOV 22 2011

The Honorable Phil Roe
Chairman
Subcommittee on Health, Education, Labor and Pensions
Education and the Workforce Committee
United States House of Representatives
Washington, DC 20515

Dear Chairman Roe:

As requested, I have enclosed a paper copy of the Questions for the Record from the Committee's July 26th hearing entitled "Redefining 'Fiduciary': Assessing the Impact of the Labor Department's Proposal on Workers and Retirees." As you are aware, we had previously transmitted the QFRs electronically on October 14, however, I understand your staff has requested a signed cover letter.

Thank you again for inviting me to testify at this hearing. Please feel free to contact Ben Gruenbaum at 202-693-4628 with any questions.

Sincerely,

Phyllis C. Borzi

Phyllis C. Borzi
Assistant Secretary

Enclosure

Response to Questions Submitted for the Record

QUESTIONS FROM REPRESENTATIVE TODD ROKITA (R-IN)

Rokita Question 1: Can you provide the Committee with your reasoning for why it is unnecessary to reopen the comment period on this rule following the many changes that DOL is planning to make?

Answer: On September 19, the Department announced it will re-propose its rule on the definition of a fiduciary. The decision to re-propose was in part a response to requests from the public, including members of Congress, that the agency allow an opportunity for more input on the rule. The extended rulemaking process also will ensure that the public receives a full opportunity to review the agency's updated economic analysis and revisions of the rule. The new proposed rule is expected to be issued in early 2012. When finalized, this important consumer protection initiative will safeguard workers who are saving for retirement as well as the businesses that provide retirement plans to America's working men and women.

Rokita Question 2: Following up an earlier question I had regarding the comments DOL received during the open comment period, please explain how DOL weighted the comments? Were all the comments treated equally? If not, how was a formula derived to weigh the comments?

Answer: As I stated at the July 26 hearing, the DOL does not have a formula for weighing comments. Instead, we examine each comment and consider its factual content and its policy and legal arguments.

Rokita Question 3: Would you please provide the Committee with the studies DOL used as a basis of this proposed rulemaking?

Answer: The Department cited the following studies in the regulatory impact analysis for the proposed rulemaking: U.S. Securities and Exchange Commission,

Office Compliance Inspections and Examinations, Staff Report Concerning Examination of Select Pension Consultants (Washington, DC: May 16, 2005), accessible at *http://www.sec.gov/news/studies/pensionexamstudy.pdf;* GAO, Conflicts of Interest Can Affect Defined Benefit and Defined Contribution Plans, GAO—09—503T, Testimony Before the Subcommittee on Health, Employment, Labor and Pensions, Education and Labor Committee, House of Representatives (March 24, 2009), accessible at *http://www.gao.gov/new.items/d09503t.pdf;* Bergstresser, Daniel B.,, John Chalmers, and Peter Trufano. "Assessing the Costs and Benefits of Brokers in the Mutual Fund Industry," Social Science Research Network Abstract 616981 (Sept. 2007), accessible at: *http://papers.ssrn.com/sol3/papers.cfm?abstract—id=616981;* Bullard, Mercer, Geoffrey C. Friesen, and Travis Sapp. "Investor Timing and Fund Distribution Channels" SSRN Working Paper, Dec. 2007, accessible at: *http://ssrn.com/abstract=1070545;* and Zhao, Xinge. "The Role of Brokers and Financial Advisors Behind Investments into Load Funds," December 2005, accessible at: *http://www.ceibs.edu/knowledge/papers/images/20060317/2845.pdf.*

The Department is reviewing a wide range of additional academic studies and information submitted by commenters as we work to re-propose the rule.

Rokita Question 4: DOL has indicated that if the proposed regulation is finalized, it will likely release a series of prohibited transaction exemptions (PTEs) to remedy the negative consequences of the proposal. What actors and transactions are you considering for exemptive relief? Why were these actors and transactions covered by the initial proposed regulation?

Answer: ERISA prohibits broad categories of transactions between plans and their fiduciaries, but authorizes the Department to issue exemptions when specific transactions or classes of transactions are in plans' and participants' interests and protective of participants' rights. For example, there are already exemptions on the books authorizing brokers who provide fiduciary advice to plans and IRA customers to receive commissions with respect to securities, mutual funds, and insurance products. We are considering issuing additional exemptions to address concerns about the impact of the new regulation on the current fee practices of brokers and advisers, and considering clarifying the continued applicability of existing exemptions. The Department will carefully craft new or amended exemptions that can best preserve beneficial fee practices, while at the same time protecting plan participants and individual retirement account owners from abusive practices and conflicted advice.

The original proposed regulation, consistent with ERISA's statutory language, covers actors who provide investment advice for a fee to a plan or IRA. ERISA's statutory provisions dictate what transactions are prohibited.

QUESTIONS FROM REPRESENTATIVE CAROLYN MCCARTHY (D-NY)

McCarthy Question 1: In your testimony, you indicated that the proposed regulation would not disrupt the broker-dealer model, suggesting that existing class exemptions enable commissions to be paid without violating the prohibited transaction rules. Would you explain how existing exemptions will enable fully disclosed revenue-sharing to continue under the terms of the proposed regulation?

Answer: Existing exemptions do not enable brokers who give fiduciary investment advice to receive revenue-sharing arrangements, even if they are fully-disclosed to the advice recipient. We will consider, in the context of the re-proposed rule, whether additional exemptions are warranted for revenue-sharing arrangements that are beneficial to plan participants and IRA holders.

McCarthy Question 2: At the hearing, you assured Members that the Department will complete a robust economic analysis by the time that a final rule is proposed. You stated: "We are looking to have the most solid cost information we can to justify the rule. * * * We are in the process of doing a much more thorough economic analysis." Could you please describe in detail the steps the Department is taking to ensure a robust economic analysis? Have you commissioned any outside experts to consider the issue? Will your analysis carefully evaluate the indirect costs to participants who lose access to information they need to make savings and investment decisions? In your view, how much uncertainty surrounding costs to participants, plan sponsors, and providers is acceptable?

Answer: To ensure a robust economic analysis, we are reviewing academic studies addressing the ability of the market to address conflicts of interest by those who provide investment advice and the effect that such conflicts have on investment returns. We are also carefully reviewing relevant information contained in the comments on the original proposed regulation. We will then re-propose a rule to ensure that the public receives a full opportunity to review the Department's updated economic analysis and revisions of the original proposed regulation. Although we dis-

agree with the assertion that plan participants will lose access to needed information as a result of the changes we are considering, we would take into account reliable information supporting such an indirect cost. Any effort to predict the economic effect of a regulation is subject to uncertainty. The degree of uncertainty will vary based on the quality of the available information and other factors. Whether the level of uncertainty on a particular issue is acceptable for purposes of informing a rulemaking decision depends on a wide range of considerations.

McCarthy Question 3: In addition to its impact on individual retirement accounts, I am also very concerned about the proposed regulation's impact on qualified plans. Under current regulations, a financial institution is able to provide extensive guidance—including model portfolios—to the owner of a small business who is considering establishing a plan. But as I understand, under the proposed regulation, helping the owner identify investment options would make the financial institution a fiduciary, which could make such guidance a prohibited transaction. Is my understanding correct? If so, how can we guard against considerable adverse consequences for plan sponsors?

Answer: Under the original proposal, financial institutions would be able to market and make available, without regard to the individual needs of the plan, a selection of securities or other investments from which a plan fiduciary may designate investment alternatives for a participant-directed plan. The financial institution may also provide general financial information and data to assist a plan fiduciary's selection of such investment alternatives for a plan, if the financial institution discloses in writing that it is not undertaking to provide impartial investment advice. The Department is considering the numerous comments it received on this particular issue.

[Whereupon, at 1:09 p.m., the subcommittee was adjourned.]