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

HEARING

BEFORE THE

SUBCOMMITTEE ON HEALTH, EMPLOYMENT, LABOR, AND PENSIONS

COMMITTEE ON EDUCATION AND THE WORKFORCE

U.S. HOUSE OF REPRESENTATIVES

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C O N T E N T S

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

Wednesday, June 17, 2015
House of Representatives
Subcommittee on
Health, Employment, Labor, and Pensions,
Committee on Education and the Workforce
Washington, D.C.

The Subcommittee met, pursuant to call, at 10:03 a.m., in Room 2175, Rayburn House Office Building, Hon. David P. Roe [chairman of the subcommittee] presiding.

Present: Representatives Roe, Wilson of South Carolina, Foxx, Walberg, Salmon, Guthrie, Heck, Messer, Carter, Grothman, Allen, Polis, Courtney, Pocan, Hinojosa, Sablan, Wilson of Florida, Bonamici, Takano, and Jeffries.

Also present: Representatives Kline and Scott.

Staff present: Andrew Banducci, Professional Staff Member; Janelle Belland, Coalitions and Members Services Coordinator; Martha Davis, Staff Assistant; Ed Gilroy, Director of Workforce Policy; Callie Harman, Staff Assistant; Tyler Hernandez, Press Secretary; Marvin Kaplan, Workforce Policy Counsel; Nancy Locke, Chief Clerk; Zachary McHenry, Legislative Assistant; Daniel Murner, Deputy Press Secretary; Michelle Neblett, Professional Staff Member; Brian Newell, Communications Director; Krisann Pearce, General Counsel; Lauren Reddington, Deputy Press Secretary; Alissa Strawcutter, Deputy Clerk; Alexa Turner, Legislative Assistant; Joseph Wheeler, Professional Staff Member; Tylease Alli, Minority Clerk/Intern and Fellow Coordinator; Denise Forte, Minority Staff Director; Christine Godinez, Minority Staff Assistant; Carolyn Hughes, Minority Senior Labor Policy Advisor; Eunice Ikene, Minority Labor Policy Associate; Kendra Isaacson, Minority Labor Detailee; Brian Kennedy, Minority General Counsel; Kevin McDermott, Minority Senior Labor Policy Advisor; Richard Miller, Minority Senior Labor Policy Advisor; Amy Peake, Minority Labor Policy Advisor; and Dillon Taylor, Minority Labor Policy Fellow.

Chairman ROE. A quorum being present, the Subcommittee on Health, Employment, Labor, and Pensions will come to order.

Good morning. I would like to begin by extending a special welcome to Secretary Perez. And we appreciate your willingness to en-

gage in open and frank conversations about important issues facing working families and job creators.

I know there are areas where we will disagree, but we will always welcome the opportunity to raise our concerns and lay out what we believe are more positive alternatives.

I wish we were here to discuss a proposal that enjoyed broad bipartisan support, one that would help strengthen our economy and improve the lives of hardworking men and women. Unfortunately, that is not the case.

Instead, we are here to address a regulatory scheme that will hurt a lot of families, retirees, and small-business owners. And it could not come at a worse-possible time.

One of the most difficult challenges we face as a country is a lack of real retirement security for America's families. The defined benefit pension system continues to experience a decades-long decline while many workers are still rebuilding the savings they lost in the recent recession.

Due to these and other challenges, including a persistently weak economy, too many workers are retiring without the means necessary to ensure their financial security.

And just a moment. I found some information about retirement security by a GAO report, Mr. Secretary, that shows that 29 percent of households 55 and older have no retirement savings and 23 percent have a defined benefit plan, but no retirement savings. So it is a real issue.

And I would like, without objection, to have this report submitted for the record; and also another report submitted for the record, the U.S. Chamber finds that the DOL-proposed fiduciary rule could impact 9 million small-business households. And I would like to have that introduced for the record also.

[The information follows:]

United States Government Accountability Office

GAO

Report to the Ranking Member, Subcommittee on Primary Health and Retirement Security, Committee on Health, Education, Labor, and Pensions, U.S. Senate

May 2015

RETIREMENT SECURITY

Most Households Approaching Retirement Have Low Savings

GAO Highlights

Highlights of GAO-15-419, a report to the Ranking Member, Subcommittee on Primary Health and Retirement Security, Committee on Health, Education, Labor, and Pensions, United States Senate

Why GAO Did This Study

As baby boomers move into retirement each year, the Census Bureau projects that the age 65-and-older population will grow over 50 percent between 2015 and 2030. Several issues call attention to the retirement security of this sizeable population, including a shift in private-sector pension coverage from defined benefit plans to defined contribution plans, longer life expectancies, and uncertainty about Social Security's long-term financial condition. In light of these developments, GAO was asked to review the financial status of workers approaching retirement and of current retirees.

GAO examined 1) the financial resources of workers approaching retirement and retirees and 2) the evidence that studies and surveys provide about retirement security for workers and retirees. To conduct this work, GAO analyzed household financial data, including retirement savings and income, from the Federal Reserve's 2013 Survey of Consumer Finances, reviewed academic studies of retirement savings adequacy, analyzed retirement-related questions from surveys, and interviewed retirement experts about retirement readiness. GAO found the data to be reliable for the purposes used in this report.

GAO received technical comments on a draft of this report from the Department of Labor and incorporated them as appropriate.

View GAO-15-419. For more information, contact Charles A. Jeszeck at (202) 512-7215 or jeszeckc@gao.gov.

May 2015

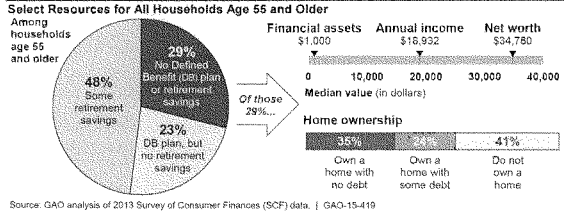
RETIREMENT SECURITY

Most Households Approaching Retirement Have Low Savings

What GAO Found

Many retirees and workers approaching retirement have limited financial resources. About half of households age 55 and older have no retirement savings (such as in a 401(k) plan or an IRA). According to GAO's analysis of the 2013 Survey of Consumer Finances, many older households without retirement savings have few other resources, such as a defined benefit (DB) plan or nonretirement savings, to draw on in retirement (see figure below). For example, among households age 55 and older, about 29 percent have neither retirement savings nor a DB plan, which typically provides a monthly payment for life. Households that have retirement savings generally have other resources to draw on, such as non-retirement savings and DB plans. Among those with some retirement savings, the median amount of those savings is about $104,000 for households age 55-64 and $148,000 for households age 65-74, equivalent to an inflation-protected annuity of $310 and $649 per month, respectively. Social Security provides most of the income for about half of households age 65 and older.

Select Resources for All Households Age 55 and Older



Source: GAO analysis of 2013 Survey of Consumer Finances (SCF) data. | GAO-15-419

Studies and surveys GAO reviewed provide mixed evidence about the adequacy of retirement savings. Studies range widely in their conclusions about the degree to which Americans are likely to maintain their pre-retirement standard of living in retirement, largely because of different assumptions about how much income this goal requires. The studies generally found about one-third to two-thirds of workers are at risk of falling short of this target. In surveys, compared to current retirees, workers age 55 and older expect to retire later and a higher percentage plan to work during retirement. However, one survey found that about half of retirees said they retired earlier than planned due to health problems, changes at their workplace, or other factors, suggesting that many workers may be overestimating their future retirement income and savings. Surveys have also found that people age 55-64 are less confident about their finances in retirement than those who are age 65 or older.

Contents

Abbreviations

DB	Defined benefit
DC	Defined contribution
EBRI	Employee Benefit Research Institute
Federal Reserve	Board of Governors of the Federal Reserve System
HRS	Health and Retirement Study
ICI	Investment Company Institute
IRA	Individual retirement account
NRRI	National Retirement Risk Index
OASI	Old-Age and Survivors Insurance
PBGC	Pension Benefit Guaranty Corporation
SCF	Survey of Consumer Finances
SSA	Social Security Administration

GAO U.S. GOVERNMENT ACCOUNTABILITY OFFICE
441 G St. N.W.
Washington, DC 20548

May 12, 2015

The Honorable Bernard Sanders
Ranking Member
Subcommittee on Primary Health
and Retirement Security
Committee on Health, Education, Labor, and Pensions
United States Senate

Dear Senator Sanders:

Baby boomers, the youngest of whom are now in their 50s, are approaching and reaching retirement in waves.[1] According to the Census Bureau, the age 65-and-over population in 2030 is projected to be about 74 million – more than 50 percent larger than in 2015, and representing more than 20 percent of the projected total U.S. population.[2] Several issues call attention to the retirement security of this sizeable First, the decades-long shift in the private sector away from defined benefit (DB) plans (which typically pay lifetime annuity benefits in retirement) to defined contribution (DC) plans (which require workers to accumulate savings over their careers and manage withdrawals in retirement) means that many workers and retirees need more savings to provide a secure retirement. In 1991, private-sector DB plans had more participants than DC plans. Since then, the number of private-sector DB plans has shrunk considerably and the number of participants has remained flat, while the number of participants in DC plans has expanded considerably.[3] Longer life expectancy means that many baby boomers will spend more years in retirement than earlier cohorts and need their savings to last longer. In addition, concerns about the long-term financial condition of Social Security, which provides the base of financial support for retirees, highlight the growing importance of Americans accumulating savings for their retirement.

[1] Baby boomers include the 78 million Americans born from 1946 through 1964.

[2] U.S. Census Bureau, "Projections of the Population by Sex and Selected Age Groups for the United States: 2015 to 2060." (NP2014-T3), December 2014.

[3] U.S. Department of Labor, Employee Benefits Security Administration, "Private Pension Plan Bulletin Historical Tables and Graphs." December 2014.

In light of these developments, you asked us to review the financial status of workers approaching retirement and current retirees. We examined the following questions: 1) What financial resources do workers approaching retirement and current retirees have? and 2) What evidence do studies and surveys provide about retirement security for workers and retirees?

To describe the financial resources of current and future retirees, we examined financial information from the 2013 Survey of Consumer Finances (SCF). Conducted by the Board of Governors of the Federal Reserve System (Federal Reserve), the SCF is a triennial national survey of assets and income. Throughout the report, we use the term "retirement savings" to mean money accrued in account-based DC plans, such as 401(k) plans, and individual retirement accounts (IRAs). We do not estimate the value of DB plans or include such an estimate in retirement savings.[4] Savings held outside of retirement accounts are included in financial assets as non-retirement savings.

To analyze other evidence of retirement security, we reviewed several studies of retirement adequacy and compared and contrasted their methodologies and findings. These included academic studies based on formal models of optimal saving behavior and consumption patterns, studies that projected savings levels in retirement based on recent savings data, and other reports examining the levels, adequacy, and sources of retirement wealth. In addition, we interviewed authors of studies and other retirement experts about retirement readiness. We also reviewed relevant questions from surveys of retirees and workers approaching retirement age to infer information about their experiences of saving for and living in retirement. These questions included those regarding financial well-being, confidence in being able to afford a comfortable retirement, and expectations of when and how people plan to retire. The surveys included the University of Michigan's Health and Retirement Study (HRS), the Federal Reserve's Survey of Household Economics and Decisionmaking, the Employee Benefit Research Institute's Retirement Confidence Survey, and other surveys.

For SCF, HRS, and other survey data used in this report, we reviewed methodological documentation and, when appropriate, interviewed

[4] While we do include DB plan benefits in retirement income, we include them in retirement savings only if a household has taken the benefit as a lump sum and rolled it into an IRA or other account balance.

individuals knowledgeable about the data and conducted electronic testing. Based on this, we found the data to be reliable for the purposes used in this report.

For the purpose of this report, we discuss households and workers nearing retirement age, from age 55-64, to isolate near retirees and determine retirement readiness, though some of this group may in fact be retired. We discuss the age group 65-74 to examine retirees in the first stage of retirement, although some members of this group may not be retired. Finally, we discuss the age group 75 and older, most of whom we expect to be retired. (A more detailed description of our scope and methodology is provided in appendix I.)

We conducted this performance audit from April, 2014 to May, 2015 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Background

Income in retirement may come from several sources, including (1) Social Security, (2) payments from employment-based DB plans, (3) savings in retirement plans, such as in a 401(k) plan or IRA, including the return on these savings;[5] and (4) other sources, including non-retirement savings, home equity, and wages.

(1) Social Security: Social Security pays benefits to retirees, their spouses, and their survivors, as well as to some disabled workers. According to the Social Security Administration (SSA), as of 2012, 86 percent of households age 65 and older received Social Security benefits. Benefits are paid to workers who meet requirements for the time they have worked in "covered employment" – jobs through which workers pay Social Security taxes, which cover about 96 percent of U.S. workers,

[5] Income in retirement may also come from earnings or returns on assets from non-retirement accounts, but for the purposes of this report we focus on retirement savings.

according to SSA.[6] Workers can claim benefits starting at age 62 (or when they become disabled), but for retiring workers the monthly benefit they receive increases the longer they delay receiving them, up until age 70.[7] Monthly Social Security benefits are based on a worker's earnings history and are progressive, meaning that Social Security replaces a higher percentage of earnings for lower-income workers and their dependents than for higher-income workers.

Social Security benefits offer two main advantages: they are a monthly stream of payments that continue until death and they adjust annually for cost-of-living increases. According to the 2014 report from the Social Security Board of Trustees, the Old-Age and Survivors Insurance (OASI) trust fund from which Social Security benefits are paid is projected to become depleted in 2034, at which point continuing income is projected to be sufficient to cover just 75 percent of scheduled benefits.[8] This projection raises the possibility of changes to Social Security benefits, taxation, or both before the depletion date.

(2) Defined Benefit Plans: these plans are "traditional" employment-based pension plans that offer benefits typically determined by a formula based on factors specified by the plan, such as salary and years of service. DB plans typically offer pension benefits in the form of an annuity that provides a monthly payment for life, although some plans also offer a lump-sum distribution option. An annuity can help to protect a retiree against risks, including the risk of outliving one's assets (longevity risk), and may also offer survivor benefits. However, DB plans carry the risk that a plan sponsor may freeze or terminate the plan. If a private-sector plan terminates with insufficient assets to pay promised benefits, the Pension Benefit Guaranty Corporation (PBGC), a federal government corporation, provides plan insurance and pays promised benefits subject

[6] About one-fourth of public employees do not pay Social Security taxes on the earnings from their government jobs and receive no service credit. Starting in 1984, individuals who began working for the federal government pay Social Security taxes and receive service credit.

[7] Individuals with disabilities who qualify for Social Security Disability Insurance receive unreduced benefits even if they claim prior to their full retirement age.

[8] *The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* (Washington D.C.: Jul. 2014)

to certain statutory limits, which may result in some beneficiaries getting reduced benefits.

(3) Retirement Savings: Introduced over 30 years ago, two primary types of retirement savings vehicles currently exist: employment-sponsored DC plans (such as 401(k) plans) and IRAs. For both types, benefits accrue in the form of account balances, which grow from contributions made by workers (and sometimes by their employers) and investment returns. Examples of employer-sponsored DC plans include 401(k) plans, 403(b) plans, and similar plans for which employers can offer payroll deductions, employer contributions to employee accounts, or both. Individuals can also save for retirement through IRAs, which allow individuals to make contributions for retirement without participating in an employment-sponsored plan.[9] DC plans and IRAs provide tax advantages, portability of savings, and transparency of known account balances. However, they also place the primary responsibility on individuals to participate in, contribute to, and manage their accounts throughout their working careers, and to manage their savings throughout retirement in order to keep from running out of money.

Workers and employers who contribute to retirement savings accounts generally receive favorable federal tax treatment, such as tax deductions for contributions and tax-deferred or even tax-free returns on investment.[10] These tax preferences are one of the largest tax expenditures in the federal government. In fiscal year 2012, the estimated

[9] While the vast majority of IRAs are individual accounts, the Internal Revenue Code also provides for "individual retirement annuities," which are annuity or endowment contracts issued by insurance companies and meeting certain requirements. 26 U.S.C. § 408(b).

[10] For 2015, individuals can contribute up to $5,500 in IRAs ($6,500 for those age 50 or older), while the contribution limit for 401(k) plans is $18,000 ($24,000 for those age 50 or older). Contributions to 401(k) plans and traditional IRAs are not subject to tax when made (26 U.S.C. §§ 402(e)(3) and 219(a) and (e), respectively); distributions or withdrawals of principal or earnings from them are subject to tax (26 U.S.C. §§ 402(a) and 408(c)(1), respectively). Contributions to Roth IRAs are not tax-deductible, but after one has been established for 5 years, upon reaching age 59½, an individual may make withdrawals of principal or earnings not subject to tax. 26 U.S.C. § 408A(c) and (d).

revenue loss associated with these accounts included $51.8 billion for DC plans and $16.2 billion for IRAs.[11]

Employment-based retirement plan coverage, especially in the private sector, has shifted from DB to DC plans. According to the Department of Labor, as of 2012 private-sector DB plans had almost 40 million participants, while DC plans had about 91 million. In contrast, in 1975, about three-quarters of private-sector pension participants had DB plans, and half of all participants in 1990 had DB plans.[12] According to Federal Reserve data, as of the third quarter of 2014, U.S. DB plans held about $11.2 trillion in assets, IRA assets totaled about $7.3 trillion and DC assets accounted for about $6.2 trillion.[13] Rollovers from 401(k) plans and other employment-sponsored plans are the predominant source of contributions to IRAs.[14]

(4) Other Sources: In addition to the three sources listed above, retirees may also have other sources of income, such as earnings or income from assets. Retirees may also choose to draw from home equity, for example, by selling their home or obtaining a reverse mortgage. Another form of income that economists also usually consider is "imputed rent"–the market rent households living in owner-occupied housing could charge, but forego, if they rented their house.[15] Earnings from work can also be

[11] Office of Management and Budget, *Fiscal Year 2014 Analytical Perspectives: Budget of the U.S. Government* (Washington, D.C.: April 10, 2013). The tax expenditure is measured as the tax revenue that the government does not currently collect on contributions and earnings amounts, offset by the taxes paid on plan distributions to those who are currently receiving retirement benefits.

[12] These figures may double-count individuals who have both a DB and DC plan. U.S. Department of Labor, Employee Benefits Security Administration, "Private Pension Plan Bulletin Historical Tables and Graphs." December 2014.

[13] These figures include assets in private-sector and public-sector pension plans. Board of Governors of the Federal Reserve System, "Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts, Fourth Quarter 2014." (Washington, D.C.: March 12, 2015.).

[14] GAO, *401(K) Plans: Labor and IRS Could Improve the Rollover Process for Participants*, GAO-13-30 (Washington, D.C.: March 7, 2013).

[15] Considering imputed rent income treats owner-occupied housing neutrally compared to renter-occupied housing. For example, consider two homeowners who each live in their homes and pay a $1,000 mortgage. If they moved into each other's home and received $1,000 per month rent, that $1,000 would be considered income, even though nothing has changed about either household's balance sheet or net expenses.

an important source of income for some households with a member age 65 or older, especially for those with a spouse younger than 62 who is not yet eligible to receive Social Security benefits.

About Half of Older Households Have No Retirement Savings, and Many Rely on Social Security

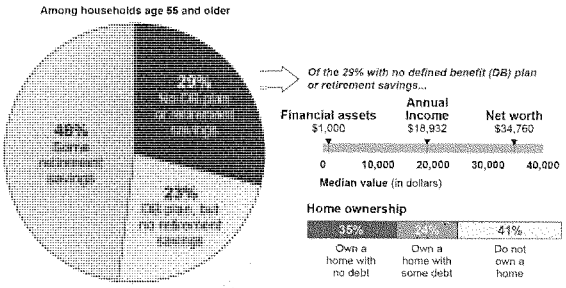
According to our analysis of data from the 2013 SCF, 52 percent of households age 55 and older have no retirement savings in a DC plan or IRA, and Social Security provides most of the retirement income for about half of households age 65 and older.[16] Among the 48 percent of households age 55 and older with some retirement savings, the median amount is approximately $109,000[17]–commensurate to an inflation-protected annuity of $405 per month at current rates for a 65-year-old.[18] Households that have sizeable retirement savings are more likely than households with lower saving to have other resources, including a higher likelihood of expecting retirement income from a DB plan. Nearly 30 percent of households age 55 and older have neither retirement savings nor a DB plan (see fig. 1). Social Security remains the largest component of household income in retirement, making up an average of 52 percent of household income for those age 65 and older.

[16] For the SCF estimates in this report, we define household age as the age of the household head. For purposes of data organization, the Federal Reserve considers the household head to be the male within a mixed-sex couple and the older individual within a single-sex couple. All percentage estimates based on the SCF have 95 percent confidence intervals of within 3 percentage points of the estimate, and all dollar estimates have confidence intervals within 5 percent of the estimate itself.

[17] We are 95 percent confident that the median retirement savings amount among those with savings is between $96,889 and $121,911.

[18] We calculated an inflation-protected single-life annuity equivalent for a 65-year-old commencing payments immediately using the Retirement Income Calculator from the Federal Thrift Savings Plan website (www.tsp.gov), which assumed an interest rate of 2 percent as of the calculation date. In 2011, we found that few retiring workers with DC plans chose or purchased an annuity. See GAO, Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices, GAO-11-400 (Washington, D.C.: June 7, 2011).

Figure 1: Select Resources for All Households Age 55 and Older



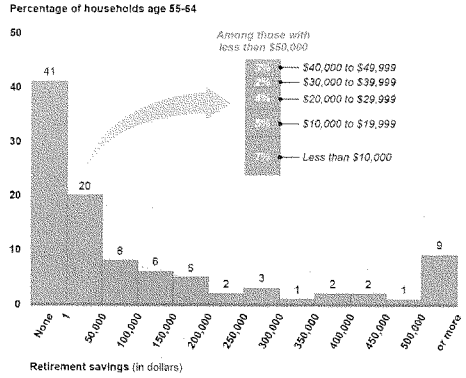
Source: GAO analysis of 2013 Survey of Consumer Finances (SCF) data. | GAO-15-419

Note: For households with no DB plan or retirement savings, we are 95 percent confident that the median financial asset value was between $763 and $1,237, the median annual income was between $17,809 and $20,055, and the median net worth was between $25,227 and $44,293. All other estimates in this figure have confidence intervals within +/- 3 percentage points.

Over Half of Households Age 55 to 64 Have Little or No Retirement Savings, and Many of These Have Few Other Financial Resources

About 55 percent of households age 55-64 have less than $25,000 in retirement savings, including 41 percent who have zero (see fig. 2 for additional detail). Most of the households in this age group have some other resources or benefits from a DB plan, but 27 percent of this age group have neither retirement savings nor a DB plan.

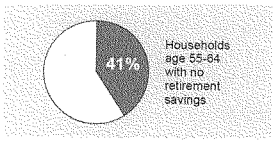
Figure 2: Distribution of Retirement Savings Amounts among Households Age 55-64



Source: GAO analysis of 2013 Survey of Consumer Finances (SCF) data. | GAO-15-419

Note: Savings amounts are expressed in 2013 dollars. The sum of the percentages of households with more than zero but less than $50,000 may not add up to 20 percent because of rounding. All estimates in this figure have 95 percent confidence intervals within +/- 3 percentage points.

Four in Ten Households Age 55-64 Have No Retirement Savings and Few Other Resources



Source: 2013 Survey of Consumer Finances (SCF) data

Among households age 55-64, the 41 percent with no retirement savings have few other financial resources but they are less likely to have debt than those with retirement savings.[19] For example, around 85 percent have less than $25,000 in total financial assets, such as in savings accounts or non-retirement investments. Compared to those with retirement savings, these households have about a third of the median income, about one-fifteenth of the median net worth, and are less likely to be covered by a DB plan (see table 1). Regarding debt, households without retirement savings are less likely to have debt than households with savings (about 70 percent compared to 84 percent). Their debt levels are comparable, though, as about 20 percent of households from each

[19] Debt includes housing debt (such as mortgages or home equity lines of credit), credit card balances, installment loans, and other lines of credit.

category have debt amounts that are more than twice their annual income.

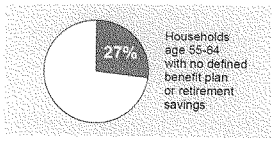
Table 1: Select Resources for Households Age 55-64 by Ownership of Retirement Savings

Dollar figures rounded to nearest $1,000		
	Households age 55-64 with no retirement savings	**Households age 55-64 with retirement savings**
Percent of households age 55-64	41%	59%
Median net worth	$21,000	$337,000
Median non-retirement financial resources	$1,000	$25,000
Median income	$26,000	$86,000
Home ownership rates	56%	87%
Percent who own a home that is paid off	22%	27%
Percent with a defined benefit plan	32%	45%

Source: GAO analysis of 2013 Survey of Consumer Finances data. | GAO-15-419

Note: We are 95 percent confident that median net worth for households with no retirement savings is between $13,668 and $28,536, that median non-retirement financial resources is between $795 and $1,205, and that median income is between $23,422 and $27,646. For households with some retirement savings, the median net worth is between $284,813 and $389,599, the median non-retirement financial resources is between $19,672 and $29,928, and the median income is between $81,645 and $91,230. All other estimates in this table have 95 percent confidence intervals within +/- 3 percentage points. The percent of households with DB plan includes those where the respondent and/or the respondent's spouse/partner has a DB plan from a current or past job.

About a Quarter of Households Age 55-64 Have No Retirement Savings and No DB Plan



Source: 2013 Survey of Consumer Finances (SCF) data.

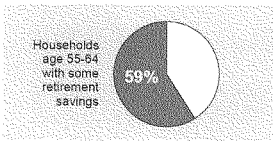
Perhaps of greatest concern are the 27 percent of all households age 55-64 that have neither retirement savings nor a DB plan. Their median net worth is about $9,000,[20] and 91 percent have less than $25,000 in financial assets. These households' median home equity is about $53,000,[21] which is less than half of what households with retirement savings or a DB plan have.

[20] We are 95 percent confident that the median net worth is between $6,469 and $12,169.

[21] We are 95 percent confident that the median home equity is between $42,174 and $63,026.

Not surprisingly, they have approximate median income of $21,000.[22] About half of these households had wage or salary income,[23] compared to 82 percent of households age 55-64 with some retirement savings or a DB plan. This indicates that a smaller portion of these households are likely working, which may limit their ability to accumulate retirement savings. About 46 percent had Social Security income, indicating that they may have claimed before the full retirement age and would receive reduced monthly benefits.[24]

Six In Ten Households Age 55-64 Have Some Retirement Savings



Source: 2013 Survey of Consumer Finances (SCF) data.

For the 59 percent of households age 55-64 with some retirement savings, we estimate that the median amount saved is about $104,000,[25] which is equivalent to an insured, inflation-protected annuity of $310 per month for a 60-year-old.[26] While about 15 percent of these households have retirement savings amounts over $500,000, 11 percent have retirement savings below $10,000 and 24 percent have savings of less than $25,000 (see table 2 for additional detail). A savings amount of $25,000 is equivalent to an insured, inflation-protected annuity of $74 per month for a 60-year-old.[27]

[22] We are 95 percent confident that the median income is between $19,146 and $22,484.

[23] We are 95 percent confident that between 49 and 57 percent had wage income.

[24] We are 95 percent confident that between 41 and 51 percent had Social Security income, which could include retirement, disability, survivors, or dependent's benefits. Eligible workers can claim Social Security retirement benefits as early as age 62, but the monthly benefit is lower for the rest of a retiree's life than if they delayed claiming. Full retirement age ranges from 65 to 67, depending on birth year. 42 U.S.C. § 416(l). As we reported in 2014, early Social Security claimers have less income and wealth in retirement and receive a larger share of their income from Social Security than those who delay claiming until their full retirement age. GAO, *Retirement Security: Challenges for Those Claiming Social Security Benefits Early and New Health Coverage Options*, GAO-14-311 (Washington, D.C.: April 23, 2014).

[25] We are 95 percent confident that the median retirement savings amount is between $88,483 and $120,197.

[26] We calculated an inflation-protected single-life annuity equivalent for a 60-year-old commencing payments immediately using the Retirement Income Calculator from the Federal Thrift Savings Plan website (www.tsp.gov), which assumed an interest rate of 2 percent as of the calculation date.

[27] Ibid.

Table 2: Distribution of Retirement Savings Amounts among Households with Some Retirement Savings, Age 55-64

	10th percentile	25th percentile	50th percentile	75th percentile	90th percentile
Retirement Savings	$8,760	$25,978	$104,340	$300,200	$718,200

Source: GAO analysis of 2013 Survey of Consumer Finances data. | GAO-15-419

Note: We are 95 percent confident that the 10th percentile amount is between $6,495 and $11,025, the 25th percentile amount is between $19,268 and $32,688, the 50th percentile amount is between $88,483 and $120,197, the 75th percentile amount is between $244,073 and $356,327, and the 90th percentile amount is between $586,956 and $849,444.

Both retirement savings and DB plan coverage rises with income levels for age 55-64 households (see table 3).[28] Across income quintiles, a similar percentage of households have a paid-off mortgage and debt levels above twice their income, whereas retirement savings and DB plan coverage generally increase with income.

Table 3: Select Retirement Resources for Households Age 55-64 by Income Quintile

Dollar figures rounded to nearest $1,000					
	1 (bottom)	2	3	4	5 (top)
Percent with retirement savings[a]	9%	42%	68%	84%	94%
Among those who have, median retirement savings[a]	—	$19,000	$68,000	$97,000	$371,000
Percent with a defined benefit plan[b]	18%	35%	43%	53%	50%
Percent who own a home that is paid off	21%	28%	24%	25%	29%
Percent with debt greater than twice annual income	17%	26%	24%	21%	14%

Source: GAO analysis of 2013 Survey of Consumer Finances data. | GAO-15-419

Note: For all percentage estimates in this table, the 95 percent confidence intervals are within +/- 6 percentage points.

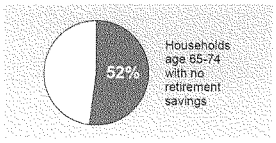
[a]Because of sample size, we could not produce a reliable estimate for the bottom quintile. We are 95 percent confident that the median retirement savings for the 2nd quintile is between $10,334 and $27,666, the 3rd quintile is between $49,909 and $86,171, the 4th quintile is between $73,479 and $119,921, and the 5th quintile is between $281,513 and $460,087.

[b]The percent of households with a DB plan includes those where the respondent and/or the respondent's spouse/partner has a DB plan from a current or past job.

[28] We found SCF estimates of future income from DB plans to be unreliable for our purposes.

Half of Households Age 65-74 Have No Retirement Savings, and Social Security is the Largest Source of Retirement Income for This Age Group

About Half of Households Age 65-74 Have No Retirement Savings



Source: 2013 Survey of Consumer Finances (SCF) data.

Turning to older households, retirement savings among those age 65-74 shows a distribution similar to those age 55-64, though a larger proportion has no retirement savings (52 percent).[29] Similar to the younger group, about 10 percent have more than $500,000 in savings.

Another similarity is that many households age 65-74 with no retirement savings have few other resources to draw upon in retirement as measured by our indicators (see table 4). Compared to those in the same age group with retirement savings, households without retirement savings have about one-seventh the net worth, and fewer have a DB plan. Unlike households age 55-64, the debt profile for households without retirement savings is not substantially better than for households with some retirement savings.

[29] We would expect most households in this age group who have retirement savings to have begun drawing these down, although balances can still grow from contributions and investment returns.

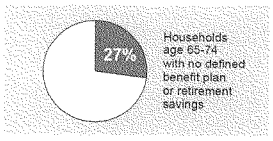
Table 4: Select Resources for Households Age 65-74 by Ownership of Retirement Savings

Dollar figures rounded to nearest $1,000		
	Households age 65-74 with no retirement savings	**Households age 65-74 with retirement savings**
Percent of households age 65-74	52%	48%
Median net worth	$86,000	$597,000
Median non-retirement financial resources	$4,000	$79,000
Home ownership rates	77%	95%
Percent who own a home that is paid off	36%	51%
Percent with a defined benefit plan	49%	58%

Source: GAO analysis of 2013 Survey of Consumer Finances data. | GAO-15-419

Note: Percentage estimates in this table have 95 percent confidence intervals that are within +/- 5 percentage points. For households with no retirement savings, we are 95 percent confident that the median net worth is between $70,841 and $100,675, the median non-retirement financial resources is between $2,539 and $5,385. For households with some retirement savings, we are 95 percent confident that the median net worth is between $483,261 and $711,607, median non-retirement financial resources is between $61,878 and $95,922. The percent of households with a DB plan includes those where the respondent and/or the respondent's spouse/partner has a DB plan from a current or past job.

A Quarter of Households Age 65-74 Have No Retirement Savings and No DB Income



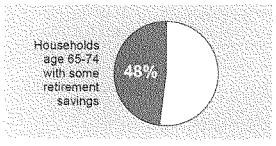
Source: 2013 Survey of Consumer Finances (SCF) data.

Similar to households age 55-64, a closer look at the 27 percent of households age 65-74 with no retirement savings and no DB plan reveals that they have very low levels of resources to draw upon for retirement income. This group has a median net worth of about $57,000,[30] which is around one-sixth the net worth of other households of this age. Compared to households with some retirement savings or a DB plan, households in this age group generally have lower home ownership rates (about 67 percent compared to 93 percent) and less home equity when they do own homes (median home equity is about $100,000, compared to $148,000).[31]

[30] We are 95 percent confident that the median net worth is between $30,821 and $83,789.

[31] For households with neither retirement savings nor DB plans, we are 95 percent confident that between 62 and 73 percent own a home and their median home equity is between $81,551 and $118,449. For other households, we are 95 percent confident the median is between $139,628 and $156,772.

Households Age 65-74 with Some Retirement Savings



Source: 2013 Survey of Consumer Finances (SCF) data.

For the 48 percent of households age 65-74 that have some retirement savings, we estimate that the median amount is $148,000,[32] comparable to an insured, inflation-protected annuity of $649 per month for a 70-year-old at current rates.[33] About one in five of these households has retirement savings amounts over $500,000, while 16 percent have savings less than $25,000 (see table 5 for additional detail).[34]

Table 5: Distribution of Retirement Savings Amounts among Households with Some Retirement Savings, Age 65-74

	10th percentile	25th percentile	50th percentile	75th percentile	90th percentile
Retirement savings	$16,800	$48,800	$148,000	$394,200	$1,112,400

Source: GAO analysis of 2013 Survey of Consumer Finances data. | GAO-15-419

Note: We are 95 percent confident that the 10th percentile amount is between $9,644 and $23,956, the 25th percentile amount is between $36,999 and $60,601, the 50th percentile amount is between $123,799 and $172,201, the 75th percentile amount is between $306,096 and $482,304, and the 90th percentile amount is between $885,356 and $1,339,444.

About Forty Percent of Households Age 65-74 Get Most of their Income from Social Security

For all households age 65-74, median annual income is about $47,000[35] and Social Security makes up on average 44 percent of income for households in this age group, larger than any other income source. About 90 percent of all households in this age range receive some Social Security income, and the median amount they receive is approximately $19,000.[36] About 41 percent of households in this age range rely on Social Security for over half of their income, while 14 percent rely on Social Security for more than 90 percent of their income. While Social Security is, on average, the largest component of household income in retirement, other sources also play a role in funding retirement for

[32] We are 95 percent confident that the retirement savings amount is between $123,799 and $172,201.

[33] We calculated an inflation-protected single-life annuity equivalent for a 70-year-old commencing payments immediately using the Retirement Income Calculator from the Federal Thrift Savings Plan website (www.tsp.gov), which assumed an interest rate of 2 percent as of the calculation date.

[34] We are 95 percent confident that between 13 and 20 percent of households age 65-74 with some retirement savings have less than $25,000.

[35] We are 95 percent confident that median income is between $44,244 and $50,706.

[36] We are 95 percent confident that the median Social Security income is between $18,071 and $20,041.

households age 65-74. Income from work and pension-based annuities, such as DB plans, contribute about a fifth of household income each, on average. Distributions from retirement savings make up a relatively small portion of average household income at 4 percent. Because Social Security and DB plans represent a relatively large portion of retiree income, it follows that much of the household income for this age group has some assurance that it will last a lifetime.

Among households age 65-74, the prevalence of both retirement savings and DB plans generally increases with income (see table 6). As with the younger age group, not only do a larger proportion of higher-income households have some retirement savings, but the amount they have saved is also larger. Similarly, the annual amount they receive from their DB plan increases with income.

Table 6: Select Retirement Resources for Households Age 65 to 74 by Income Quintile

Dollar figures rounded to nearest $1,000

	First (bottom)	Second	Third	Fourth	Fifth (top)
Percent with retirement savings	9%	33%	48%	65%	84%
Among those who have, median retirement savings[a]	—	—	$104,000	$144,000	$468,000
Percent with a defined benefit (DB) plan[b]	19%	46%	67%	68%	65%
Among those with DB income, median annual amount[c]	$4,000	$11,000	$17,000	$24,000	$37,000
Percent who own a home that is paid off	44%	50%	40%	44%	39%
Percent with debt greater than twice annual income	17%	17%	27%	14%	10%

Source: GAO analysis of 2013 Survey of Consumer Finances data. | GAO-15-419

Note: For all percentage estimates in this table, the 95 percent confidence intervals are within +/- 8 percentage points.

[a]Because of sample size, we could not produce a reliable estimate for the bottom two quintiles. We are 95 percent confident that the median retirement savings for the 3rd quintile is between $66,041 and $142,359, the 4th quintile is between $114,070 and $172,730, and the 5th quintile is between $345,986 and $590,414.

[b]The percent of households with a DB plan includes those where the respondent and/or the respondent's spouse/partner has a DB plan from a current or past job.

[c]We are 95 percent confident that the median DB income for the 1st quintile is between $2,242 and $6,446, for the 2nd quintile is between $8,484 and $12,876, for the 3rd quintile is between $13,910 and $19,210, the 4th quintile is between $17,902 and $30,146, and the 5th quintile is between

$25,560 and $47,640. DB income includes income from DB plans and any annuitized DC plans.

Social Security makes up a larger share of household income for households with no retirement savings, which is not surprising as these households have lower incomes. The 52 percent of households age 65-74 with no retirement savings rely primarily on Social Security for income in retirement, as it makes up 57 percent of their household income on average (see figure 3). These households have median income of approximately $29,000, and 25 percent of them rely on Social Security for more than 90 percent of their income.[37] Those in the same age range who have some retirement savings have a median income of $76,000.[38] Social Security makes up on average 31 percent of income for those with savings, about the same percentage that wage or salary income contributes.[39] Reflecting Social Security's progressive benefit structure, 86 percent of those in the lowest income quintile receive more than half of their household income from Social Security, while 66 and 44 percent of those in the second and third quintiles do, respectively.[40]

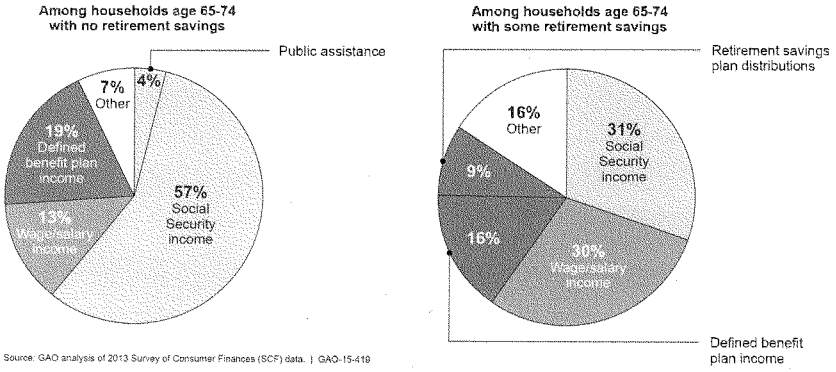
[37] We are 95 percent confident that the median income is between $26,132 and $32,654 and that between 21 and 28 percent relied on Social Security for more than 90 percent of their income. The 2012 poverty threshold for a two-adult household age 65 and older was $13,878.

[38] We are 95 percent confident that the median income is between $64,594 and $87,150.

[39] While wage or salary income makes up, on average, 30 percent of household income among this population, we are 95 percent confident that between 52 and 59 percent of these households had wage or salary income. For comparison, we are 95 percent confident that between 27 and 35 percent of households with no retirement savings had wage or salary income.

[40] We are 95 percent confident that the figures are between 81 and 91 percent, 57 and 74 percent, and 37 and 51 percent, respectively.

Figure 3: Average Composition of Income for Households Age 65-74 by Retirement Savings Status



Source: GAO analysis of 2013 Survey of Consumer Finances (SCF) data. | GAO-15-419

Note: Other includes income from non-retirement investments, such as interest, dividends, mutual funds, stocks, and bonds. It also includes rental income, real estate, child support, alimony, and business/farm income. Public assistance includes income from unemployment or worker's compensation, and programs such as Temporary Assistance for Needy Families or Supplemental Security Income. Retirement savings distributions do not include annuity equivalents from assets remaining in the plan. Sums may not add up to 100 because of rounding. All estimates in this figure have 95 percent confidence intervals within +/- 3 percentage points.

Households age 65-74 with no retirement savings or DB plan have about one-third the income of other households in the same age group and are even more likely to rely on Social Security. Specifically, their median income is about $19,000 compared to $60,000 for the other group.[41] Only about a quarter of these households have wage income, compared to 49 percent of other households in this age range, while 45 percent of them relied on Social Security for over 90 percent of their income, compared to

[41] We are 95 percent confident that income for households with neither retirement savings nor DB plan is between $16,728 and $20,684. For other households it is between $56,092 and $63,852.

3 percent for households with either some retirement savings or a DB plan.[42]

Most Households Age 75 and Older Have No Retirement Savings and Social Security Provides Most Household Retirement Income on Average

Households age 75 and older have even fewer retirement assets than younger households, and only 29 percent have retirement savings. About 35 percent have neither retirement savings nor a DB plan, though a larger percentage of households in this age group have a DB plan than those nearing retirement (55 percent compared to 40 percent for households age 55-64). Of those households that have savings, the median savings is approximately $69,000,[43] which is commensurate to an insured, inflation-protected annuity of $467 per month at current rates for an 80-year-old.[44]

Social Security provides the bulk (on average 61 percent) of household income for those 75 and older (see fig. 4). The median income for households age 75 and older is about $27,000, and the median Social Security income is approximately $17,000.[45] When compared to younger households age 65-74, Social Security makes up a larger share of household income for retirees age 75 and older, with 62 percent of these households relying on Social Security for more than 50 percent of their income, and 22 percent relying on Social Security for more than 90 percent of their income.[46] Moreover, according to Census data, about 43

[42] Among households with neither retirement savings nor a DB plan, we are 95 percent confident that between 20 and 30 percent had wage income and that Social Security made up more than 90 percent of income for between 39 and 50 percent of them.

[43] We are 95 percent confident that the retirement savings amount is between $49,199 and $88,801.

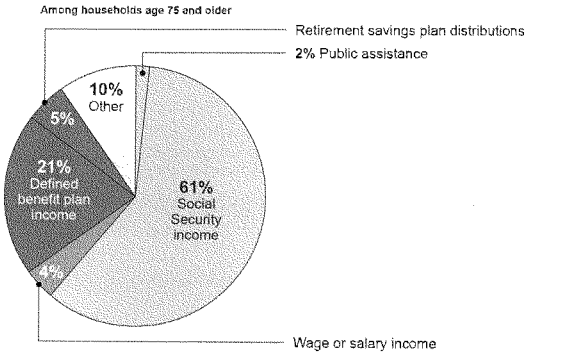
[44] We calculated an inflation-protected single-life annuity equivalent for an 80-year-old commencing payments immediately using the Retirement Income Calculator from the Federal Thrift Savings Plan website (www.tsp.gov), which assumed an interest rate of two percent as of the calculation date.

[45] We are 95 percent confident that median income is between $25,626 and $29,184 while Social Security income is between $15,617 and $17,983. About 98 percent of households age 75 and older had income from Social Security.

[46] We are 95 percent confident that between 58 and 65 percent rely on Social Security for more than 50 percent of their income.

percent of people 65 years and older would have incomes below the poverty level if they did not receive Social Security.[47]

Figure 4: Average Composition of Income for Households Age 75 and Older



Source: GAO analysis of 2013 Survey of Consumer Finances (SCF) data. | GAO-15-419

Note: Other includes income from non-retirement investments, such as interest, dividends, mutual funds, stocks, and bonds. It also includes rental income, real estate, child support, alimony, and business/farm income. Public assistance includes income from unemployment or worker's compensation, and programs such as Temporary Assistance for Needy Families or Supplemental Security Income. Retirement savings plan distributions do not include annuity equivalents from assets remaining in the plan. Sums may not add up to 100 because of rounding. All estimates in this figure have 95 percent confidence intervals within +/- 3 percentage points.

As with the younger age groups, households age 75 and older with no retirement savings have fewer resources based on our indicators than those with some retirement savings, as one might expect. For example, their median net worth is about $127,000, compared to $435,000 for same-aged households with some retirement savings.[48] Additionally,

[47] U.S. Bureau of the Census. Current Population Survey, Annual Social and Economic Supplements, "Impact on Poverty of Alternative Resource Measures by Age: 1981 to 2013," accessed March 27, 2015 from http://www.census.gov/hhes/www/poverty/data/incpovhlth/2013/Impact_Poverty.xls.

[48] We are 95 percent confident that the median net worth for households with no retirement savings is between $107,366 and $147,194, while for other households it is between $354,804 and $515,952.

households with no retirement savings have lower homeownership rates than other households in the same age range (75 percent compared to 93 percent) and a smaller proportion own their homes outright (55 percent compared to 74 percent).[49] A larger share of households in this age range have paid off their mortgages than have younger groups.

Similarly, households age 75 and older with no retirement savings have lower median incomes than those with some retirement savings. Specifically, they have about half the median income as households with some retirement savings (about $24,000, compared to $47,000).[50] Retirement savings distributions contribute, on average, about 17 percent of household income among those with some retirement savings, adding a median amount of $4,000 to these households' income.[51] Households with retirement savings in this age group obtain just under half their income from Social Security on average (46 percent).[52]

[49] We are 95 percent confident that between 51 and 58 percent of households with no retirement savings own their home with no debt, while between 70 and 79 percent of other households do.

[50] We are 95 percent confident that the median income for households with no retirement savings is between $22,041 and $25,015, while it is between $39,833 and $53,729 for other households.

[51] This amount represents the median amount of retirement savings plan distributions among households that had some retirement savings, regardless of whether they withdrew from these savings accounts. We are 95 percent confident that retirement savings distributions contribute between 13 and 21 percent of these households' income while the median amount is between $2,434 and $6,494.

[52] We are 95 percent confident that Social Security contributes between 42 and 50 percent of these households' income on average.

Studies and Surveys Provide Mixed Evidence on the Adequacy of Retirement Savings among Workers and Retirees

Studies of Retirement Savings and Income Adequacy Conclude Different Things about U.S. Retirement Security, Largely Because of Different Savings Targets

Economists broadly agree that a conceptual benchmark measure for adequate retirement saving is an amount that will, along with other sources of retirement income, allow a household to maintain its pre-retirement standard of living into retirement. However, there is no consensus about how much income this standard requires. Economists and financial planners generally agree that many retirees do not need to replace 100 percent of working income in order to maintain their standard of living because most retirees probably have reduced expenses—for example, no longer needing to provide for payroll taxes, retirement saving, and commuting expenses—relative to when they were working. Other big expenses that many households may face while working but not while retired include the cost of raising children (who are likely grown and financially independent by the parents' retirement age) and of housing if homeowners pay off their mortgage by retirement. Conversely, health costs may represent a greater expense for a household in retirement than while working.

Setting a specific target for, and even calculating, the "replacement rate"–a household's post-retirement income as a percentage of pre-retirement income–required to maintain a household's standard of living requires many complicated assumptions.[53] There is broad agreement over some aspects of replacement rates, at least in concept if not necessarily in practical application to calculations. Because higher-income households tend to pay a higher percentage of their income in taxes and save more

[53] For a study of the complexity and limitations of figuring replacement rates, see MacDonald, B-J. and K. D. Moore. 2011. "Moving Beyond the Limitations of Traditional Replacement Rates." Society of Actuaries. http://www.soa.org/research/research-projects/pension/default.aspx.

for retirement while working, they generally require a lower replacement rate in retirement when these expenses decline; for the opposite reasons, lower-income households generally require higher replacement rates. For these reasons, there is no single replacement rate that represents a "success" for retirement income.

Several studies have attempted to evaluate the adequacy of retirement income or project the likelihood of current workers having sufficient retirement income.[54] Some of these studies attempt to judge the retirement readiness of workers by using data on consumption, income, and wealth for working-age households and projecting a replacement rate at retirement; they then compare this projection to a target replacement rate that they estimate to be enough to maintain a standard of living in retirement. As Table 7 shows, different studies use different replacement rate or other benchmarks for retirement income adequacy. The Center for Retirement Research at Boston College produces a National Retirement Risk Index (NRRI) based on data from the 2013 SCF and concluded that 52 percent of households faced risk of having insufficient retirement income to maintain their standard of living. This percentage is almost the same as the one calculated from the 2010 SCF and is up from 44 percent in 2007.[55] However, at-risk percentages vary considerably by sub-group in the NRRI. For example, Boston College calculates that 60 percent of households with income in the lowest third of the income distribution are at risk, and 43 percent of households in the highest-third are at risk of having insufficient retirement income to maintain their pre-retirement standard of living. The NRRI also finds a greater percentage of households age 30-39 at risk than age 50-59.

The Employee Benefit Research Institute (EBRI) uses its Retirement Security Projection Model to project the percentage of workers at risk of having retirement income that is inadequate to cover minimum retirement

[54] Some studies focus on retirement savings amounts while others speak more in terms of retirement income. Throughout this section we assume that all forms of usable retirement wealth can be used to finance consumption in retirement, without necessarily making assumptions about the decision to annuitize lump-sum assets or to convert home equity to liquid financial assets. For citations for all the studies in this section, please see app. II.

[55] Boston College defines a household at risk if their projected replacement rate falls at least 10 percent below their target replacement rate for their income group.

expenditures.[56] EBRI's projections show about 44 percent of their sample falling short of target retirement income. However, EBRI's projections show a much higher percentage of lower-income households at risk of falling short on retirement income: 12.5 percent of those born 1948-1954 in the highest-income quartile compared to 86.8 percent of the same cohort in the lowest-income quartile. In a 2012 study, Aon Hewitt projects savings of its sample against a target 85 percent replacement rate and estimates that 85 percent of workers will fail to hit this target by age 65. Even when focusing on "full career" workers who have the potential to contribute to a retirement account for at least 30 years, 71 percent of these workers still are projected to fall short of the benchmark.

The 2015 National Institute on Retirement Security (NIRS), instead of using a projection model, uses the 2013 SCF to compare net worth among workers to financial industry-suggested savings benchmarks at different ages. NIRS finds that approximately two-thirds of workers have savings below the suggested benchmark, enough for an 85 percent replacement rate target at age 67. A 2012 Urban Institute study focuses on Baby Boom workers and retirees and sets a 75 percent replacement rate target, but measures retirement income at age 70. Depending on alternative assumptions they made about whether retirees annuitized retirement assets and how they calculated pre-retirement income, they find about 30 to 40 percent of their sample fell short of their replacement rate target.[57]

[56] EBRI defines this measure as a set of expenses, varying by income, from the Consumer Expenditure Survey, in addition to some health insurance and out-of-pocket health expenses, plus stochastic expenses from nursing home and home health care.

[57] The Urban Institute's first method for calculating future retirement income counts income from assets, money withdrawn from retirement accounts, and income from Social Security, pensions, and earnings. The second assumes retirees annuitize 80 percent of all financial assets in addition to income from Social Security, pensions, and earnings. The second method yields results in which more retirees meet the 75 percent replacement rate target.

Table 7: Selected Studies of Retirement Income Adequacy

Organization (year of study)	Retirement adequacy benchmark (replacement rate unless otherwise specified)	Percentage of sample projected to be below benchmark	Other notes and statistics
Aon Hewitt (2012)	85%, or 11 times pay at age 65.	85% of sample, including 71% of employees with potential to participate in employer plan for 30 years.	Estimates that savings shortfall relative to target for full-career contributing employee is 2.2 times pay.
Biggs-Schieber (2014)	Able to maintain standard of living in retirement, but no specific target stated	N/A	For those who work to full retirement age, Social Security typically replaces 62 percent of final-average earnings; income from 401(k)'s and IRA's underreported by SSA.
Center for Retirement Research at Boston College (2014)	69% for highest-third income, 72% for middle, 79%, for lowest.	52% overall; 60% of low-income and 43% of high-income households.	Projects retirement income at age 65. Assumes annuitization of wealth, including housing equity.
Employee Benefit Research Institute (2012)	Sufficient to meet basic expenses, including health expenses, throughout retirement.	44% of 1948-1954 birth cohorts; 87% of lowest income quartile, 13% of highest income	Assumes age-65 retirement. Assumes housing equity converted to savings only when other resources are exhausted.
Hurd-Rohwedder (2012)	Enough resources to maintain pre-retirement consumption and die with bequeathable assets	30% of age 66-69-year-olds; 23% of married households, 51% of single persons	Estimate consumption trajectories based on pre-retirement consumption. Assumes housing wealth not depleted until other forms of wealth are. Lowest rates of preparedness for people with shortest financial planning horizons and with least education.
National Institute on Retirement Security (2015)	85%, or 8 times income at age 67	66% of working households age 25-64; 70% of age 55-64 households.	Estimates that 62.4% of households age 55-64 fall short of target using a 25% lower savings goal.
Investment Company Institute (2012)	Able to maintain standard of living in retirement, but no specific target stated.	N/A	Declining poverty rates of 65-and-older population, and smaller percentage of 65-and-older in poverty than 18-64; Social Security and housing equity comprise key components for lower-wealth workers; most 55-64 year olds covered by some pension wealth

Organization (year of study)	Retirement adequacy benchmark (replacement rate unless otherwise specified)	Percentage of sample projected to be below benchmark	Other notes and statistics
Scholz-Seshadri-Khitatrakun (2006)	Wealth consistent with predictions of lifecycle model.	16% of households overall; 30% of lowest-income decile, 5% of highest-income decile	Sample from 1992 wave of the Health and Retirement Study. Progressive Social Security benefits, other transfers, and children leaving household account for much of lower-income savings adequacy.
Urban Institute (2012)	75% replacement rate at age 70.	30-40% of 1956-65 birth cohorts	Calculates working-years income using age 50-54 income and 35 years highest earnings.

Source: GAO analysis of studies listed. See app. II for bibliographic information on studies. | GAO-15-419

Other studies have somewhat more optimistic conclusions about whether American workers are likely to have enough income in retirement to maintain their standard of living. A 2006 study by Scholz, Seshadri, and Khitatrakun uses the Health and Retirement Study to compare individuals' earnings and savings history against wealth predictions of a lifecycle model over a household's lifetime, with different targets for different household characteristics.[58] They find that only 16 percent of households have savings below the predictions of their model. Their findings emphasize the impact of children and the progressive benefit structure of Social Security, which replaces a higher percentage of income for lower-income earners than higher-income earners, as key factors explaining how such a high percentage of households can reach retirement income

[58] A lifecycle model of saving in economics tries to explain patterns of consumption and saving over an individual or household's lifetime. The model generally predicts that individuals seek to smooth consumption over their lives, leading to a prediction of borrowing during younger years, saving during middle-age years, and living off accumulated savings in retirement.

adequacy.[59] However, even with these factors, Scholz, Seshadri, and Khitatrakun find that the percentage of households with adequate retirement income declines with earnings: about 30 percent of lowest-decile earners undersave in their estimation, compared to 5 percent of the highest decile. A 2012 study by Hurd and Rohwedder similarly uses a lifecycle framework that estimates consumption paths of Health and Retirement Study households, based on consumption in the years prior to retirement, and projects which households have enough financial resources to maintain this consumption path until death. The studies by Hurd and Rohwedder and Scholz, Seshadri, and Khitatrakun assume that households value consumption later in retirement less than earlier, in part reflecting the declining probability of being alive later in life;. This assumption lowers consumption targets later in retirement than they would under an assumption that households smooth their consumption throughout retirement. Hurd and Rohwedder found that 23 percent of married couples and 51 percent of single persons fall short of these targets. However, they find that single households and those with less education are more likely to be unprepared for retirement by the study's targets.

A 2012 study from the Investment Company Institute (ICI) and a 2014 study by Andrew Biggs and Sylvester Schieber also express doubt that Americans are not saving adequately for retirement, although they do not set an adequacy benchmark based on replacement rate or standard of living targets against which to measure household savings. ICI argues that a "five-tiered pyramid" of retirement assets, made up of Social Security, employment-based DB and DC pensions, IRAs, housing equity,

[59] In 2014, SSA published estimated replacement rates for retired worker beneficiaries who were newly entitled in 2013. At age 65, these measured 34.6 percent for those with indexed career-average earnings of 160 percent of the average wage index, 41.7 percent for those with indexed career-average earnings equal to the average wage index, 56.3 percent for those with indexed career-average earnings of 45 percent of the average, and 77.4 percent for those with indexed career-average earnings of 25 percent of the average. There has been recent debate regarding the methodology of published Social Security replacement rate estimates, with some commentators saying the published rates understate the replacement rate and others countering this critique. For discussion of different measures of Social Security replacement rates, see Andrew G. Biggs and Glenn R. Springstead, "Alternate Measures of Replacement Rates for Social Security Benefits and Retirement Income," *Social Security Bulletin*, vol. 68, no. 2, 2008; and Stephen Goss, Michael Clingman, Alice Wade, and Karen Glenn, "Replacement Rates for Retirees: What Makes Sense for Planning and Evaluation?" SSA, Office of the Chief Actuary, Actuarial Note Number 155, July 2014.

and other financial assets, has successfully provided for retirees. However, while they find that, based on 2010 data, most near-retiree households across income groups have some assets in an employment-sponsored plan or an IRA, they also find that the percentage of such households rises with income: about half of households with income less than $30,000 to about 95 percent of households with income of at least $80,000. ICI also cites a lower percentage of 65-and-older Americans living in poverty than the overall population as evidence of success with the retirement system. They conclude that "on average" households are able to maintain their standard of living in retirement.

The Biggs and Schieber study argues that reported replacement rates published in prior Social Security Trustees reports understated the extent to which Social Security benefits replace earnings because Social Security uses lifetime earnings (instead of final-year earnings) and indexes earnings to average wages instead of average prices. These assumptions, they argue, overstate income during working years, and thus, published estimates understate how much Social Security benefits replace as a percentage of working income. Biggs and Schieber, like Scholz, Seshadri, and Khitatrakun, also argue that some studies set too-high replacement rate targets because they ignore the favorable economic impact of children leaving the household.

Assumptions about income targets and methodology help drive the conclusions of these different studies. Some considerations in evaluating all of these studies include:

How income and expenses may change during retirement. One limitation of replacement rate calculations is that they suggest a fixed amount of retirement income and expenses. In reality, retirement income may vary throughout retirement, depending in part on the degree to which a household's income is annuitized. To the extent that retirees have to manage savings in lump-sum form, such as in an IRA or DC plan, they face risk from investment returns and outliving their resources, among other factors. Even annuitized income, if not adjusted for inflation, may lose purchasing power, especially over longer retirement periods. To the extent that Social Security makes up a significant portion of retirement income, as we find earlier in this report, the amount and purchasing power of income throughout retirement may be more predictable, as would annuitized income from a DB plan or any other annuitized wealth (if inflation adjusted). Similarly, expenses, especially health care, may be neither steady nor predictable in retirement. Finally, for women

approaching or in retirement, becoming divorced, widowed or unemployed can have detrimental effects on their income security.[60]

How the impact of children on target income may be complicated. To the extent that children become independent long before parents retire, households approaching retirement may already have adjusted to higher levels of consumption, possibly raising their standard of living and required replacement rates. In retirement, the extent to which grown children may remain partially dependent on retired parents also would lessen the extent to which the cost of raising children is a foregone expense in retirement.

How income from Social Security may change. The 2014 Social Security Trustees; Report projects the Old-Age and Survivors Insurance Trust Fund, which pays Social Security retirement benefits, to become insolvent in 2034, at which point revenues are projected to be enough to cover 75 percent of scheduled benefits.[61] Should benefits fall, either because of insolvency or because of reforms to extend the solvency of the trust fund, this could represent a major challenge to households who rely heavily on Social Security for retirement income. Similarly, if reforms raised payroll taxes on workers, this could affect their ability to save for retirement. Further, as the normal retirement age continues to rise for receiving full benefits (gradually from 65 for beneficiaries born in 1937 or earlier to 67 for those born in 1960 or later), future Social Security replacement rates will fall unless workers delay claiming until they are older.

[60] GAO, *Retirement Security: Women Still Face Challenges*, GAO-12-699 (Washington, D.C.: July 19, 2012).

[61] Under the Trustees' intermediate assumptions. *The 2014 Annual Report of the Board of Trustees of the Federal Old-Age and Survivors Insurance and Federal Disability Insurance Trust Funds* (Washington, D.C.: July 28, 2014).

Surveys Show That Workers Age 55 and Older Approaching Retirement May Overestimate Their Ability to Earn Future Income

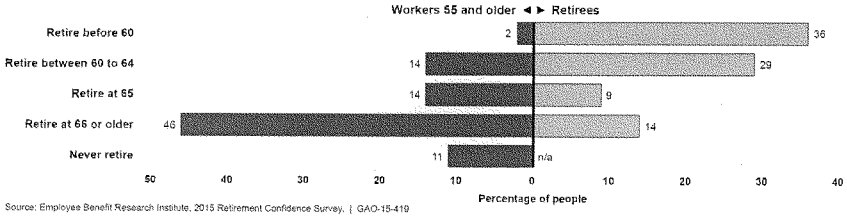
Surveys indicate that workers age 55 and older generally plan to retire at an older age and work more in retirement than current retirees actually did.[62] These plans may indicate that the current cohort of workers nearing retirement will in fact work longer than current retirees did. However, if these expectations for retiring later prove unrealistic or do not come to fruition, workers' retirement security may be at risk, since workers may have fewer years to work and save for retirement than they are planning.

According to the 2015 Employee Benefit Research Institute's (EBRI) Retirement Confidence Survey, among workers 55 and older, nearly half say they plan to retire at 66 or older, while 14 percent of current retirees report having done so (see fig. 5). Gallup polling indicates that plans to retire later may be associated with low confidence in retirement savings. In a 2013 Gallup survey, baby boomers who strongly disagree with the statement "you have enough money to do everything you want to do" plan to retire at 73, while those who strongly agree with the statement plan to retire at 66.[63] According to a 2013 Society of Actuaries survey, retirement expectations also vary by household income, with workers from lower-income households more likely to plan to retire at older ages than workers from higher-income households. Furthermore, among pre-retirees age 45 and older, 31 percent of those making less than $50,000 a year, 14 percent of those making between $50,000 and $99,000 a year, and 7 percent of those making $100,000 or more a year do not plan to retire. Among those who said they do not plan to retire, the dominant reason was the expectation of never having enough money to retire (55 percent).

[62] In this section, retirees refers to people who self-identify as retired, and the term is not dependent on age, unless stated otherwise in this report.

[63] Gallup defines baby boomers as people born between 1946 and 1964.

Figure 5: When Older Workers Plan to Retire Versus When Retirees Actually Retired[64]



Source: Employee Benefit Research Institute, 2015 Retirement Confidence Survey. | GAO-15-419

The EBRI study found that those who retired earlier than expected are more likely than other retirees to say they are not confident about having enough money for a comfortable retirement or paying for basic expenses, medical expenses, and long-term care expenses. Similarly, a 2008 study by Michael Hurd and Susan Rohwedder of RAND found that those who said that health was an important reason for retirement were disproportionally from the lowest wealth quartile, tended to retire earlier than planned, and reduced consumption more than others in retirement, indicating their standard of living may have dropped in retirement.[65]

Many people retire for reasons they did not anticipate or that are out of their control, further indicating that workers' financial plans for retirement may not hold and that workers may need to plan for uncertainty. According to the 2012 Health and Retirement Study (HRS), 43 percent of retirees report having felt forced into retirement, while the EBRI study reported that 50 percent of retirees left the work force earlier than planned.[66] Moreover, younger retirees are more likely to feel forced into retirement; according to the HRS, 51 percent of retirees age 55-64 felt forced into retirement, while 34 percent of retirees age 65-74 said the

[64] Numbers do not add up to 100 because the remainder of the respondents either did not to answer or said they did not know.

[65] Michael D. Hurd and Susan Rohwedder, *The Retirement Consumption Puzzle: Actual Spending Change in Panel Data.* (Cambridge, MA: National Bureau of Economic Research, April 2008.)

[66] GAO's analysis is based on data from the 2012 Health and Retirement Study. Confidence intervals are between 40.4 percent and 46 percent with 95 percent certainty.

same.[67] In the EBRI study, where respondents could report multiple reasons for retiring earlier than planned, some said they did so because they could afford to or wanted to do something else, but more cited reasons such as health problems or disability (60 percent), changes at their workplace (27 percent), and having to care for a spouse or another family member (22 percent).

Other events outside a worker's control, such as the 2007-9 recession, may have caused workers to change their retirement plans. The recession had disparate effects on people approaching retirement, causing some to retire earlier than expected, likely when they could not find employment, and others to retire later, likely because their retirement savings balances had dropped. According to a 2013 Federal Reserve study, 38 percent of people age 55-64 and 47 percent of people age 65-74 who had not yet retired reported that they delayed retirement since the recession, and 21 percent of people age 55-64 and 13 percent of people 65-74 who had retired reported retiring earlier than planned.[68]

The 2013 survey sponsored by the Society of Actuaries found that current workers age 45 and older expect similar sources of income in retirement as current retirees are receiving, with a few key exceptions. Specifically, in one exception, 59 percent of pre-retirees expect to receive income from a DB plan while 73 percent of retirees receive income from a DB plan; in another, 81 percent of pre-retirees expect income from an employment-sponsored retirement savings plan, while 53 percent of retirees receive this. Most notably, 57 percent of pre-retirees expect employment, including self-employment, to constitute a source of income in retirement, while 28 percent of retirees report having this.

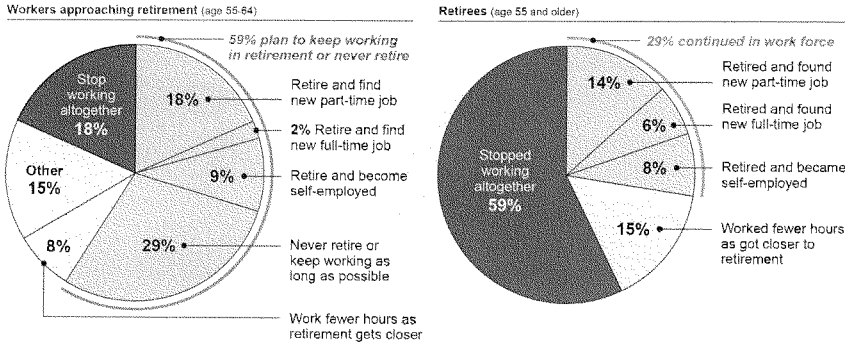
The Federal Reserve survey also suggests that many workers may unrealistically expect to continue working as long as possible or transition to new work when they "retire". Only 18 percent of workers approaching retirement who have done some planning for retirement expect to stop

[67] GAO's analysis is based on data from the 2012 Health and Retirement Study. Confidence intervals for 55-64–year-olds are between 46.8 percent and 54.8 percent with 95 percent certainty. Confidence intervals for 65-74-year-olds are between 29.5 percent and 38.1 percent with 95 percent certainty.

[68] GAO's analysis is based on data from the Federal Reserve's 2013 Survey of Household Economics and Decisionmaking. As with all survey data, there is an associated sampling error.

work completely at retirement, while 59 percent of workers plan to work as long as possible, or plan to shift jobs in retirement by finding a different job or working for themselves. This contrasts with the experiences of retirees, among whom 29 percent shifted jobs in retirement (see fig. 6).[69]

Figure 6: Comparison of Retirement Plans of Older Workers and How Retirees Left Their Jobs[70]



Source: Federal Reserve, 2013 Survey of Household Economics and Decision Making. | GAO-15-419

People Age 55-64 Are Less Confident about Their Financial Well-Being in Retirement Than Those over 65

As compared to people age 55-64, many people over 65 report being able to manage financially. According to a Federal Reserve survey, 72 percent of people age 65-74 and 84 percent of people 75 and older say they are managing okay or better financially, while only 59 percent of people age 55-64 report they are managing okay or better financially. [71]

[69] This includes those who retired from their previous career and then found a different full-time or part-time job or started working for themselves.

[70] Asked among workers who have done some planning for retirement. Retirees were able to report multiple responses for this question.

[71] Age groups refer to everyone in that age group, retired and working, unless stated otherwise.

While most people 65 and over have confidence in their retirement security, levels of confidence among people approaching retirement age are lower. According to an older EBRI survey, conducted in 2014, 69 percent of retirees say that their experience in retirement with respect to their finances has been about the same or better than they expected it to be. According to the 2013 Survey of Consumer Finances, two-thirds of households age 65-74 say their received or expected retirement income is at least enough to maintain living standards (66 percent). On the other hand, just over half (52 percent) of people age 55-64 say retirement income they expect or receive will be enough to maintain living standards.[72]

However, confidence in affording certain types of expenses in retirement varies, suggesting that expenses such as for long-term care may be a cause of concern for retiree financial security. According to the EBRI study, 82 percent of retirees are very or somewhat confident they will have enough money to take care of basic expenses in retirement, 78 percent are very or somewhat confident they will have enough to take care of medical expenses during retirement, and 59 percent are very or somewhat confident they will have enough money to pay for long-term care should they need it during retirement.

Moreover, poverty rates are higher for people approaching retirement and people who are 75 and older. According to the Current Population Survey, about 8 percent of people age 65-74 and 11 percent of those age 75-84 are in poverty, which is also the poverty rate for people age 55-64. Twelve percent of people 85 and older are in poverty.[73] The Supplemental Poverty Measure, an alternate poverty measure, found that 14 percent of people age 55-64 are in poverty according to this

[72] GAO analysis based on data from the 2013 Survey of Consumer Finances. The margin of error for 65-74 year olds is 3.2 percent with 95 percent certainty and for 55-64 year olds, 2.2 percent with 95 percent certainty.

[73] Considerable variation exists across demographic subgroups. A greater proportion of blacks, Hispanics, and women over the age of 65 are in poverty as compared to other groups.

definition.[74] For people 65-74, this number decreases to 12 percent, and then increases for the oldest Americans: 17 percent for people between 75-84, and 20 percent for people 85 and older. Lastly, according to the HRS, many retirees say that "not having enough income to get by" is a concern, with 41 percent of retirees saying that this "bothers or worries" them a lot.[75]

While 23 percent of retirees report working for pay since they retired, according to the 2015 EBRI study, the reasons people work in retirement vary, including that they enjoy working (83 percent) and want to stay active and involved (79 percent). Some other reasons include wanting money to buy extras (54 percent), needing money to make ends meet (52 percent), a decrease in the value of their savings or investments (38 percent), or keeping health insurance or other benefits (34 percent).[76]

[74] The official poverty measure from the Current Population Survey is sometimes used to determine eligibility for government programs and funding distributions. The Supplemental Poverty Measure (SPM) is considered an experimental measure. The SPM serves as an additional indicator of economic well-being and provides a deeper understanding of economic conditions and policy effects. First published in 2011, it calculates poverty thresholds using recent expenditures by families, including food, shelter, clothing, and utilities, and is adjusted for differences in family size, geographic variation in living costs, and homeownership. Unlike the official poverty measure, the SPM considers a family's resources after taxes and transfer programs. Medical out-of-pocket expenses are also considered in the SPM, by being subtracted from a family's resources. This means that SPM values health insurance in how it reduces out-of-pocket medical costs, but it does not account for the benefits of health insurance, such as access to medical providers or reduced stress from having insurance.

[75] GAO's analysis is based on data from the 2012 Health and Retirement Study. Confidence intervals are between 32.8 percent and 48.9 percent with 95 percent certainty.

[76] The reasons retirees report working for pay is from the 2014 EBRI Retirement Confidence Survey, where 27 percent of retirees reported working for pay.

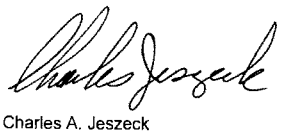
Agency Comments

We provided a draft of this report to the Department of Labor, the Department of the Treasury, and the Social Security Administration for review and comment. The Department of Labor provided technical comments, which we incorporated as appropriate. The Department of the Treasury and the Social Security Administration did not have comments.

As agreed with your office, unless you publicly announce the contents of this report earlier, we plan no further distribution until 30 days from the report date. At that time, we will send copies of this report to the Secretary of Labor, the Secretary of the Treasury, and the Commissioner of Social Security, and other interested parties. In addition, the report will be available at no charge on the GAO website at http://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-7215 or jeszeckc@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made contributions to this report are listed in appendix III.

Sincerely yours,



Charles A. Jeszeck
Director, Education, Workforce, and Income Security

Appendix I: Objectives, Scope, and Methodology

To analyze retirement savings and income for workers approaching retirement and for those of retirement age, we answered the following questions:

1. What financial resources do workers approaching retirement and current retirees have?
2. What evidence do studies and surveys provide about retirement security for workers and retirees?

Retirement Financial Resources

To describe the financial resources of near and current retirees, we examined financial information from the 2013 Survey of Consumer Finances (SCF). The SCF is a triennial survey of household assets and income from the Board of Governors of the Federal Reserve System (Federal Reserve). The 2013 SCF surveyed 6,026 U.S. households about their pensions, incomes, asset holdings and debts, and demographic information. The SCF is conducted using a dual-frame sample design. One part of the design is a standard, multistage area-probability design, while the second part is a special over-sample of relatively wealthy households. This is done in order to accurately capture financial information about the population at large as well as characteristics specific to the relatively wealthy. The two parts of the sample are adjusted for sample nonresponse and combined using weights to make estimates from the survey data representative of households overall. In addition, the SCF excludes people included in the Forbes magazine list of the 400 wealthiest people in the United States. Furthermore, the 2013 SCF dropped 11 observations from the public data set that had net worth at least equal to the minimum level needed to qualify for the Forbes list.

We found the 2013 SCF to be reliable for the purposes of our report. While the SCF is a widely used federal data source, we conducted an assessment to ensure its reliability. Specifically, we reviewed related documentation and internal controls, spoke with agency officials, and conducted electronic testing. When we learned that particular estimates were not reliable for our purposes–such as estimates of future DB income–or had sample sizes too small to produce reliable estimates, we did not use them.

Nonetheless, the SCF and other surveys that are based on self-reported data are subject to nonsampling error, including the inability to get information about all sample cases; difficulties of definition; differences in the interpretation of questions; respondents' inability or unwillingness to provide correct information; and errors made in collecting, recording,

coding, and processing data. These nonsampling errors can influence the accuracy of information presented in the report, although the magnitude of their effect is not known.

Estimates from the SCF are also subject to some sampling error since the 2013 SCF sample is one of a large number of random samples that might have been drawn. Since each possible sample could have provided different estimates, we express our confidence in the precision of the sample results as 95 percent confidence intervals. These intervals would contain the actual population values for 95 percent of the samples that could have been drawn. In this report, we report percentage or other numerical estimates along with their 95 percent confidence intervals. Unless otherwise noted, all percentage estimates based on the SCF have 95 percent confidence intervals that are within 3 percentage points, and all numerical estimates other than percentages have 95 percent confidence intervals that are within 5 percent of the estimate itself. All financial figures reported using SCF data are in 2013 dollars and most are rounded to the nearest thousand dollars.

Where possible, we relied on variable definitions used for Federal Reserve publications using the SCF.[1] For example, we used the Federal Reserve's variable for age, which is the age of the household head.[2] We also used the Federal Reserve's variable for retirement savings, which included assets accrued in defined contribution (DC) plans such as 401(k) plans as well as individual retirement accounts (IRA).[3] We do not include the value of defined benefit (DB) plans, "traditional" pension plans that provide benefits based on a formula and typically pay lifetime benefits as an annuity unless a household has taken the benefit as a lump sum and converted it into an IRA or other account balance. Retirement savings also does not include savings held outside of a retirement account, which is included in financial assets as non-retirement savings. Similarly, we

[1] See Jesse Bricker, et al. "Changes in U.S. Family Finances from 2010 to 2013: Evidence from the Survey of Consumer Finances," Federal Reserve Bulletin, vol. 100, no. 4 (September 2014).

[2] For purposes of data organization, the Federal Reserve considers the household head to be the male within a mixed-sex couple and the older individual within a single-sex couple.

[3] This includes IRAs that have been rolled over, for example, from retirement savings plans.

used other Federal Reserve variables to describe additional resources asked about in the SCF, such as home ownership, financial assets (including savings in and outside of a retirement account), debt, and net worth. This measure of net worth does not include the total value of anticipated DB plan or Social Security benefits, in part because it is difficult to determine the present value of these benefits.[4]

An important exception to our use of Federal Reserve variables is our estimation of household income: in order to separately estimate key components of retirement income, such as Social Security and DB plans,[5] we developed our own variable for income while attempting to mirror the Federal Reserve's income variable as closely as possible. We consulted with Federal Reserve staff to inform our calculations of Social Security and DB plan income. One limitation to these income calculations is that Social Security and DB plan income are for the respondent and his or her spouse/partner for 2013, whereas other income is reported for the entire family for 2012. However, we believe the estimates are reliable for our purposes. For example, 88 percent of households age 65 and older consist only of the respondent and his or her spouse/partner. Further, we conducted electronic testing and found no statistically significant difference between estimates of income using our variables and the Federal Reserve's variables, either in aggregate or by various age groups. When describing the average share of household income from a particular source, we divided for each household the amount from that source by the household's total income, and reported the average across all households.[6]

To provide context to retirement savings amounts, we calculated annuity equivalents using the Thrift Savings Plan retirement calculator. This provides information on the approximate amount of monthly lifetime income participants in the Thrift Savings Plan could receive if they used their retirement savings to purchase an inflation-protected annuity through

[4] While we do include DB plan and Social Security benefits in retirement income, we include DB plan benefits in retirement savings only if a household has taken the benefit as a lump sum and rolled it into an IRA or other account balance.

[5] Income from DB plans includes traditional pensions with lifetime benefits and annuitized DC plans. In 2011, we found that few retirees with DC plans chose or purchased an annuity (GAO-11-400).

[6] We conducted this calculation for households with positive, non-zero income.

the plan.[7] The Thrift Savings Plan offers an annuity with monthly payments that increase each year up to 3 percent, based on inflation. Annuities purchased through other channels may provide different levels of lifetime income. If a household purchased an annuity without inflation protection, the initial amount of income would be higher. Similarly, different assumptions about the interest rate would change the annuity amount. For example, the calculator currently uses an interest rate of two percent as of the calculation date, though a higher interest rate would increase the annuity amount.

Defining retirement for Americans is not without difficulty, as retirement is a nebulous concept and different people may define retirement for themselves differently. Self-defined retirees may work or not claim Social Security benefits, while people who do not identify as retired may claim Social Security benefits or not work. For the purpose of this report, we discuss households and workers nearing retirement age as 55-64 to isolate near retirees and determine retirement readiness, though some of this group may in fact be retired. We discuss the age group 65-74 to examine retirees in the first stage of retirement, although some members of this group may not be retired. Finally, we discuss the age group 75 and older, most of whom we expect to be retired.

Studies and Surveys on Retirement Security

To analyze other evidence of retirement security, we reviewed several studies of retirement adequacy and compared and contrasted their methodologies and findings. These included academic studies based on formal models of optimal saving behavior and consumption patterns, those that projected savings levels in retirement based on recent savings data, and other reports examining the levels, adequacy, and sources of retirement wealth. We selected savings projections models that we had familiarity with from past GAO reports, and chose other studies and reports based on recommendations from internal and outside stakeholders. We also interviewed authors of studies and other retirement experts about retirement readiness.

We also reviewed survey questions of retirees and workers approaching retirement age to infer information about their experiences of saving for

[7] While we reported rounded savings amounts, we based the annuity equivalent estimates off of non-rounded amounts.

and living in retirement. These surveys asked questions regarding financial well-being, confidence in being able to afford a comfortable retirement, and expectations of when and how people plan to retire contrasted with the actual experiences of current retirees. We analyzed the most recent available data from all of the surveys used as of April 2015.

The University of Michigan's Health and Retirement Study (HRS) is a longitudinal panel study that surveys a representative sample of approximately 26,000 Americans over the age of 50 every 2 years, with new cohorts being added to the sample every 6 years. The HRS also includes off-year studies to cover specific topics, like consumption, in depth. GAO used data from the 2012 core survey. As with all survey data, some statistical imprecision exists in the data that are presented in this report.

The Federal Reserve's 2013 Survey of Household Economics and Decisionmaking is a first-time survey conducted by the Federal Reserve to better understand the financial state of U.S. households. The survey was conducted by the Board's Division of Consumer and Community Affairs in September 2013 using a nationally representative online survey panel. The survey was administered by GfK, an online consumer research company. It created a nationally representative probability-based sample by selecting respondents, adults 18 years and older, based on both random digit dialing and address-based sampling. A total of 4,134 surveys were fully completed. The data are weighted using the variables of gender, age, race/ethnicity, education, census region, residence in a metropolitan area, and access to the Internet. Demographic weighting targets are based on the Current Population Survey. As with all survey data, some statistical imprecision exists in the data that are presented in this report.

Gallup conducts daily tracking of public opinion through the Gallup U.S. Daily. For the Gallup U.S. Daily, Gallup samples 3,500 respondents a week, 15,000 a month, and 175,000 a year. Surveys are conducted among U.S. adults ages 18 and older, using both landline and cell phone numbers. Each sample of national adults includes a minimum quota of 50 percent cell phone respondents and 50 percent landline respondents. The data are weighted by gender, age, race, Hispanic ethnicity, education, region, population density, and phone status. Demographic weighting targets are based on the Current Population Survey. Gallup samples landline and cell phone numbers using random-digit-dial methods. The results we reported on are based on the sub-sample of baby boomers, or

1,929 adults born from 1946 through 1964. The margin of sampling error is plus or minus 4 percentage points at the 95 percent confidence level.

The 2015 Retirement Confidence Survey, conducted by the Employee Benefit Research Institute (EBRI) and Greenwald & Associates, is an annual survey on the views and attitudes of working-age and retired Americans regarding retirement, their preparations for retirement, their confidence with regard to various aspects of retirement, and related issues. The survey was conducted in January and February 2015 through 20-minute telephone interviews with 2,004 individuals (1,003 workers and 1,001 retirees) age 25 and older in the United States. Random-digit dialing was used to obtain a representative sample, as well as a cell phone supplement. All data are weighted by age, sex, and education to reflect the actual proportions in the adult population. The weighted samples of workers and retirees yield a statistical precision of plus or minus 3.5 percentage points, with 95 percent certainty, of what the results would be if all Americans age 25 and older were surveyed with complete accuracy.

The 2013 Risks and Process of Retirement Survey, sponsored by the Society of Actuaries and prepared by Greenwald & Associates, is a survey intended to provide insights into how Americans decide to retire, how they perceive post-retirement risks, and how they manage financial resources in retirement. The survey was conducted online among Americans age 45-80 and included both pre-retirees and retirees at all income levels. A total of 2,000 interviews, half among pre-retirees and half among retirees, lasting an average of 20 minutes, were conducted using Research Now's online consumer panel from August 19-28, 2013. The sample data are weighted by age, sex, and census region to the 2012 population estimates released by the Census Bureau. As with all survey data, some statistical imprecision exists in the data that are presented in this report.

The official poverty rates and Supplemental Poverty Measures that we report come from the Census Bureau. The official poverty rate is sometimes used to determine eligibility for government programs and funding distributions. The Supplemental Poverty Measure is considered an experimental measure and serves as an additional indicator of economic well-being and provides a deeper understanding of economic conditions and policy effects. We reported on the poverty rates for older Americans, to indicate financial well-being.

For all survey data used in this report, we reviewed methodological documentation and, when appropriate, interviewed individuals knowledgeable about the data and conducted electronic testing. Based on this, we found the data to be reliable for the purposes used in this report.

Appendix II: List of Selected Studies of Retirement Income Adequacy

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Appendix III: GAO Contact and Staff Acknowledgments

GAO Contact	Charles A. Jeszeck, (202) 512-7215 or jeszeckc@gao.gov
Staff Acknowledgments	Michael Collins (Assistant Director), Mark Glickman, Shilpa Grover, and Laura Hoffrey made key contributions to this report. In addition, support was provided by James Bennett, Mitchell Karpman, Kathy Leslie, Sheila McCoy, Susan E. Offutt (GAO Chief Economist), Mark Ramage, Joseph Silvestri, Frank Todisco (GAO Chief Actuary), Walter Vance, Charles Willson, and Craig Winslow.

Related GAO Products

Private Pensions: Participants Need Better Information When Offered Lump Sums That Replace Their Lifetime Benefits, GAO-15-74. Washington, D.C.: January 27, 2015.

Retirement Security: Challenges for Those Claiming Social Security Benefits Early and New Health Coverage Options, GAO-14-311. Washington, D.C.: April 23, 2014.

Retirement Security: Trends in Marriage and Work Patterns May Increase Economic Vulnerability for Some Retirees, GAO-14-33. Washington, D.C.: January 15, 2014.

401(k) Plans: Other Countries' Experiences Offer Lessons in Policies and Oversight of Spend-down Options, GAO-14-9. Washington, D.C.: November 20, 2013.

Automatic IRAs: Lower-Earning Households Could Realize Increases in Retirement Income, GAO-13-699. Washington, D.C.: August 23, 2013.

401(k) Plans: Labor and IRS Could Improve the Rollover Process for Participants, GAO-13-30. Washington, D.C.: March 7, 2013.

Retirement Security: Annuities with Guaranteed Lifetime Withdrawals Have Both Benefits and Risks, but Regulation Varies across States, GAO-13-75. Washington, D.C.: December 10, 2012.

Retirement Security: Women Still Face Challenges, GAO-12-699. Washington, D.C.: July 19, 2012.

Unemployed Older Workers: Many Experience Challenges Regaining Employment and Face Reduced Retirement Security, GAO-12-445. Washington, D.C.: April 25, 2012.

Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices, GAO-11-400. Washington, D.C.: June 7, 2011.

Private Pensions: Some Key Features Lead to an Uneven Distribution of Benefits, GAO-11-333. Washington, D.C.: March 30, 2011.

Locked Out of Retirement

The Threat to Small Business Retirement Savings

U.S. CHAMBER OF COMMERCE

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The U.S. Chamber of Commerce is the world's largest business federation representing the interests of more than 3 million businesses of all sizes, sectors, and regions, as well as state and local chambers and industry associations.

Locked Out of Retirement:

The Threat to Small Business Retirement Savings

Bradford P. Campbell, Counsel
Drinker Biddle & Reath LLP

Locked Out of Retirement

The Threat to Small Business Retirement Savings

U.S. CHAMBER OF COMMERCE

SUMMARY

- Small business owners, through SEP and SIMPLE-type IRA plans, provide roughly $472 billion in retirement savings for over 9 million U.S. households.

- Ninety-nine percent of U.S. employers are small businesses, and they produce 63% of new private-sector jobs. These small business owners and employees need retirement plans at work.

- The DOL is proposing broad new regulations that would impose significant new compliance costs and legal liabilities on advisors to SEP and SIMPLE IRAs, costs that will be passed on to these small business plans and employees.

- Many small businesses cannot offer 401(k) or similar "traditional" retirement plans because of administrative complexity, costs, or eligibility requirements, and instead offer simplified, basic retirement plans built around IRAs.

- SEP IRAs and SIMPLE IRAs are popular choices that are easy and inexpensive to set up and operate. Studies estimate that more than 9 million households own IRAs as a result of these small employer-provided retirement plans.

Locked Out of Retirement

The Threat to Small Business Retirement Savings

U.S. CHAMBER OF COMMERCE

Executive Summary

Stretching its current regulatory authority over employer-provided retirement plans, the U.S. Department of Labor (DOL) proposed in April a new regulatory package that would put DOL in charge of financial advice provided to all Individual Retirement Accounts (IRAs) as well as to all private-sector, employer-provided retirement plans. This regulatory expansion would change the rules governing how financial advice is provided to roughly $15 trillion in retirement savings, putting DOL in charge. Unsurprisingly, this kind of sweeping change would result in a lot of unintended consequences.

The DOL is expanding the definition of fiduciary investment advice under a federal law known as the Employee Retirement Income Security Act (ERISA). The result would be that many traditional forms of compensation, such as commissions that vary from one investment to another, for financial advisors could become illegal under special provisions in that law called "prohibited transactions." A number of aspects of the proposal appear unworkable in actual practice, and would negatively impact how advisors assist small businesses in providing retirement benefits for their employees. In particular, the change would impact two of the most popular retirement savings vehicles for small businesses: Simplified Employee Pension IRAs (SEP IRAs) and Savings Incentive Match Plan for Employees IRAs (SIMPLE IRAs).

The proposal would adopt a broad definition of fiduciary "investment advice" encompassing "sales" communications, certain educational materials, and other situations where no intention to provide individualized fiduciary advice traditionally has been expected. Under the DOL's new proposal, even providing a small business with marketing materials containing sample investment lineups for SEP IRAs or SIMPLE IRAs could constitute investment advice, as could providing an individual account holder with certain educational materials that reference the specific investment funds that are available to him or her. Consequently, small businesses may find it even harder to offer retirement plans than they do today.

Small businesses make up 99% of all U.S. employers, and account for 63% of new private-sector jobs, as well as almost half of all private-sector employment and output.[1] Like their large employer counterparts, small business entrepreneurs and the millions of workers they employ need retirement savings opportunities. But unlike large employers, many small businesses may not be able to offer a 401(k) or similar "traditional" retirement plan due to cost, administrative complexity, or eligibility rules. Instead, many of these small businesses rely on simplified retirement plans to cover their owners and employees.

Two of the most attractive and popular retirement savings solutions used by small businesses are SEP IRAs and SIMPLE IRAs. SEP IRAs and SIMPLE IRAs are easy and inexpensive to set up, and do not impose ongoing administrative or reporting requirements on employers, allowing

[1] *See* U.S. Small Business Administration, Office of Advocacy, "Frequently Asked Questions," March 2014, *available at* https://www.sba.gov/sites/default/files/FAQ_March_2014_0.pdf.

their focus to remain on growing their businesses. These special IRAs have been very successful in helping small business workers save for retirement—nearly 10% of all current IRAs come from SEP/SIMPLE-type plans.[2] As of the end of 2014, there were approximately $472 billion of retirement savings in these types of IRA plans.[3] Another study of IRA data concluded that more than 9 million U.S. households owned employer-sponsored IRAs like SEP and SIMPLE IRAs.[4]

More complex regulations mean more hurdles and compliance costs, and a greater likelihood of lawsuits. Main Street advisors will have to review how they do business, and likely will decrease services, increase costs, or both. Small business SEP IRA and SIMPLE IRA arrangements that currently depend on these advisors for affordable assistance are likely to disproportionately bear the costs of excessive regulation—their small scale means they are more expensive to serve. The U.S. Chamber believes that DOL's proposed regulations risk hurting the very small businesses and workers they are intended to protect.

[2] "Individual Retirement Account Balances, Contributions, and Rollovers, 2013; With Longitudinal Results 2010–2013: The EBRI IRA Database," Craig Copeland, EBRI Issue Brief #414, May 2015.

[3] *See* Investment Company Institute, "The U.S. Retirement Market, Fourth Quarter 2014," March 2015, *available at* www.ici.org/info/ret_14_q4_data.xls.

[4] *See* Investment Company Institute, "How Many Households Own IRAs," based on year-end 2012 data, *available at* http://www.ici.org/faqs/faq/faqs_iras.

Locked Out of Retirement

The Threat to Small Business Retirement Savings

U.S. CHAMBER OF COMMERCE

Introduction

This DOL regulatory expansion would change the rules governing how financial advice is provided to roughly $15 trillion in retirement savings. Unsurprisingly, this kind of sweeping change would result in significant unintended consequences. One such unintended consequence is that small businesses may find it even harder to offer retirement plans than they do today, and some may stop offering employer-sponsored IRA plans to employees. SEP and SIMPLE IRAs are basic retirement plans that allow small businesses to offer retirement savings opportunities to their employees, and are set up with the help of financial professionals that they trust. DOL, however, thinks these Main Street financial advisors need a new set of complex rules and regulations to prevent potential conflicts of interest.

The DOL proposal would adopt a broad definition of fiduciary "investment advice" encompassing "sales" communications, certain educational materials, and other situations where no intention to provide individualized fiduciary advice traditionally has been expected. Under the DOL's new proposal, even providing a small business with marketing materials containing sample investment lineups for SEP IRAs or SIMPLE IRAs could constitute investment advice, as could providing an individual account holder with certain educational materials that reference the specific investment funds that are available to him or her.

The proposed standards for defining what would or would not be fiduciary investment advice are highly subjective and would be difficult to observe in practice. Even well-meaning advisors who do not intend to provide specific, individualized investment advice may inadvertently "step in" to fiduciary status, triggering potential prohibited transactions and greater legal liability. To compensate for the significant liability they could face, these advisors, and the financial institutions they work for, would likely have to include an additional risk premium in the fees they charge to clients.

This expanded fiduciary definition can also make it hard for advisors to recommend SEP and SIMPLE IRA investments that use certain proprietary investment products. For example, an insurance agent advising a SEP or SIMPLE might not be able to discuss some of the investments offered by the insurance company for which the agent works, regardless of their performance or suitability for the individual.

In order to comply with the proposed regulatory package, many advisors and their related financial institutions would have to change how their products and services are structured, and how the retirement plans and IRA accounts are charged fees. If finalized in its current form, the proposed rule would very likely increase the costs associated with SEP IRAs and SIMPLE IRAs, and would make it more difficult for retirement savers to receive meaningful assistance, such as choosing appropriate asset allocations, within their accounts. Some Main Street advisors may choose to exit the SEP and SIMPLE IRA marketplace in light of the costs and risks of compliance with the new rule.

Locked Out of Retirement

The Threat to Small Business Retirement Savings

U.S. CHAMBER OF COMMERCE

Benefits of SEP and SIMPLE IRAs

SEP and SIMPLE IRAs provide benefits for more than 9 million households because they are simpler for employers to offer than 401(k)s, but give employees more generous benefits than traditional IRAs not offered through employers. Though SEP and SIMPLE IRAs are built around IRAs, they are plans provided by the employer, and the tax laws permit more tax-preferred contributions than are allowed in a non-employer provided IRA, which limits contributions to $5,500 in 2015 ($6,500 for individuals 50 and older). SEP and SIMPLE IRAs are different from one another, however, and one may be better for a particular small business over another.

SEPs and SIMPLE IRAs are simplified plans presenting less administrative burden than 401(k) and other plans. For example, unlike many other plans, the assets and investments in SEP and SIMPLE IRAs are held within each participating employee's IRA account rather than in a common trust account. This reduces the record keeping at the plan level. Likewise, unlike other plans, there is no annual Form 5500 filing requirement for a SEP IRA or SIMPLE IRA, a significant cost savings in and of itself. Perhaps the most significant differences relate to investments. Under a traditional 401(k) or other defined contribution plan, the employer (or its plan committee, etc.) must evaluate, select, and monitor each of the core investment options offered to participants. There has been a significant uptick in lawsuits against 401(k) plan sponsors in recent years, often alleging excessive fees and expenses associated with selected investments.

For a SEP IRA or SIMPLE IRA, the investment funds offered are not individually selected by the employer—rather, they generally constitute a broad range of alternatives offered by the vendor through its IRA platform. The employer does not generally have involvement with monitoring the options or instructing the IRA vendor to add, replace, or discontinue the alternatives made available. Employers considering a SEP IRA or SIMPLE IRA that select the IRA vendor should review potential providers and make a prudent determination that the vendor selected offers a suitable product at a commercially reasonable price. Likewise, DOL guidance indicates that employers should periodically monitor the vendors (that is, the IRA trustees) to ensure they are doing their jobs and not charging unreasonable fees.[5] But, in comparison with a traditional qualified plan, the employer's fiduciary obligations as to a SEP IRA or SIMPLE IRA are very limited in scope. Not only does this limit the fiduciary liability of small business owners, but it also allows them to focus more of their time in managing and growing their business while increasing jobs.

Of course, the significant reductions in cost and administrative burdens also mean that SEP IRAs and SIMPLE IRAs are less flexible than traditional retirement plans. Employers have less ability to limit eligibility for participation, to vary contribution amounts for different employee groups,

[5] *See* DOL, SEP Retirement Plan for Small Businesses, "Monitoring the Trustee," *available at* http://www.dol.gov/ebsa/publications/SEPPlans.html; *and* SIMPLE IRA Plans for Small Businesses, "Monitoring the Trustee," *available at* http://www.dol.gov/ebsa/publications/simple.html.

and to offer certain other features than they would under a traditional qualified plan. However, this loss of flexibility is often a blessing in disguise for small businesses—with the flexibility of a traditional qualified plan comes complex nondiscrimination testing, numerous participant disclosures, government reporting, vendor oversight, and day-to-day administrative tasks.

SEP IRAs

SEP IRAs provide benefits similar to qualified profit sharing plans, in that contributions are funded by the employer. Contributions are limited to 25% of each eligible employee's compensation, and the same percentage must be applied for each eligible employee. Annual contributions are also capped at $53,000 (for 2015) and cannot be based on compensation exceeding $265,000 (also for 2015), which are the same limits that apply to qualified defined contribution plans. Employees are not allowed to contribute to a SEP IRA, but they benefit from the employer contributions, which are not taxed to the employee until the funds are withdrawn at retirement. As such, SEP IRAs are mostly utilized by sole practitioners or employers with a very small number of employees.

A SEP IRA can be established by executing Form 5305-SEP, issued by the Internal Revenue Service (IRS), or another prototype or individually designed plan document. All contributions are immediately 100% vested, and can generally be withdrawn or rolled over according to the same rules governing traditional IRAs.

Once a SEP IRA is established, the employer may, but is not required to, make contributions each year. Each eligible employee must be provided with certain information about the SEP IRA, and must have an IRA account established for his or her benefit. Eligible employees, subject to a few exceptions, generally include all employees who (i) receive $600 or more in compensation during the year (for 2015), (ii) are at least 21 years of age, and (iii) have worked for the employer during three of the previous five years. The employer can always be more generous in terms of eligibility, but cannot exclude employees who meet these eligibility criteria.

SIMPLE IRAs

SIMPLE IRAs are an option for employers that do not maintain other retirement plans, and have 100 or fewer employees. If the business grows, a two-year grace period is allowed in most cases after the 100-employee threshold is exceeded to transition to a 401(k) plan or some other retirement plan. SIMPLE IRAs are more similar to 401(k)s—eligible employees can make elective deferral contributions from their own pay, subject to a $12,500 annual limit (for 2015, plus up to $3,000 in catch-up deferrals for employees aged 50 and over), and employers make either (i) a dollar-for-dollar matching contribution on elective deferrals up to 3%, or (ii) a flat (nonmatching) contribution for all eligible employees equal to 2% of compensation. Again, contributions cannot be based on compensation exceeding $265,000.

Locked Out of Retirement

The Threat to Small Business Retirement Savings

U.S. CHAMBER OF COMMERCE

A SIMPLE IRA can be established by executing IRS Form 5304-SIMPLE or 5305-SIMPLE (depending on whether each employee can select his or her own IRA institution, or if there is a designated financial institution for the entire arrangement), or another prototype or individually designed plan document. Again, all contributions are immediately 100% vested, and can generally be withdrawn or rolled over according to the same rules governing traditional IRAs. Once a SIMPLE IRA is established, each eligible employee must be provided with certain information about the SIMPLE IRA, and must have an IRA account established for his or her benefit. Eligible employees, subject to a few exceptions, generally include all employees who are expected to earn at least $5,000 in compensation during the year, and have earned $5,000 or more during any previous two years. Again, the employer can always be more generous in terms of eligibility, but cannot exclude employees who meet these eligibility criteria.

Small Businesses Are Most Harmed by the DOL Proposal

The DOL proposal expands the universe of financial advisors considered to be fiduciaries. The effect of being a fiduciary is that many traditional compensation arrangements, such as commissions that vary from investment to investment, utilized by advisors to SEP and SIMPLE IRAs would no longer be permitted. Unfortunately, the proposal puts small business retirement plans at a further disadvantage relative to large employer plans because they are not treated the same.

Small Business Advisors Unfairly Excluded From the Seller's Carve Out

The DOL proposal "carves out" large plan advisors from fiduciary status. If a plan has 100 or more participants, or $100 million or more in plan assets, the advisor to that large plan does not have to be a fiduciary, while an advisor to a small plan does. Because an advisor to a small plan is not carved out of the rule, the advisor who is trying to market retirement saving vehicles to a small plan is considered to be providing investment advice and must determine how to comply

Realizing the Impact

Consider Kathleen's Wedding Kakes, a hypothetical small business in Tucson, Arizona, that employs about eight people in its shop, bakery, and delivery service. Like most small business owners, the founder, Kathleen Carver, wanted to help her employees save for their retirements, but because her business was so small, she could not afford to offer a traditional 401(k).

Instead, she established SEP IRAs for each of her employees, and contributes matching funds each month. When these new rules go into effect, the cost of offering these plans could significantly increase. Her financial advisor says he may have to change his whole business model, and that he may not be able to afford to spend the time it takes to help her and her employees with their small account balances unless he charges higher, up-front fees. If this happens, Kathleen will have to reassess her ability to offer this important benefit to her employees.

with the rule. This advisor must either now provide advice for a level fee or, if the advisor has variable compensation, he or she must comply with the many conditions of an applicable prohibited transaction exemption (an exemption that may still limit fee variation). Advisors to large plans are not burdened with these additional hurdles under the carve out. Due to these additional burdens, advisors to small plans are likely to incur additional costs, which will be passed on to the plan. Further, some advisors to small plans may determine that the small-scale of such plans means the expense and risk of changing business models and fee structures is not justified, and may no longer offer their services to small plans.

It does not make sense that small business plans should have to absorb costs that large plans do not simply because of regulatory fiat. While DOL may intend this as "extra protection" for small plans, it really represents "extra cost." SEP IRAs and SIMPLE IRAs are popular among small businesses because they are cheaper and easier to offer and operate than 401(k) plans; therefore, imposing additional costs would make SEP and SIMPLE IRAs less attractive to small business owners, making it harder to offer plans to their employees.

The Proposal Will Increase the Cost of Providing Services to Small Businesses

Because advisors to small businesses are not carved out of the fiduciary definition, they must change their fee arrangements, or qualify for a special rule called an "exemption" in order to provide services on the same terms as before. However, the new exemption proposed by the DOL may not apply to small business plans. It does apply to individual owners of IRAs, but it is not clear whether this exemption is available for SEP and SIMPLE IRAs while they are being offered by the employer. Further, even if it does apply, the new exemption—called the "Best Interest Contract Exemption"—would itself substantially increase costs for advisors due to its many conditions and requirements.

The reason the DOL regulatory package causes such significant change is that a fiduciary investment advisor under ERISA generally has engaged in a prohibited transaction if the advisor recommends investments that either pay the advisor a different amount than other investments, or that are offered by affiliates (for example, the advisor is connected with the insurance company that offers the investment). There are certain exceptions to these rules, called "prohibited transaction exemptions," but as the DOL has proposed the new rules, the exemptions generally won't help Main Street financial advisors who are working with small businesses to set up plans. Therefore, it may be illegal for those advisors to get commissions or to recommend certain investments.

For example, it may not be possible for a bank official to recommend that an IRA invest in the bank's own certificates of deposit under some circumstances. Or if a financial institution provided SEP IRA or SIMPLE IRA marketing materials to a prospective small business client, and those materials described a sample allocation that included some of the institution's own investment products, the marketing materials could be viewed as prohibited advice.

One way advisors might try to comply is by charging a flat fee for their SEP or SIMPLE IRA services. However, many IRA vendors prefer not to charge a direct fee to account holders, and many account holders prefer not to pay flat fees, especially in small accounts where a flat fee may be a significant portion of the assets. Logically, a vendor must generate a certain amount of revenue from servicing a SEP IRA or SIMPLE IRA account to generate some profit from it, or it will not provide the service. If advisors and vendors change to a flat fee model, they may actually charge more than before to account for the risk and expense associated with changing their method of doing business. This potential loss of low-cost investment assistance was one of the reasons why the DOL's previous proposal to redefine fiduciary investment advice several years ago—a proposal that was ultimately withdrawn—raised objections from many within Congress.[6] It is important to note, however, that some advisors may already be compensated in a manner consistent with the proposed DOL requirements, though this is less common in IRAs and small 401(k) plans.

How to Make a Difference

The public comment period for this proposal is open until July 20, 2015. After the comment period, there will also be public hearings at DOL. After all of the comments and hearings are concluded, DOL will have to review the comments and take them into account in writing a final rule. In all likelihood, this process will not be complete until sometime in 2016, and DOL proposed an eight-month transition period before the final rule would take effect.

To be most effective, the DOL proposal needs to strike a proper balance between protecting the interests of retirement investors and ensuring they have access to reasonably priced investment services. To accomplish this, advisors and financial institutions need to be provided with practical and clearly defined boundaries as to what is or is not fiduciary investment advice, as well as with commercially realistic and reliable standards.

Under the current proposal, Main Street advisors are very concerned that there may be no reasonable avenue to communicate meaningfully with individual and small plan investors (including SEP IRAs and SIMPLE IRAs) about matters related to investments without incurring potentially significant new costs and legal risks.

[6] *See, e.g.* Letter from members of the Congressional Black Caucus serving on the House Financial Services Committee to then-Acting Labor Secretary Seth Harris dated March 15, 2013, warning that the "if the re-proposal reflects the Department's initial fiduciary proposal it could disparately impact retirement savers and investment representatives in the African American community…We are particularly concerned about the effects these regulations will have on savers in [IRAs]. If brokers who serve these accounts are subject to ERISA's strict prohibitions on third-party compensation, they may choose to exit the market…[i]f that occurs, it could cause IRA services to be unattainable by many retirement savers in the African American community."

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Chairman ROE. Our goal as policymakers should be to advance bold bipartisan solutions that will help more Americans plan, invest, and save for retirement. Regrettably, the Department's fiduciary regulation would move our country in the opposite direction. It would cut off a vital source of support too that many low- and middle-income families and small-business owners rely on, and that is the help of a trusted financial adviser.

Four years ago, the Subcommittee examined a similar proposal that was later withdrawn under intense bipartisan opposition. I said at the time that anyone who provides investment assistance should be well-trained, committed to high ethical and professional standards, and devoted to the best interests of those they are serving.

That is why financial advisers have long been subject to a host of securities, tax, and disclosure requirements. It is a complex system of rules and regulations, but it is an important one that has worked well for decades.

That doesn't mean we shouldn't look for opportunities to improve current standards, but we cannot in any way make it harder for workers, retirees, and small-business owners to receive the financial advice they need.

Yet that is precisely what this regulatory proposal would do. Offering some of the most basic assistance would be prohibited, such as advice on rolling over funds from a 401(k) to an IRA. Financial advisers would no longer be able to assist individuals on how to manage their funds on retirement. And small-business owners would be denied help in selecting the right investment options for their workforce, which would lead to fewer employees enrolled in a retirement plan.

It has been suggested on numerous occasions that this proposal will simply apply to financial advisers the same standard recognized in the medical profession.

Mr. Secretary, I believe you have drawn that comparison from time to time and it is a clever talking point, but one that couldn't be more flawed.

As a physician with more than 30 years of experience in treating patients, let me just say that the approach reflected in this proposal would destroy what is left of our health care system. Imagine what would happen if doctors were prohibited from receiving compensation or were required to sign a contract with each patient before delivering services or were forced to publish online each and every treatment that had been prescribed the following year.

No doctor could run a successful practice under this type of regulatory regime and no responsible financial adviser will be able to, either.

Make no mistake. If this rule goes into effect, a lot of people will quickly learn that their financial adviser, someone they have known and trusted for years, will no longer be able to take their call.

And it is important to note that low- and middle-income families are the ones who will bear the brunt of this misguided proposal. They will lose access to their personal service that they have relied on and be forced to find suitable advice online or simply fend for themselves.

As is often the case with big-government schemes, the wealthiest Americans will do just fine. And those we really want to help we will hurt the most.

Mr. Secretary, this latest fiduciary proposal will lead to the same harmful consequences as the first and should suffer the same fate. Please withdraw this proposal and work with this committee on a responsible, bipartisan approach that will strengthen protections for investors and preserve robust access to financial advice. Our nation's workers and retirees deserve nothing less.

With that, I will now recognize the ranking member of the subcommittee, Congressman Polis, for his opening remarks.

[The statement of Chairman Roe follows:]

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

Good morning. I'd like to begin by extending a special welcome to Secretary Perez. We appreciate your willingness to engage in open and frank conversations about important issues facing working families and job creators. I know there are areas where we disagree, but we always welcome the opportunity to raise our concerns and lay out what we believe are more positive alternatives.

I wish we were here to discuss a proposal that enjoyed broad bipartisan support, one that would help strengthen our economy and improve the lives of hardworking men and women. Unfortunately, that's not the case. Instead, we are here to address a regulatory scheme that will hurt a lot of families, retirees, and small business owners, and it could not come at a worse possible time.

One of the most difficult challenges we face as a country is a lack of real retirement security for America's families. The defined benefit pension system continues to experience a decades-long decline, while many workers are still rebuilding the savings they lost in the recent recession. Due to these and other challenges – including a persistently weak economy – too many workers are retiring without the means necessary to ensure their financial security.

Our goal as policymakers should be to advance bold, bipartisan solutions that will help more Americans plan, invest, and save for retirement. Regrettably, the department's fiduciary regulation would move our country in the opposite direction. It would cut off a vital source of support many low- and middle-income families and small business owners rely on, and that is the help of a trusted financial advisor.

Four years ago, the subcommittee examined a similar proposal that was later withdrawn under intense bipartisan opposition. I said at the time that anyone who provides investment assistance should be well trained, committed to high ethical and professional standards, and devoted to the best interests of those they are serving.

That is why financial advisors have long been subject to a host of securities, tax, and disclosure requirements. It is a complex system of rules and regulations, but it is an important one that has worked well for decades. That does not mean we shouldn't look for opportunities to improve current standards. But we cannot – in any way – make it harder for workers, retirees, and small business owners to receive the financial advice they may need.

Yet that is precisely what this regulatory proposal would do. Offering some of the most basic assistance would be prohibited, such as advice on rolling over funds from a 401(k) to an IRA. Financial advisors would no longer be able to assist individuals in how to manage their funds upon retirement. And small business owners would be denied help in selecting the right

investment options for their workforce, which will lead to fewer employees enrolled in a retirement plan.

It has been suggested on numerous occasions that this proposal will simply apply to financial advisors the same standard recognized in the medical profession. Mr. Secretary, I believe you have drawn that comparison from time to time. It is a clever talking point, but one that couldn't be more flawed.

As a physician with more than 30 years of experience treating patients, let me just say that the approach reflected in this proposal would destroy what's left of our health care system. Imagine what would happen if doctors were prohibited from receiving compensation, or were required to sign a contract with each patient before delivering services, or were forced to publish online each and every treatment that had been prescribed the following year. No doctor could run a successful practice

under this type of regulatory regime, and no responsible financial advisor will be able to either.

Make no mistake, if this rule goes into effect, a lot of people will quickly learn that their financial adviser – someone they may have known and trusted for years – will no longer be able to take their call. And it is important to note that low- and middle-income families are the ones who will bear the brunt of this misguided proposal. They will lose access to the personal service they rely on and be forced to find suitable advice online or simply fend for themselves.

As is often the case with big government schemes, the wealthiest Americans will do just fine and those we want to help will be hurt the most. Mr. Secretary, this latest fiduciary proposal will lead to the same harmful consequences as the first and should suffer the same fate: Please withdraw this proposal and work with this committee on a responsible, bipartisan approach that will strengthen protections for investors and preserve robust access to financial advice. Our nation's workers and retirees deserve nothing less.

With that, I will now recognize the Ranking Member of the subcommittee, Congressman Polis, for his opening remarks.

Mr. POLIS. Thank you, Mr. Chairman.

Today we will be discussing an important issue that has been simmering for several years now after the Department of Labor chose to modify the first version of this rule several years ago, they have been working to listen to a broad spectrum of stakeholders on how best to proceed.

And I think that everybody in the room on all sides of this issue believes in a best-interest or fiduciary standard because I think we are all here out of concern that the clients' interests should be paramount.

But what this comes down to is how to make that happen and how to implement the rule in a way that makes sense and benefits consumers.

I truly believe today that most advisers do what is in the best interest of their clients, and hopefully the final rule won't be an overwhelming burden on those good actors.

However, providing a standard that those few bad actors need to abide by is absolutely essential, as well as to improve transparency in the industry.

As we all know, most Americans are not saving enough for retirement. It is essential that what little is being invested should not be biased by conflicted advice. Investors should be able to trust the person advising them about the money they need to live after retirement without having to worry about that adviser's self-interest.

On the other side of the coin, we need to protect individuals and small businesses to make sure that they have access to quality advice, because mistakes in investments cost billions of dollars, and good advice is well worth the price.

I am thankful to all of our witnesses for coming today to share their experience, and I am particularly glad that we are beginning with the Secretary of Labor. And I am glad to hear that he is interested in hearing our feedback about the rule. And I am thrilled that he has decided to extend the comment period by an additional 15 days.

I know that he has been working diligently on an overall goal of expansion of retirement savings as a way to address the retirement crisis. They have been doing a great deal of work in the Department of Labor on financial literacy, increasing effective enforce-

ment by the Employee Benefits Security Administration, providing technical assistance to employers and workers and retirees about saving for retirement.

A good, workable rule regarding a best-interest standard can help increase trust between a client and their adviser, and that is an important part of expanding retirement savings.

I don't think anybody thinks that the current rule is perfect, and that is why I am thrilled we are having this conversation and that the Secretary has extended the comment period for 15 more days.

I will be asking some in-depth questions, both at this hearing as well as for the record, because although I believe that this process should continue forward to close a loophole and establish a fiduciary standard that reflects today's retirement landscape, we also need to understand and fix any unintended consequences, especially for low- and middle-income investors and small businesses.

Ensuring that people are receiving good, affordable, conflict-free advice should be our end goal here. And I look forward to hearing in-depth answers from the knowledgeable questions from the members of this committee so that we can help the Secretary reach an end result that helps those most in need and improves trust in the client-adviser relationship and leads to greater retirement savings for Americans.

Thank you, and I yield back the balance of my time.

[The statement of Mr. Polis follows:]

Prepared Statement of Hon. Jared Polis, Ranking Member, Subcommittee on Health, Employment, Labor, and Pensions

Today we discuss an important issue that has been simmering for the past five years. After the Department of Labor retracted the first version of this rule several years ago, they have been working to listen to a broad spectrum of stakeholders on how to proceed.

I believe that everyone in the room, on every side of this issue, believes in a "Best-Interest or Fiduciary Standard" because the client's interest should be paramount. What this comes down to is how to make it happen, and how to implement this rule in a way that makes sense.

I truly believe that today most advisors do what is in the best interest of their clients, and the final rule needs to not have an overwhelming burden on those good actors. However, providing a standard that those few bad actors need to abide by is absolutely essential.

As we all know, today, most Americans are not saving enough for retirement. It is essential that what little is being invested must not be biased by conflicted advice. Investors must be able to trust the person advising them about the money they need to live after retirement. On the other side of the coin we must protect individuals and small businesses access to advice. Because mistakes in investments cost billions of dollars.

I am thankful to all of our witnesses for coming today in order to share their expertise. We are all interested in learning why this is necessary and how this will impact advisors; but more importantly how it impacts the advice individuals receive.

I am especially glad The Secretary of Labor has joined us. I know he is glad to be hearing feedback about the rule, and I am especially pleased that he decided to extend the comment period by an additional 15 days.

I know that he has been working diligently on an overall goal of "expansion of retirement savings" as a way to address the retirement crisis. They have been doing a great deal of work on financial literacy, they have increased effective enforcement by the Employee Benefits Security Administration and technical assistance that has been provided to employers, workers and retirees. A good workable rule regarding a best-interest standard will increase trust between a client and their advisor, and I know we all agree that is necessary part of expanding retirement savings.

I don't think the Secretary or anyone on his staff would say this rule is perfect, but that is why having this conversation and having a comment period is so vital.

I will be asking some very in-depth questions now and also for the record, because although I believe this process needs to continue forward to close a loophole and establish a fiduciary standard that reflects the retirement landscape as it looks today, we need to understand and fix any unintended consequences, especially for low and middle-income investors and small businesses.

Ensuring that people are receiving good, affordable, conflict-free advice should be, and I believe is the end-goal for everyone.

Chairman ROE. I thank the gentleman for yielding.

Pursuant to committee rule 7(c), all subcommittee 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 statements, questions for the record and other extraneous material referenced during the hearing to be submitted in the official hearing record.

It is now my pleasure to introduce our distinguished witness on the first panel.

The Honorable Thomas E. Perez was sworn in as the 26th U.S. Secretary of Labor on July 13, 2013. Prior to his confirmation, he served as Assistant Attorney General for Civil Rights at the U.S. Department of Justice and as the Secretary of Maryland's Department of Labor, Licensing and Regulation.

Mr. Secretary, I will ask you to stand and raise your right hand.

[Witness sworn.]

Let the record reflect the witness answered in the affirmative.

You may be seated.

Before I recognize you for your testimony, let me briefly review so you understand the lighting system; you will have five minutes; we will have some latitude with that with the Secretary here.

And with that, you are recognized.

TESTIMONY OF HON. THOMAS E. PEREZ, SECRETARY, U.S. DEPARTMENT OF LABOR, WASHINGTON, D.C.

Secretary Perez. Good morning. Thank you, Mr. Chairman. It is a pleasure to be here, Ranking Member Polis, Chairman Kline, and other members of the Committee. It is an honor to be here, and thank you for allowing me to come to discuss the Department's important efforts to help ensure that your constituents and all Americans have access to sound investment advice that a middle-class retirement requires.

Merlin Toffel did everything right. He was a veteran of the U.S. Navy and an electrician. He and his wife, Elaine, raised their four kids in Lindenhurst, Illinois, and instilled in them those middle-class values befitting of their greatest generation.

They loved to travel. They worked hard and they took care to save wisely. Over four decades, they built up an impressive portfolio with Vanguard: Merlin at the helm managing the account and Elaine, an accountant, keeping the books.

Life took its toll. Merlin was diagnosed with Alzheimer's. When Merlin could no longer manage their finances, Elaine made an appointment at the local retail bank. This is the bank they had been using for years. They trusted them.

The bank's investment broker told her to liquidate the impressive Vanguard portfolio and sold them variable annuities to the

tune of $650,000. Elaine trusted that advice. It was in her best interests, she thought.

But those variable annuities charged nearly 4 percent of the investment per year, or $26,000, the rough cost of buying a new car each year. And if the Toffel's needed to access the money right away, as all too many families face when their loved one is in decline, a 7 percent surrender charge would cost them more than $45,000.

In the end, the broker's conflicted advice cost a hardworking, middle-class family more than $50,000.

The Toffel's story is tragic, but regrettably is it not unique.

Conservative estimates by the Council of Economic Advisers place the cost of conflicted advice at more than $17 billion annually. Our economic analysis shows that conservatively the amount that savers would benefit from our rule, and this is only based on a slice of the IRA market, would be $40 billion over 10 years.

For families like the Toffels, families who have done everything we ask of the American middle class, the stakes could not be higher.

ERISA is over four decades old. In my parents' generation, average Americans retired after working their entire life in the same company. Their retirement was met by with both a commemorative pen and a concrete pension. Because that pension was a defined benefit, the only thing at risk of running dry was the ink in the pen.

But times have changed. Defined benefit plans have given way to defined contribution plans. Now consumers are in control of making their own investment decisions through from 401(k)s and IRAs. We can still count on that commemorative pen, but a secure retirement is less predictable.

For the majority of Americans without a finance degree, the market is, at best, a confusing place.

I appreciate the fact that you are a very distinguished doctor in addition to a member of Congress, Mr. Chairman. I have four siblings and they are all doctors. And you know, I am a lawyer, and I promised them I would never be a plaintiff's personal injury lawyer, and I kept that promise, no disrespect to any plaintiff's personal injury lawyers around the table.

But you know what? As I said, three of the most important decisions that people make in their lives are medical, legal, and financial. And I know my siblings, the doctors, they understand that they have a very concrete obligation to put their patients' best interests first, just as I as a lawyer have an obligation to put my clients' best interests first. That is clear.

And most people assume that the same holds true for their financial professionals. But that is not necessarily the case.

Indeed, many of those working in the retirement space are in fact doing the right thing. Many of them are fiduciaries already, having taken an oath to serve in the best interests of their clients.

Yet many more are not fiduciaries, and despite marketing that might suggest otherwise, they operate under no such commitment to do what is in the best interests of their clients.

When seeking advice on retirement, consumers are at an informational disadvantage. This playing field is not level.

But this is not simply about people who do bad things. I actually think, and I agree with both the Chairman and the Ranking Member, that the vast majority of people who provide advice are trying to do the right thing. I have not heard from anyone who said that I don't do anything but try to put my customers' best interests first.

But the challenge is that the system is flawed. They are operating within a structurally flawed system, a market that sees the personal financial interests of the adviser and the firm all too frequently misaligned with the best interests of the customer.

So the Labor Department's conflict of interest proposal has a singular goal: to align the best interests of the customer with those of the adviser and the firm. Simply put, we want to create an enforceable best-interest standard so that you can have certainty that your financial adviser is working for you first and foremost.

This proposed rule is a product of lengthy, exhaustive outreach. It includes extensive consultation with the SEC, whose expertise has been invaluable as we have developed this rule. Our outreach to the SEC was not a box-checking exercise, it was critical to the rulemaking and it has helped us make a better proposal.

The proposed rule was also following very significant outreach to representatives of consumer groups, the financial services industry and members of Congress. And we appreciate that input that we have gotten throughout the process.

We have established a lengthy comment process of roughly 140 days, which is one of the longest that we have done in a rule, and for good reason.

Throughout this outreach process, I have been very heartened by the calls that we have gotten from many in the industry to establish a best-interest standard.

So for instance, John Thiel, the head of Merrill Lynch Wealth Management, said, "Since 2010, we have supported the notion of a consistent and higher standard for every professional that deals with the American investor and those that deal with retirement plans. As an organization, we have provided input to policymakers in Washington. We believe we were heard and we will have an additional opportunity to comment."

The CEO of Bank of America, Brian Moynihan, said, and I quote: "We believe that doing what is in the best interests for your customers is absolutely the right thing to do. We have been clear that we see the industry moving and we expect to help it move there."

There is an increasing recognition inside and outside the industry that the best-interest standard is in fact the right way to go. The debate has shifted unmistakably from what problem to an acknowledgment of the problem that people providing investment advice should have an enforceable obligation to look out for their customers' best interests.

And now the important questions that remain, and I agree with the Ranking Member, is how do we operationalize this standard?

And we look forward to the feedback and constructive dialogue that we continue to have so that we can get ideas on how best to operationalize this because leaders of large and small businesses alike have recognized not simply that this is the right thing to do, but it is the smart thing to do.

Jack Bogle, the founder of Vanguard, said, and I quote: "For as long as I can remember I have pressed for a federal standard of fiduciary duty, a simple rule that stresses that clients come first."

Mr. Bogle has 64 years in the business and he said, "I learned early on that when you put your customers' interests first it is great for your customer and it is great for business."

He has retired, but Vanguard's competitiveness has not.

And while Jack Bogle, who built Vanguard, understands the importance of acting in the best interests of his clients, so do many small- and medium-sized companies.

Wealthfront is a relatively small investment adviser just shy of four years old. And they wrote to us recently to say, and I quote: "We were built from the ground up to operate under the full fiduciary standard despite serving small accounts and charging incredibly low fees. Thankfully, our effort to serve the small investor has been rewarded with unprecedented growth. Wealthfront is living proof that not only is it possible to provide fiduciary service at low cost to small investors nationwide, but also that the market greatly rewards these efforts."

This is what we are hearing from members of the industry. And what we are hearing is that the rule is good news for both American workers and retirees and everyone who is leaving a job and deciding what to do with their hard-earned money.

But ultimately, it is not about simply the firms, it is about the people. The middle-class life rests on five pillars: fair pay, a roof over your head, health care for your family, education for you and your children, and the ability to save for you and your family's retirement.

I totally agree with you, Mr. Chairman, that we have a retirement crisis. We have got to save more. And what we are trying to do in this rule is to ensure that the hard-earned money that people have saved throughout their career can go to them and at the same time making sure that we have an industry that continues to be able to do good and do well. You can do both.

And I look forward to hearing your questions and concerns. And I look forward to continuing the outreach because it has been a very, very constructive process for the two years, or roughly two years, I have been in this job. I have appreciated the input from many members of this Committee who have helped us frame an even better rule.

So thank you, Mr. Chairman, for your courtesy. And I look forward to your questions and those of everyone on the Committee.

[The testimony of Secretary Perez follows:]

STATEMENT OF
THOMAS E. PEREZ, SECRETARY
U.S. DEPARTMENT OF LABOR
BEFORE THE
HEALTH, EMPLOYMENT, LABOR AND PENSIONS SUBCOMMITTEE
COMMITTEE ON EDUCATION AND THE WORKFORCE
U.S. HOUSE OF REPRESENTATIVES

JUNE 17, 2015

Thank you for the invitation to appear before the Subcommittee to speak about the Department's proposal to protect workers from conflicts of interest in retirement investment advice. As this Subcommittee explores the issues facing America's workers, I'm pleased to have the chance to discuss this rulemaking, and hope that we can continue to engage in a productive dialogue throughout the remainder of the comment period and the public hearing process. We believe that we have proposed a reasonable, middle-ground approach that is responsive to our extensive outreach and feedback. It is grounded in a basic principle – that investment advisers should act in their clients' best interest, not their own. The proposal remains open for comment in the *Federal Register* and I want to assure all stakeholders, including Congress, that the Department is very open to input to further refine, clarify, and improve this rule.

Retirement security is a fundamental pillar of the middle class. We must ensure that Americans who work hard and save responsibly for retirement are getting a fair share of the returns on those savings. This Subcommittee knows too well that there is a retirement crisis in America and that not enough Americans are saving for retirement. I'm deeply concerned that even if you've done the right thing, worked hard, and saved what you could, you could end up in a situation where you do not have what you need for retirement simply because your adviser isn't required to put your interests first. The majority of advisers already do the right thing and serve their clients' interests first, but most Americans do not have room for error and cannot afford to invest in products with unnecessarily high fees or low returns that benefit their advisers but do not meet their own needs.

Throughout my career, I've seen over and over again that making the right financial decisions is critical to a person's life and future, but that far too often, people don't have the information and tools they need to make the best decisions. When I was in state government and at the Justice Department, I saw firsthand how the foreclosure crisis turned the American Dream into a nightmare for millions of families; I saw how it turned thriving communities into decaying neighborhoods.

The crisis was a function of inadequate regulation and irresponsible, sometimes predatory, lending practices. But it was also a stark reminder of how little so many of us understand the biggest financial decisions we make, and how we so often have to rely on what we are told by professionals, and to trust that they're giving us the best information.

The biggest decisions we're faced with fall into one of three categories: medical, legal or financial. Most people know that lawyers and doctors have an obligation to look out for what's best for you. When you go to a doctor, you expect to get advice that's in your best interest. If you have cancer, you don't want your doctor telling you just what's "suitable" for you. You need your doctor to tell you what's *best* for you. When you hire an attorney, that attorney is legally bound to work in your best interest.

And most people assume the same is true for professionals who provide financial advice. You should expect that when you are relying on someone to provide retirement investment advice, they are going to tell you what is best for you, not what earns the most money for them. But in reality, conflicts of interest and hidden fees too often result in bad advice that is not in our best interests.

There are many advisers who work every day to do right by their clients. Some financial advisers commit to serve your best interests. But others operate under no such commitment, and there's nothing stopping them from getting backdoor payments at their client's expense. The corrosive power of fine print and buried fees can eat away like a chronic illness at a person's savings.

An analysis by the Council of Economic Advisers concluded that this kind of conflicted advice leads to losses totaling about $17 billion every year for IRA investors. Losses due to conflicts of interest, on average, reduce returns for affected savers by about 1 percentage point per year. Over 35 years of saving, this could reduce savings by more than a quarter. And in many cases, the affected consumers don't even know it is happening. The lack of rules of the road is confusing, it creates an un-level playing field, and it hurts working people who just want to be able to save enough to retire comfortably.

When I became Labor Secretary nearly two years ago I committed to slowing this rulemaking in order to ensure that we got it right. During that time, my review of the evidence has demonstrated that there is in fact a large problem that needs to be solved. I heard from too many hard working Americans whose golden years became tarnished when the savings they thought would carry them through retirement disappeared into high fees and poor performance. One of the people whose story I learned is named Phil, a retiree from California. In 2002, Phil was offered a buyout from the company where he had worked for 30 years, and he was presented with three choices: he could ignore the offer and keep working; he could take the company's pension and receive a monthly check of $1,500 for life; or he could take a lump sum of $355,000 – money he had earned. After talking it over with his wife, he decided to call a financial adviser whom the company had brought in a few years prior to provide some retirement advice to employees.

That adviser came to Phil's house, and sat with them at their kitchen table. She encouraged Phil and his wife to take the lump sum and let her invest it for them. When Phil came to Washington recently to tell lawmakers his story, he said "*I will admit, being a blue-collar union employee*

and being watched over, cared for and protected by the company and the union my entire career, I was ignorant when it came to these financial matters I had to deal with, and I needed professional help." As so many of us do every day, Phil and his wife trusted the adviser to guide them in the right direction.

But she didn't do what was in their best interest. Instead, she put Phil's money in investments that weren't appropriate for him, and she misled him about how much monthly income he could safely withdraw. Today, Phil and his wife have lost nearly all of their savings. They live on a strict budget and shop at thrift stores. They're at risk of losing the home they've lived in for more than 40 years. They won't have anything to leave for their kids or grandkids.

In addition to stories like this, the Department's own economic analysis conservatively estimates that the proposed regulatory package would save investors more than $40 billion over ten years, even if one focuses on just the one subset of transactions that have been the most studied. The real savings are likely much larger as conflicts and their effects are both pervasive and well hidden.

Even as I became more convinced of the problem, I knew that we had to act carefully to solve it in a way that protected people like Phil, but that avoided unwarranted disruption to the industry. As I assured this Committee when I appeared before you just a couple of months ago, our proposal serves three main principles: (1) it updates our regulation to protect retirement savings in the much-changed retirement landscape; (2) it allows flexibility so the industry can use its knowledge and expertise to find the best way to serve its clients and continue to innovate; and (3) it meaningfully responds to the input we received in the extensive outreach that we have conducted. I would like now to show how I believe our proposed rule honors those three principles.

The existing DOL rule was put in place a generation ago, in 1975, when most of America's workers did not have to worry about making decisions regarding how to invest their retirement savings. But now that the retirement landscape has changed, our rules have to change as well. When the rules were last overhauled almost forty years ago, Individual Retirement Accounts had just been created and employer-based 401(k)s did not even exist. Today, America's workers have more than $7 trillion invested in IRAs and more than $5 trillion in 401(k)-type plans, which, combined, exceed the value of traditional pension benefits. As more baby boomers retire, more and more of them are moving their retirement savings from employer-sponsored plans into IRAs, making the protection of rollovers and IRAs increasingly important. Congress created and encouraged the growth of this 401(k) and IRA marketplace by giving those savings tax preference – as a result, under ERISA and the tax code, we have an obligation to ensure that those savings are protected.

The proposal will close the loopholes in the 1975 DOL rule that today make it possible for advisers to exclude from protection the kind of advice relationships that are common now for 401(k) and IRA holders. Under the proposal's new definition, a fiduciary is a person providing investment advice for a fee or other compensation with respect to a plan or IRA if either the person doing so acknowledges he or she is acting as a fiduciary within the meaning of ERISA or the Internal Revenue Code OR the advice is provided pursuant to an agreement or understanding, written or verbal, that the advice is individualized to, or specifically directed to, the advice recipient for consideration in making investment or management decisions with respect to investments of plans or IRAs.

To serve our second principle to allow maximum flexibility, the proposal that we published in April does not include detailed rules as to what advisers can and cannot do to serve their clients. Instead, the proposal has one fundamental tenet that should be unassailable -- retirement advisers should put the best interests of their clients above their own financial interests. This proposal is intended to provide guard rails, but not to be a straightjacket, because we know there is not a one-size-fits-all solution to putting clients' interests first.

Our proposal's second principle is best illustrated by the proposal's carve outs and exemptions, which allow for flexibility and workability. The proposed exemptions from ERISA's prohibited transaction rules would broadly permit firms to continue common fee and compensation practices, as long as they are willing to adhere to basic standards aimed at ensuring that their advice is in the best interest of their customers. Rather than create a highly prescriptive set of transaction-specific exemptions, the Department instead is proposing a set of exemptions that accommodate a wide range of current business practices, while minimizing the harmful impact of conflicts of interest on the quality of advice.

At the heart of the proposal is the best interest contract that would govern the advisory relationship if the adviser is receiving conflict of interest fees or other payments. It is an innovative approach designed to respect existing business models while protecting consumers and leveling the playing field for impartial advisers. This principles-based approach obligates the adviser to honor the interests of the plan participant or IRA owner, while leaving the adviser and employing firm with the flexibility and discretion necessary to determine how best to satisfy these basic standards in light of the unique attributes of their business.

The proposal clearly reflects our third principle – a commitment to being responsive to the substantial input we received from a wide range of stakeholders. My staff and I have met with representatives of all of the major financial industry groups, CEOs of big and small firms in the financial services industry, and representatives of employers who offer retirement plans to their workers. I have also met with consumer groups and civil rights groups who are concerned that their members are the ones who can least afford to see their retirement savings dissipated by conflicts of interest among financial advisers they rely on for investment advice. We have also

worked extensively with colleagues throughout the government, including and especially the Securities and Exchange Commission.

I am encouraged by the substantial and growing areas of agreement between the Department and the financial services industry. For example, there is an acknowledgment and acceptance among our stakeholders in the financial services sector that there are significant conflict of interest problems in the marketplace serving retirement investors. There is also a broadening consensus around the core elements of a solution, including 1) an enforceable best interest standard, 2) a requirement that firms carefully design structures and procedures to mitigate conflicts, 3) adherence to the existing securities laws, 4) more effective disclosures to investors, and 5) the need for concrete steps to address fees and other revenue incentives that may improperly influence investment recommendations.

We heard from numerous stakeholders, in both the industry and advocacy communities, that a principles-based rule would work best in this rapidly evolving marketplace. We responded with the best interest contract exemption – a completely new approach that directly addresses these suggestions.

You can also see our responsiveness not just in what the rule will do, but also in what the proposal won't do:

- We heard that banning commissions would cause excessive disruption in the industry – therefore, like the prior proposal, the new proposal does not ban commissions or many other common payments for advisers.
- We heard that including appraisals or valuations of stock held by employee stock ownership plans in this rule was too complicated and not a good fit – so the rule does not apply there.
- We heard that large plans with sophisticated fiduciaries making investment decisions need greater flexibility in dealing with advisers so we included a carve-out for them, commonly referred to as the seller's exception.
- We heard that it was important to provide retail customers who want to direct their own transactions with the ability to place orders without unnecessary process, so the rule will not apply to brokers who just take direct orders from customers and do not provide advice.
- Finally, we heard about the important role that the financial services industry plays in providing much needed financial education. Because we value that role, the proposed rule does not limit access to financial education. In fact, it would expressly allow employers, call center employees, and other financial professionals to continue to provide general investment education without becoming fiduciaries, and extends this express allowance, historically applicable only in the 401(k) market, to distributions, rollovers and IRAs as well.

The proposed rule and its accompanying Regulatory Impact Analysis includes numerous requests for comments on particular issues – more than any other rule that we have published while I have been Secretary. I think of these specific requests as an invitation to a very real conversation that I hope will prove to be a productive one. Our track record gives us credibility when I say that we are open to making real changes in the rule to improve it, and that's why we urge our partners in the industry and advocacy community to engage in a good faith dialogue during the comment process. For example, we included in the rule some illustrative examples of the kinds of practices and procedures that firms could adopt to meet the requirements of the best interest contract exemption. We would like to hear from our stakeholders on whether these are the right examples or whether there are better ones.

Many of you have raised important questions about how this may affect retirement savers with small balances, something we carefully considered while drafting. I simply don't believe the argument that small savers cannot be served by advice that is in their best interest, especially with the advent of new, technology-based and technology-assisted models. We know that advisers can live up to a best interest standard and still make a living because so much of the industry already does just that. Every day, Americans are served by advisers like the certified financial planner with whom my wife and I work, who has embraced the best interest standard. In fact, the rule will help the best advice win out, because those already selling good products or giving good advice stand to benefit in a world where a client's best interest has to be put first. What I've learned through a robust and exhaustive outreach process is that when you put the interests of your customers first, it's good for your customers and it's good for business. Jack Bogle, the founder of Vanguard, made this concept a cornerstone of his business model, and he and other firms large and small have proven that it can be done to great success.

As of today, we are about one-half of the way through the comment period, which the Department has extended to 90 days to ensure sufficient time for all stakeholders to comment. There will be a public hearing during the week of August 10th, after which the comment period will reopen until approximately two weeks after the hearing transcript is published – a process that we anticipate will provide an additional 30 to 45 days of public comment. We have received incredibly helpful input so far, and are eager to hear more. I look forward to working with Congress to ensure all voices are heard.

We have put forth a simple proposition – the client's best interest should come first. So far, we have heard from some who want us to go further and ban all conflicts of interest and end commissions, while others have said that we don't need to act at all. Those comments tell me that we have probably found the right middle ground in providing greater consumer protection in a way that respects the important role played by investment advisers in helping the middle class achieve the American dream of a secure retirement. I am most heartened by the comments that

offer suggestions on even better ways to achieve that objective. I hope to continue that conversation here with you.

Thank you again for the invitation to testify.

Chairman ROE. Mr. Secretary, thank you for being here. And I will start off the questioning.

I know one of the premises that was made is that we have a crisis and basically there is a $17 billion number. Being a numbers guy, I went back and sort of dug through how that number came up, how that actually happened.

And the way that occurred, the Council of Economic Advisers, the way they put that number together was they took the total value of loaded mutual funds and IRAs and the total value of annuities and IRAs, added them together, and somewhere in the literature found out or determined that there was a 1 percent difference in that advice and other advice, and there is $1.7 trillion in the total assets when you add those together. And that is how the $17 billion got there.

The problem with that is there are a lot of assumptions and extrapolations when you get to that. One assumption was that when you paid a loaded mutual fund that you did that every year instead of just going ahead and having the one-time load. I have got a loaded mutual fund in my own retirement plan that I haven't changed in 15 years.

And it was a terrible example that you gave. I really feel badly for that family that had a 4 percent annuity and a 7 percent surrender. I agree with that, that is very bad advice that they got. But making them a fiduciary, Bernie Madoff was a fiduciary and look what happened there.

So making a fiduciary and more rules, I guess the first question I have for you is, do you think all this rulemaking—we have got 29 percent of the people that don't have retirement savings—will make it easier for people? Will it make it simpler and easier for me as a small-business person to provide retirement benefits for every employee I had from the day I started my medical practice?

Will this rule make it easier for me to set that up and provide for those retirement savings for people, or will it make it harder?

Secretary PEREZ. I think it makes it easier for both workers and for employers. And let me talk about workers first.

It is a very confusing world for people who want to get advice, because some people that give advice have taken an oath to have a fiduciary obligation, some people are broker dealers and they are under a suitability standard, and some are actually dual-hatted. So depending on where you are in the conversation, they are a fiduciary one minute and they are not a fiduciary the next minute.

That is remarkably confusing for consumers. And that is not the case for a doctor or a lawyer. When you go in there, your doctor is always looking out for your best interests and your lawyer is looking out for your best interests.

So, this rule makes it simpler by making sure we have one standard.

As it relates to businesses, businesses are often victims. And I have spoken to a lot of small businesses who, you know, they know how to make widgets, they are not experts in investing. And what they are often getting is advice that also has the same structural flaws.

So when small businesses who are trying to do well by their employees are looking for that advice, this rule is going to ensure that

businesses and consumers alike are going to have access to that same non-conflicting advice.

Chairman ROE. My time is limited, Mr. Secretary. Why would the NFIB and the Chamber, who represent small businesses, object to this rule the way it is proposed?

Secretary PEREZ. Well, I can tell you that we have also spoken to a lot of small businesses as well. And one interesting one—

Chairman ROE. No. I asked why would they oppose. And then to make it easier, these are the rules right here. This is yours right here, this big, whole, thick thing you have to read through. And let me just go through a couple of things.

This is what someone has to do now with a BIC exemption, to get an exemption, which you provided in there, you did provide a way to exempt the broker dealers. A total cost of disclosure must be provided to the investor before executing any investment transaction. Disclosure must be provided and all the end costs and anticipated future costs, recommended assets over one-, five-, and 10-year periods, making reasonable assumptions about investment performance. And the all-in inclusion includes acquisition ongoing, deposition, and any other costs that reduce the asset's rate of return.

I mean, it is very simple. I looked up mine this morning. And it is very simple with the account I have to be able to tell exactly what my returns are net of fees.

I mean, I see some things right here. A public website must be maintained and updated quarterly showing the direct and indirect material compensation paid to the adviser, financial institution, and any affiliate of a financial institution with respect to any asset that the investor is able to purchase, hold, or sell through the adviser or financial institution over the last 365 days.

This is going to be thousands of things that you have to do. Does that sound like it makes it easier?

Secretary PEREZ. I think, sir, this rule is very straightforward. You have an obligation, if you are providing advice, to look out for your customers' best interests.

Chairman ROE. Totally agree with that.

Secretary PEREZ. Well, that is what the rule says. And that is what the proposal says. And what we heard in our feedback was we don't want a straitjacket. We want to make sure that we don't have to ban commissions, for instance. And the rule doesn't ban commissions. We want a flexible road map for compliance that enables us to design what works best for our business, and the best-interest contract is exactly responsive to that.

Now, if there are questions about how to operationalize it, as the Ranking Member said, we are having that conversation right now. And we are having very productive conversations about how to make it work.

The issue you said about publishing fees, I believe in transparency, the problem right now is that the system is really, really opaque. You don't know what your fees are because there are a lot of hidden fees. And when you publish these and have that sunshine, there will be, I predict, third parties that are going to emerge that are going to start the consumer reports of financial ad-

vice. And so consumers are going to be more empowered when you have that transparency.

Chairman ROE. Permit me to interrupt. My time is expired.

Mr. Polis, you are recognized.

Mr. POLIS. Thank you, Mr. Chairman.

Secretary Perez, I want to thank you for your Department's work on the lifetime income disclosure regulation. As you know, I am an original sponsor of that bill and I strongly believe all workers should have access to this tool that federal workers currently have.

In a snapshot, workers will know not only how much they have saved, but also what the balance would translate into in guaranteed lifetime income, very relevant for their own retirement plans.

And I know that this particular rule here is also part of your plan to make sure Americans save enough to retire.

I wanted to address a few issues in the rule.

There have been question about the extent to which your Department has sought input from the SEC and other regulators regarding the specifics of the proposal. Would you provide some details regarding these interactions and how the Department has gone about receiving input in crafting a proposal that marries well with securities law?

Secretary PEREZ. Sure. We have had extensive conversations with the SEC. We detailed this in a letter. I have had, I think, eight different, either face-to-face or calls, meetings with Chair White throughout this process.

We provided the day before yesterday roughly 800 pages of documentation to note and document the extent of the coordination. And it has been very helpful. Our career staffs have met countless times over the last four years. And as the materials describe, you will see that they had helped inform our judgment in every aspect of the rule.

This Committee has helped inform our judgment as well. And I want to thank Congressman Guthrie.

We had a provision in the old rule that related to ESOPs. And there were some concerns raised by Congressman Guthrie and some of his constituents with whom we met. And as a result of that, we took that out of the current proposal.

And so we are going to continue to listen and learn, whether it is from the SEC, whether it is from members of Congress, whether it is from industry. All the stakeholders have really helped us make this a better rule. And I am confident that the final rule will be even better because we continue to get good input.

Mr. POLIS. Thank you. And as you know, the proposal includes a significant exemption from the prohibited transaction rules for financial advisers who enter into a best-interest contract with customers. To use that exemption, the adviser needs to comply with significant disclosure requirements.

And my question is around the cost-benefit of the amount of disclosures and whether the disclosures actually provide an average investor with information that they can process and whether that additional burden is worth it.

And of course, we have heard from some advisers that the disclosures currently in the rule are so burdensome that they simply won't serve some of the middle-income investors.

So I was hoping you could address that kind of cost-benefit tradeoff around those disclosure retirements.

Secretary PEREZ. Sure. The best-interest contract is our way of making sure. This is our Ronald Reagan provision in the rule, which is that we want to trust and verify.

I have yet to meet somebody who is an adviser who hasn't told me that they put or they think they put their clients' best interests first.

And so what we are saying in this rule is we agree with you, that is the rule and it is now enforceable. And the best-interest contract is a way to make sure that you have a flexible road map for compliance and that it is enforceable.

There are a number of disclosure requirements that we believe are very discrete and very targeted. You ought to know how much, you know, what the fees are. I think that is a good idea so that you can make informed judgments because, you know, an educated consumer is the best consumer.

Mr. POLIS. Would the consumer also have some basis to know whether those fees are high or low relative to the fees of others? Because I mean, they might not know in seeing the fee.

Secretary PEREZ. And that is part of the education that they can absolutely get, because you want to comparison shop. There is a lot of modeling that you can do to figure out, well, what are the fees for a similar product elsewhere? And those are the types of things that this rule would permit and, actually, good practice would dictate.

Mr. POLIS. Along with that education question, in your last 30 seconds, there is a carve-out, as you know, for investment education in the rule. And I was hoping you could clarify about where that distinction is between advice and education.

Secretary PEREZ. Sure. One of the main things we did, and this was responsive to the feedback we got, is to clarify and really explain the line between education and advice, because we all agree that education is exceedingly important. And this rule establishes very broad parameters for education.

So one of the most important things that you can do in education is talk about asset allocation. That is totally education, nothing kicks in there. You know, you should have some of your money in, you know, equities, bonds, cash. That is education.

Tradeoffs between risk and reward are education.

We had 1996 guidance that we put into the rule, the proposed rule, so that we are operationalizing something that the industry has been using for some time.

We clarified that employers can provide advice because employers are trusted advisers that people go to. And they are not generating a fee so they are not fiduciaries, so we clarified that employers can provide advice.

And we welcome your comments on whether the line is drawn in the right place or whether we should do something different and better.

Mr. POLIS. Thank you, Mr. Secretary.

Yield back.

Chairman ROE. I thank the gentleman for yielding.

Next is Chairman Kline.

Mr. KLINE. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being here.

I think there is nobody probably in this room and certainly up here who doesn't agree that financial advisers ought to be acting in the best interests of their client. But the rule doesn't simply say that. The rule is in fact quite complex.

Dr. Roe lifted up the book and it is about this thick. And clearly, there is a lot of confusion.

And so I am not as thrilled as the Ranking Member that you have extended the comment period by 15 days; 45 would have been better. But the more discussion we have, I think, the better because right now I am afraid the rule is going to prove to be pretty complex and in some cases may be unworkable.

Mr. Secretary, you said that you have had extensive outreach to the SEC. And since you are here under oath, I have got to assume that is a true statement, but it may depend upon what "extensive" and what "outreach" means.

As you know, Mr. Secretary, going back to March 4, the Committee has asked for documents and communications to verify that substantive coordination has occurred between the Department of Labor and the Securities and Exchange Commission. And after months of virtually no response, less than 48 hours before this hearing the Department produced 827 pages of mostly scheduling emails, Outlook calendar items, and similar things.

And this leads us to believe the Department has still not provided a complete response to our inquiry.

So here are the questions. Do these 827 pages represent the entirety of the written communications between DOL and the SEC?

Secretary PEREZ. Could you repeat the question, sir? I am sorry.

Mr. KLINE. Do these 827 pages that we just got from the Department represent the entirety of the written communications between DOL and the SEC on this fiduciary standard?

Secretary PEREZ. No. We have had an extensive conversation with your staff. And I am a big believer in the importance of oversight. And I think you and I have had this conversation in many contexts. And we look forward to continuing to work with you.

We also had agreed—we offered, I am sure you are aware, to provide a briefing about the extent of the coordination. The materials were due the close of business yesterday; we provided them to you at the close of business Monday so you would have an extra day to review them in preparation for today.

And we will continue to work with you on this.

Mr. KLINE. And we reviewed them quickly.

So I am not sure I still have the answer to the question. Is there more documentation that we have not yet received?

Secretary PEREZ. We are still reviewing everything. This process has taken place over five years. And so we wanted to demonstrate our good faith in the work that we are doing. And so we turned over the 800 pages.

Mr. KLINE. But you are not claiming executive privilege for not providing more documents, you just haven't found them yet?

Secretary PEREZ. No. We are continuing to work with your staff, and I think we are working in a collaborative fashion. And again, we offered up a briefing to show the coordination.

And with all due respect, the documents demonstrate, because all of the areas of discussion for a particular meeting are noted on the document, so the issue that was presented in the oversight request was are we collaborating with the SEC. The documents that you have, I would respectfully assert, clearly demonstrate both a wide breadth and depth of collaboration with the SEC.

Mr. KLINE. Well, is it all of the collaboration? That is what we are getting at.

I mean, we would like to have a log from you identifying responsive documents by date, author, subject line, recipients, and a summary of content. That is what we have asked for and we haven't gotten that. We got 827 pages of stuff, and I appreciate getting the 827 pages.

But as you know, Mr. Secretary, there has been a great deal of debate and conversation and unrest about who should be doing this in the first place, right? The SEC is charged under Dodd-Frank with some activities here. DOL is acting under ERISA for this.

But we have been looking at coordination. We have had legislation in this body insisting that SEC act before DOL, that has not been signed by the President, it is not law.

But we are very, very concerned as a body about what this coordination is between DOL and SEC. You have given us a bunch of stuff, we are looking for something a little bit more precise than that. And I hope you will be able to provide that.

Secretary PEREZ. Well, I look forward to our staff oral briefing because I think you will get even more depth about what we have been doing.

And again, the documents that you have now and the proposed rule, you will see that virtually every section of the rule, there were conversations with us and the SEC.

So if the question is, were we talking? The answer is, a lot.

Mr. KLINE. I guess I believe a lot; I am looking for a little more precision.

I yield back.

Chairman ROE. I thank the chairman for yielding.

Mr. Courtney, you are recognized for five minutes.

Mr. COURTNEY. Thank you, Mr. Chairman.

And thank you, Mr. Secretary, for being here today.

Secretary PEREZ. Good morning, Congressman.

Mr. COURTNEY. You know, just at the outset, I would just sort of change maybe a little bit of the tone of the last exchange. And again, I have nothing but the highest regard for the Chairman, but you know, this Secretary, since he took over, in my opinion, has shown, you know, a real willingness to work with the committee members on a whole host of issues.

Mr. Kline and I raised the question of whether or not the Department of Labor's actions in the Office of Contract Compliance with hospitals was an overreach by the Department.

And to your credit, you ran the forensics and came back and actually terminated an enforcement action which, again, was what generated our objection.

The pension amendment to the Cromnibus, which the chairman of the subcommittee and the Chairman of the full committee worked with your Department to produce, you know, a change to

the crisis that existed in defined benefits again is another example of where this Secretary has shown a willingness to work with this committee.

And frankly, that has been a change since you took over.

The last time the Department came forward with a proposal on a fiduciary rule, it was a disaster. I mean, and I am saying that as a, you know, as a Democrat. It just was a fiasco.

And you have already sort of alluded this morning to some of the changes that the Department has implemented or proposed with the new proposed rule compared to the first fiduciary proposal.

Again, you mentioned Mr. Guthrie's concern regarding ESOPs. That was deleted.

The financial education piece, which frankly I personally think needs more work, and you have already said this morning you are willing to listen to people about ways to let the call centers do their jobs without sort of too much restriction.

But the sellers' exemption is an example. Maybe you could talk a little bit about, you know, where we are today versus where we were whatever it was, three or four years ago, when the Department came out with its first set of rules.

Secretary PEREZ. I think we have come a long way, in short. And we have come a long way because I am a big believer, and we had this chat yesterday, Mr. Chairman, when you are in the regulatory process, number one, you have got to build a big table, you have got to make sure you are listening to every stakeholder. You have got to understand what the consequences of your proposed actions are, intended and unintended.

And the best way to learn about the latter is to make sure you have a big table so that you can hear and learn from people who have been in it. And that is what we have done.

And I am heartened by the fact that this conversation has evolved from a there really isn't a problem to address to an increasing recognition that we have to have one standard and it needs to be a best-interest standard because we don't save enough.

And when a family works hard to save $50 or $100,000 or a few hundred thousand in the case of the example I cited, we need to make sure that the advice they are getting is in their best interests. And that is what this is about.

And the question of how to operationalize that, we asked literally dozens of questions in our proposed rule about precisely that, because another principle of effective rulemaking is humility.

We have ideas about how we think you can operationalize it. But we also recognize that so do others. You know, we have met with, and I have personally met with CEOs of Fidelity and others, and their input is invaluable to us. And we will continue to have those meetings.

I have met with small businesses who are in this space, who, frankly, they tell me with regularity anyone who says that they are going to get out of the $11 trillion market, could you give them my email, because I am serving a lot of small savers, and I am making good money using technology and looking out for their best interests. So there is a way to do it.

And so, I think we have improved the rule as a result of that listening, whether it is a more robust economic analysis, whether it

is the ESOP issue that Congressman Guthrie addressed and we took it out, whether it is the best-interest contract exemption, which is an effort to make sure that we have guardrails, the best-interest rule, but we have flexibility and compliance.

There is no bar on commissions. That was an issue that we heard and feedback we got and we listened.

And we clarified the line between education and advice. And as I said earlier, if people think that further clarification is necessary, give me chapter and verse because we are all ears.

Mr. COURTNEY. And you know, we are going to obviously watch closely as the Department continues its deliberations.

So when August rolls around and there is a revised, I guess, reg that comes out, there is an additional comment period after that as well. I mean, if doesn't just shut down at that point. Am I right about that?

Secretary PEREZ. Absolutely. We are having a public hearing in August. The comment period closes, then we have a public hearing, then we publish the transcript of that hearing, and we invite comment on that transcript. So we are going to end up having roughly 140 days of formal comment, and that is on top of the 2 years or so of outreach that we have done to date.

Chairman ROE. I thank the gentleman.

And Dr. Foxx, you are recognized.

Dr. FOXX. Morning.

Secretary PEREZ. Good morning. It is great to see you again.

Dr. FOXX. Nice to see you.

Thank you, Mr. Chairman.

And thank you, Secretary Perez, for being here today.

I have been listening to the comments made already and having read a lot of the material about this with a great deal of interest. This, I will tell you, is not an area of expertise for me, but my husband and I discuss these things a lot. He generally handles our investments for us with a little bit of input from me.

But I am really interested in this issue of best-interest contracts. And I know in many cases you can get advice that people think is in the best interest. I know my husband over the years has invested money in areas where he thought there would be a great return, and yet something happens outside his ability to control it.

It happens all the time in investments. You invest in one thing and the market is going up and all of a sudden a new technology comes along or some substitute for that product and your investment isn't worth as much.

You know, best interest, it seems to me, is in the eye of the beholder.

But I want to ask you a quick question about this. If I talk to somebody, a financial professional, to help me open an IRA, why do I need to sign a contract before we can even have a conversation? Do you think that kind of requirement is going to intimidate the new investors that we need to get into the market and ultimately discourage them from saving?

You know, signing a contract for the average person is a big deal.

Secretary PEREZ. The short answer is you don't have to sign a contract before you have a conversation. And we understand that the proposed rule and part of our feedback that we have heard, this

issue has come up with some frequency. And there have been concerns raised about the timing of when the contract requirement would go into place.

And so your question is a perfect example of the issue of, how do we operationalize this, because we have a shared goal in making sure that you can go out and get access to advice, shop around.

You know, I want to know what you are telling me, , and I want to make an informed choice. Just like if I buy a car or I buy a refrigerator, I want to do some comparison shopping.

And our goal is to make sure that comparison shopping is facilitated.

So we have heard that and that is an issue that we, I am confident, are going to clarify because we want to encourage shopping, we want to encourage informed consumers.

And there is a lot that you can go to now and not have a contract. You can go and see somebody and talk about asset allocation. You know, what should my asset allocation be? You can look at interactive modeling and plug in a number of different assumptions and you don't need a contract. That is all a part of the shopping.

The most important part I have learned from talking to folks in the industry about the conversations is the asset allocation conversation. You know, what is your risk tolerance threshold? And my wife and I have different risk tolerance thresholds in this, and we learned that during the course of meeting with our financial planner.

And those are the things we want to facilitate. And those don't require a contract to have those conversations.

Dr. FOXX. Well, one of the things it sounds to me like, in terms of best interest, is that this is going to be a full employment regulation for trial lawyers, because who decides what that best interest is going to have to ultimately be decided.

One more question. Are you concerned at all that long-standing, positive relationships between investors and advisers will be disrupted if they are forced to comply with a host of new mandates?

Secretary PEREZ. I am not concerned because everybody that I have spoken to has said that I put my customers' best interests first. I haven't met anybody who says they haven't. And so what we are trying to do is operationalize and memorialize that.

And as it relates to your question about—

Dr. FOXX. If they are already doing that, then why do we need to have a host of new rules and regulations?

Secretary PEREZ. Because we are trusting and verifying. Because I am sure that when, you know, the Toffels went in they thought they were getting advice that was in their best interest.

But there is a structural problem here. And it isn't about bad actors as much as it is about the fact that when you have a suitability standard there are five different products that are suitable, but many of those products get you a better commission. And it is completely appropriate for you to steer someone to a product that gives you a better commission and does so at the expense of the consumer.

I think that isn't in the best interests of the consumer, and so that is why we are trying to change it.

And by the way, there is a substantial percentage of folks who are already fiduciaries. There is no evidence of a litigation boom with folks who are already fiduciaries.

And we also have a provision in the rule, for your information, that allows a best-interest contract to have a mandatory arbitration clause for individual claims. So a firm can put that in if they want. And it was designed to get at the concern that you address.

Chairman ROE. The gentlelady's time is expired.

Mr. Pocan, you are recognized for five minutes.

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

And thank you, Mr. Secretary, for being with us this morning.

Secretary PEREZ. Good morning, good to see you again.

Mr. POCAN. Good to see you. Thanks for being here today.

And you know, I think we all agree that far too many people don't have enough money put aside to live comfortably in retirement and we need to do something to reverse this trend. And I really appreciate the work that you and your Department are doing to ensure that Americans savings for retirement are able to receive investment advice that is in their best interest.

I appreciate the open-comment period and extension for the extra 15 days as well. And I think one of the things that you have said over and over is in order for this rule to be successful it must be workable. And I think that is where I just have a few issues that I would like to bring up, just that people brought up to me that I think are something I hope you are looking at closely that maybe we can have some impact on.

I would echo Dr. Foxx's comment about this idea on signing a contract with an adviser. I think it does need some clarity and clarification.

While I completely disagree that the U.S. Chamber and NFIB represent small business, I have been a small-business owner for 28 years, I work in a business-to-business market, a fraction of 1 percent aren't members of those organizations.

But you do know your thing. You are a chef, you may not be the best businessperson, but you certainly may not be your best retirement adviser, right?

But it does have some questions about whether or not if you have to sign a contract right away, it isn't just asset allocation, you might have some broader questions about, you know, I want to do this in retirement, what should I be looking at. It is just a step further. But if you have to sign a contract for that, it is something that seems larger, I think, than just getting some initial advice.

So you know, I guess I would just like to associate myself with the comments on that, but just kind of really raise that issue, because I was talking to another Democrat on the floor yesterday and this issue came up with that person as well. So I think more of us do look at this as something perhaps a little bigger and would appreciate any consideration you can give to that.

Secretary PEREZ. Absolutely. And you are addressing two issues; one is the line between education and advice, and we have a proposal out there, we think it is broad, but we are hearing feedback about how we can make it even clearer. And that feedback is really helpful.

Secondly is the issue that Congresswoman Foxx raised about when you execute that. And again, we have heard that and that is why I keep coming back to why I love this process because you have to have humility to understand that, you know, you have done your best to integrate the feedback you have gotten and folks are going to help you make it better.

And your question, Congresswoman Foxx's question, other questions about the operational aspects of this are very important.

Mr. POCAN. And let me raise a couple more, if I could, just while I have got the time.

Secretary PEREZ. Sure.

Mr. POCAN. Another one is there has been some concern over the data that is being collected as part of the rule, both from a substantive perspective and from the cyber security perspective. And you have probably heard some of these through the comment process.

A few of the things were, like, if you represent the investment fees versus the return it can be misleading on the type of investments. Some investments are more like apples, some are more like oranges, but now we are going to try to combine them completely.

There have been some conversations about the six years of sensitive data that we are going to collect just making sure that doesn't become something that is a collection of data that isn't as useful.

And then there is a very specific about, you know, if someone makes a good-faith mistake versus something that instantly puts them into the excise tax area.

Those are some of the things that came up. But also then, I guess, is this question on the cybersecurity levels and whether DOL has the funding within the Department to make sure they are going to have that.

We know we aren't great at appropriations around here. We want to make sure that is all in place. So that is another level, I guess, I would just like to raise real quickly.

And I do have one more after that.

Secretary PEREZ. No. I mean, the good news is that we have heard from various stakeholders every one of those items. And again, they are all in a bucket of how do you operationalize this.

One of our goals is transparency. Right now the system is very opaque. You don't know what the precise fees are. Actually, people think it is free. And it isn't free. And so that is why what we are trying to do here is to make sure that, you know, by publishing what various fees are then you can have, as I said before, a consumer reports of apples to apples comparisons that will help consumers make informed judgments.

But all of the issues that you raised are absolutely things that we have been thinking about.

Mr. POCAN. Yes, looking at it, I appreciate it. And the last thing I would say with only seconds left, just real quickly, on the eight month thing, a few folks have said it is a little short. Can you just tell me how the eight month idea for implementation came in mind and where we are in flexibility?

Secretary PEREZ. Well, that is another area where we are hearing a lot of feedback on. And there have been a number of sugges-

tions that have been raised about phase-ins or, you know, how you can make sure that the rule is in effect. So that is an area where we invite, we affirmatively ask for comment about that. And we are getting a fair amount of it.

So I hope that we can have more conversation about that.

Mr. POCAN. Yes. And we will relate some of these concerns directly to you.

Secretary PEREZ. Sure.

Mr. POCAN. I just really appreciate the openness, again. I think, you know, every time you have come to this committee you have been one of the most open folks that I have dealt with in my two–1/2 years here. And thank you for—

Secretary PEREZ. Well, it is an honor to be here. And I learn a lot. You make me smarter, all of you, so I appreciate it.

Chairman ROE. I thank the gentleman for yielding.

Mr. Walberg, you are recognized.

Mr. WALBERG. Thank you, Mr. Chairman.

Secretary PEREZ. Good to see you again, Mr. Chairman.

Mr. WALBERG. Good to see you. And I hope you have got your wife a trip planned back to Michigan, right?

Secretary PEREZ. Absolutely.

Mr. WALBERG. Good.

Secretary PEREZ. U.P.

Mr. WALBERG. Say hi to the U.P., too.

Secretary PEREZ. I don't have a Harley, though.

Mr. WALBERG. Well, you have got to get one.

Secretary PEREZ. Yes, I will borrow yours.

[Laughter.]

Mr. WALBERG. You are welcome to do that.

I heard you say nothing is free, and that is absolutely true. So in relationship to some costs, I am concerned about the cost of this proposal, including the potential litigation and administrative costs that may go with it as a result.

How many additional ERISA fiduciary lawsuits do you project will be filed annually if your proposal is finalized?

Secretary PEREZ. Well, again, there is a provision in the proposal that allows for mandatory arbitration clauses in the best-interest contract. And that is a provision actually that we took from I believe it was SIFMA or FINRA.

And so in the area of trying to make sure we are harmonizing our rules with other rules, we put that in place because we recognize that was a concern people brought to our attention.

Mr. WALBERG. Any figure that you have considered on additional costs and a number of lawsuits that might be filed?

Secretary PEREZ. Well, we certainly have considered that. I would observe that we now have a controlled experiment going on because there is a substantial subset of people in this space who are already fiduciaries. So if your theory is correct that if you are operating under the best-interest standard you are more susceptible to litigation, that hasn't been borne out.

There is no evidence that folks who are fiduciaries get sued more often. What the evidence shows is that when times are good, there tend to be less lawsuits against advisers. And when times are bad,

there tend to be more lawsuits, regardless of whether you are a broker dealer or whether you are a fiduciary.

Mr. WALBERG. Well, in order to make sure that happens, how expensive will this proposal be for participants and IRA holders due to increased litigation risks and insurance costs?

Secretary PEREZ. Well, again, you know, the premise of increased litigation risk, I mean, the evidence to date has shown that folks who are fiduciaries aren't dealing with increased litigation risk.

And everybody who has come in, including broker dealers, and said I would like to think that I put my customers' best interests first, if they are in fact doing that then they have little to worry about.

Mr. WALBERG. But they are worried about the complexity of the regulation that is expanding with this for all sorts of reasons. But there will be litigation costs. Is there any figure out there that you have considered for the best interests because, ultimately, won't these costs just be passed on to the investors?

Secretary PEREZ. Well, again, if there was evidence that fiduciaries were facing increased litigation costs, then that is something we would have flagged. And there is no evidence of that.

So the notion that this is going to trigger a litigation bonanza when you have a mandatory arbitration clause in there and when folks are already doing this, presumably, you know, I respectfully take issue with the premise.

Mr. WALBERG. Well, I mean, expanded regulation always adds some costs. So I guess I will take your answer, but I am concerned that we haven't assumed some greater costs and, ultimately, the impact upon the investor as well as the IRA holders, participants, *et cetera*. That would be a concern for me. And I guess I would put it out still further.

I would like to see the workup done to ultimately bring satisfaction to your mind that you have seen evidence, and that is fine, that this won't increase the costs and, ultimately, those investors will experience paying for that cost.

Let me jump onto one other thing.

Secretary PEREZ. There is the real cost of the status quo, sir, as well. So I mean, and we have that.

Mr. WALBERG. I can understand that. Yesterday, I spent significant amount of time in the Oversight and Government Reform Committee on the issue of OPM and the data breach that went on there.

We also had in recent months VA in front of us as well.

I was in a classified briefing there also and it was unbelievable the lack of preparation and expertise and ability to handle this with the OPM director. And ultimately, as you are probably aware, there has been a call for her resignation.

In this issue with the increased amount of data that you are going to be pulling in, what are you doing to make sure that data is secure and we have investors as well as the fiduciaries protected from a breach like that?

Secretary PEREZ. Well, if you look at our budget request for the fiscal 2016 budget, we have a very robust request for IT. And it is not simply for this, but it is to make sure that our IT infrastructure is as impermeable as possible.

And so I look forward to citing you during our budget deliberations about the need to have our IT requests—

Mr. WALBERG. Yes, it isn't always money. It is preparation and I hope you are prepared to a great degree right now. I would like to have some confidence in that.

Chairman ROE. The gentleman's time is expired.

Mr. Sablan, you are recognized for five minutes.

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

And Mr. Secretary, it is always good talking to you and having conversations.

I have some concerns in addressing, how best do you operationalize this best-interest standard in my district?

Coming into this room, I thought we had nine securities investment or advisers, now I only count that we may have actually four, three with each one of the banks and one, the gentleman that is a dealer or agent for Fidelity. And so you can see how small the market is for us.

And how do we do this, how do we bring this very well-intentioned best-interest standard, which I like very much, without forcing these investment agents, at least the one with Fidelity, to stop doing business in the Northern Marianas with forcing them to close shop because the costs of managing this government oversight is going to go higher, of course, when his clients aren't very large?

And I would like to maybe work with your office. And maybe if I understand, maybe—I am sure you may have an answer for this, I don't know. But because we are so small and I can tell, I can probably count on my two hands how many people have investments with firms that are, you know, housed in Honolulu probably and they have the means to get up and fly there and be there.

But for those who are the smallest investors, retirement savings investors, there is very little. And I would like to see how would we manage these small accounts.

Secretary PEREZ. In the same way you would manage every account. And that is, you know, small investors are the ones who are most vulnerable.

Mr. SABLAN. Very small.

Secretary PEREZ. Because you know, if you have a 1 percent loss, let's say you invested, you know, I think it is $10,000 and you have it in for 35 years, if you as a result of conflicted advice see a 1 percent diminution in your return, that translates to almost $10,000 less. So it would be about $35,000 over time and instead it is $25,000.

And so, I think that this rule is most designed for small investors.

Mr. SABLAN. Don't get me wrong. I think I like the rule, I think it is about time. But it is just that for places as small as the Northern Marianas where there isn't very much money invested, it is just forcing these companies to decide to say, no, we will just stop doing business there.

Except for those 10 people I can count on my hands, everyone else would lose the chance towards accessing an investment agent maybe, not necessarily a broker, but an agent on how they could invest their retirement savings, aside from those who are employer-based.

Secretary PEREZ. Well, one thing that has been really helpful, and I have certainly learned a lot about this industry over the course of the last two years, is that technology is a huge ally. It is a huge ally in rural America, it is a huge ally in the CNMI.

And I mentioned in my opening remarks a company out of California Wealthfront. They are a startup. They are four years in. They have now over about $2 billion in assets. They don't charge a fee for anyone who is under $10,000, and that is because they believe that—they have a platform that enables them to significantly lower the fees, operate as a fiduciary and do well by doing good.

And so I think technology is a big ally for the residents of the CNMI because—

Mr. SABLAN. Mr. Secretary, and I don't doubt the well intention of this rule. Let me just give you an example. Primerica, for example, has 21 investment accounts in the Northern Marianas, 21. I am sure Fidelity has much more. ASC Trust does a larger business there.

But Primerica is a huge company. They have 1.9 million investment accounts in the country, 21 of that is in the Northern Marianas, so we are very small.

I am just concerned that this new rule will force people to close shop. And instead of growing the market for us, it would have a negative effect.

I am not trying to stop your rule and I probably won't. But just having this conversation, I hope that—

Secretary PEREZ. Well, I look forward to talking with you about the various vehicles that are accessible as we speak right now.

Mr. SABLAN. Thank you for your recent decision, Mr. Secretary, that this five years extension also works for that. I appreciate that very much.

Chairman ROE. Thank you. The gentleman's time is expired.

Mr. Guthrie, you are recognized for five minutes.

Mr. GUTHRIE. Thank you.

Thank you, Mr. Secretary. Thanks for being here.

Secretary PEREZ. Good to see you, Congressman.

Mr. GUTHRIE. And I know it has been mentioned a couple of times, us working together on sections of this proposed rule. And that was just a great process.

I want to reiterate, I think I talked about it before when we were in a public hearing, but I mentioned something in a hearing such as this, you said let's get together and talk about it and followed through. And I think that it was a healthy change to the proposed rule and we appreciate you doing that very much so.

The one thing I just want to talk about is the President had a proposal. The myRAs, myRAs, and so there is a difference in myRAs and IRAs, IRAs. And I know it is Treasury so it isn't in your area, but just how your rule treats, does it treat these differently?

And I will just start by asking, and I will do this. There is a December 2014 letter from the Department of Treasury that exempts the myRA program from ERISA's fiduciary obligations. And the letter states that the exemption is granted for employers, in part, because, and I will quote: "some employers may also want to hold em-

ployee meetings to explain the myRA program and encourage eligible employees to participate. Others may want to answer employees' inquiries about the myRA program or refer them to Treasury's financial agent."

And so this description does sound a lot like the advice in many similar circumstances that workers in my district rely upon. And since the letter acknowledges that workers need to get information and begin saving and then exempts myRAs for fiduciary liability, why are myRAs different from IRAs? And is that in your area that you have looked at?

Secretary PEREZ. The myRAs are not covered in this rule. And the Treasury Department controls all aspects of the myRA rule.

Mr. GUTHRIE. But in your proposed rule, do you treat the myRAs different from IRAs in your proposal?

Secretary PEREZ. MyRAs are not covered under our rule.

Mr. GUTHRIE. So you don't have the fiduciary—

Secretary PEREZ. Yes. So that wouldn't kick in at all.

Mr. GUTHRIE. And the reason they are different, the reason you treat the myRAs and IRAs differently?

Secretary PEREZ. Well, again, the myRAs as I understand it, and again, I am outside my lane here, so I want to note that at the outset, the purpose of the myRA was to encourage auto enrollment in a different way so that we can help more people who are trying to save.

And when the Treasury Department put those in place, you know, as a result of the fact that it is kind of a startup, that was the decision that was made. And I think it makes sense. And so that is the situation there.

I can get you more information because I don't want to misrepresent anything. And at the moment, you know, what I do know is that the myRA isn't covered here. You know, what I don't know are the nuts and bolts of the myRA.

Mr. GUTHRIE. You know, and I think it is because the myRA—I guess where the Treasury Department seems to look at it is the myRA is a government-run thing so the government agent wouldn't be a bad actor or a physical agent.

Secretary PEREZ. Right. Yes.

Mr. GUTHRIE. I assume that is where they are coming from.

Secretary PEREZ. Well, there is also no referral fees for myRAs. So you aren't falling into any of the tests that would come under here still. That is kind of a biggie.

Mr. GUTHRIE. Okay. So if an employer—well, you wouldn't really hit the employer in this. But if an employer is making a presentation to employees and said here is myRAs, here is IRAs, I mean, how is that handled in the proposed rule?

Secretary PEREZ. Sure. Well, an employer, if you are talking about an employer, I have 50 people in my business, I have a grocery store, I think that was the one we met—

Mr. GUTHRIE. Yes.

Secretary PEREZ.—and you are making a presentation, you aren't a fiduciary because you aren't the one—and I think it was Congressman Pocan who said, you know, I am a good cook, but I am not, you know, this is not my bailiwick.

So employers can provide those seminars and provide that advice. And they wouldn't fall within the rule because, again, they aren't the ones who are—

Mr. GUTHRIE. Selling the product.

Secretary PEREZ. Right, exactly.

Mr. GUTHRIE. Okay. I guess my confusion is that the Treasury Department treats employers and says employers wouldn't be fiduciaries. So it seems maybe, and it is probably different than your section, so it is probably—I think we have answered where I need to go with that.

But again, appreciate the work that you have done on that and done with me and different members of the committee and people you have talked to, and I think it has been an open process.

I know there are some questions and more information will flow, but I will tell you I had a good experience working with you and I really appreciate it.

Secretary PEREZ. Anything else that comes up, feel free to give me a call to my cell.

Mr. GUTHRIE. Thanks.

Chairman ROE. I thank the gentleman for yielding.

Ms. Bonamici, you are recognized for five minutes.

Ms. BONAMICI. Thank you very much, Mr. Chairman. Thank you for holding this hearing on this really important topic.

And we talk a lot about retirement security. And I have to tell you, I have had a lot of meetings about this issue.

I am particularly proud of my state. The legislature just passed the Oregon retirement security bill which is a voluntary plan to make an IRA available to all Oregonians without access to a retirement plan at their workplace, which once again our state is showing some leadership there on this really important issue.

This is a fascinating, but complex issue and I am fairly new to it, even though I did some work years ago as a lawyer in securities. So to try to understand the whole jurisdictional issue with when the Department of Labor is involved because it is ERISA and when state law is preempted and then the SEC involvement.

And I am glad you are working with the SEC. And I appreciate your comments about telling the committee about all of those discussions and correspondence.

So I wanted to just emphasize how important this is to our constituents, particularly middle- and low-income families in my district and all of our districts. It is important for them to have access to financial advice that they can trust.

And again, I have had a lot of meetings about this. I have also heard from people in the industry who are very concerned about the implementation. We have made progress with the consensus now that the best interest is what the industry is saying they agree to and it is the implementation that appears to be the issue.

I have also heard from AARP, NAACP, National Council of La Raza all supporting the rule. And they have really made consumer rights a centerpiece of their advocacy. And I have a background in consumer protection and I very much appreciate that.

And to me, it seems like we have the same goal here, to make sure that the people who are getting advice are getting advice that they can trust and that it is in their best interests.

So let's talk a little bit about some of the issues that have been raised. Particularly, will you please clarify because I have heard over the past couple of years it is going to be a big problem because we won't be able to sell any products on commissions? That has been clarified, correct?

Secretary PEREZ. We won't be able to?

Ms. BONAMICI. Sell products and get a commission.

Secretary PEREZ. Right. Commissions are not banned under the rule.

Ms. BONAMICI. Thank you. And then the information versus advice, and this has to do with the timing. Are you open to working on that and taking advice from people who are here? When does that contract—you talked a little bit about what if somebody calls in and can they get advice about the balance of investments. Let's talk about the timing because that has been raised by industry as well. When does that contract need to be signed?

Secretary PEREZ. Right. And as I said, I think, in response to a couple of other questions, we want to make sure that we are facilitating advice and that conversation and the shopping that is critically important for consumers. And so that is an area that people have said it doesn't feel clear enough to me when I have to sign the contract.

And so we are working together to make it clear. And our goal is to make sure that we can facilitate the shopping and that we are talking about it.

And one thing I think that is clear in the rule is that there is a heck of a lot that you can do right now. So you can go to your adviser and he or she will tell you, you know, what is your asset allocation and what is your risk tolerance threshold and let's go online and, you know, we can plug in some assumptions and you can see how if you go more equities versus bonds and given your risk tolerance threshold how it will affect you.

All of these things are in the realm of education. We have a whole group of folks that do a steady diet of educating, including seminars and things of that nature, because we recognize, again, as I have said, an educated consumer is the best customer.

At the same time, I am confident that line is going to be drawn even sharper as a result of the input that we are getting right now. And we welcome that.

Ms. BONAMICI. And I appreciate your involvement. And certainly, the products are much more complex than when I think ERISA was enacted in the mid-1970s. And you know, it really is a different world out there and it is critical.

So I just want to emphasize that I appreciate your Department's willingness to work with the industry, your openness to hear the concerns. Because again, we have the same goal, we want to make sure that people are getting advice that they can trust, that is in their best interest.

And even though prevention is obviously ideal, your story that you told at the beginning about what happened to the family, you know, it is devastating what happened. I hope they had a remedy and I hope that through this process we make sure that people who do end up in those situations have a remedy so that they don't lose their life savings and their home.

So again, thank you for your willingness to work with us. And appreciate your being here.

Secretary PEREZ. I look forward to it.

Ms. BONAMICI. Yield back. Thank you, Mr. Chairman.

Chairman ROE. Thank you for yielding.

Dr. Heck, you are recognized for five minutes.

Mr. HECK. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for being here today.

Secretary PEREZ. Good morning.

Mr. HECK. You know, I think we have heard from everybody on the panel that no one would disagree of the importance of making sure that it is the best interest of the client who is seeking investment advice that comes first, just like the patient seeing their doctor or the client seeing their attorney.

And again, it comes down to what my colleague just said about the implementation that seems to be under discussion and making sure that the actions of a few don't impact the practices of the many who are doing a good job and providing advice and education to their clients.

You know, I appreciated the anecdote you told about that couple that had problems with their investments. And you know, I have a constituent, Janice who called her insurance agent to see if he could help her with her recently deceased husband's 401(k) plan.

They were retired, lived off of his pension as well as Social Security. From time to time, they take some money out of the 401(k) to supplement their income.

Once her husband passed away, she became a beneficiary of a decedant 401(k). So then when Janice tried to get some much-needed money from a plan, she was informed from the company that she was not eligible to withdraw the funds anymore because she was the beneficiary and that she needed some help in understanding what her options were.

So she called her agent. They discussed her needs, went over some of her options. She could take the funds out and pay taxes, continue to invest the dollars using a rollover, discuss the types of risks she was willing to take in the time frame they were working with to help her meet her needs.

Ultimately, she was able to make a decision, rolled over approximately $21,000.

There are many people like Janice who perhaps would not be able to find the information and knowledge to take care of these or many types of 401(k) rollovers or transactions that are in their best interest under the proposed rule.

So if you could tell me, how does the rule actually protect the interests of individuals in this type of a situation?

Secretary PEREZ. Well, the rollover market is a huge market. And that is where you really need the right advice. And one thing that our rule does is clarify that employers are very much able to provide advice, including keep your 401(k) with us even after you leave. Because we are talking about, you know, a trillion-dollar impact here.

And so the standard, whether it is the rollover, whether it is, you know, how do I invest my 401(k), is the same. You have to make sure you are looking out for your clients' best interests.

Mr. HECK. And I would say that this situation, this is the insurance agent that they have used their entire lives, that they did have trust in, and that this insurance agent did look out for—

Secretary PEREZ. I would agree from the circumstances that you have described. And again, that insurance agent sounds to me, at least from the limited facts that we know, has been already looking out for people's best interests, which is why compliance with something you are already doing is very readily attainable.

Mr. HECK. You quoted, you know, Mr. Bogle of Vanguard saying that, you know, they would basically look for a simple rule where clients come first. However, it doesn't appear that this rule is that simple.

So there are concerns amongst those individuals, like this insurance agent, that the proposed rule would actually limit their ability for providing these services to their long-term clients, because before they enter into this discussion they are going to have to have a contract signed, they are going to have to have all this disclosure and disclose any potential fees that might be upfront.

I mean, it is the same thing if somebody was coming into my office that I had a long relationship with and all of a sudden I had to ask them to sign a disclaimer form and all these forms about potential fees and what not. Why would I continue to use that individual as my adviser?

Secretary PEREZ. Well, I actually think that the implementation of this is a lot simpler, sir, especially for those like the person you described who is already doing the job and is already abiding.

Because folks, whether it is a large firm, they already have in place policies and practices to make sure that they are mitigating conflicts. And so what we are saying now is, you know, you have an obligation to do that.

And so if they are already doing it, I think compliance is very workable.

Mr. HECK. I think we have a few seconds left. You said several times that commissions aren't banned under the rule.

Secretary PEREZ. Yes.

Mr. HECK. But what are the restrictions, obstacles or impediments to people providing products based on commission under the rule, if any?

Secretary PEREZ. Well, you have to make sure that you are putting your clients' best interests first. And so, you know, the situation that we deal with now is under the suitability framework. You may have four or five different options that are suitable, and two of those options get you a significantly higher fee than the other two options.

Well, if under a review of the circumstances that is reasonable, well, then, you could do it. But chances are, you know, the thing we are trying to do is correct the malalignment right now because I want to make sure that when that person is making the decision, making the recommendations to me, that he or she is motivated by my best interest as opposed to I have got four products here that are suitable and I want you to take these two products, even if it gets you 1 percent less.

I don't think that is right. And I think that has real costs for people.

And we have prepared a toolkit for every member of Congress who wants to use it so that they can help educate their constituents on the questions to ask. Because this is a complicated world and there is an inequality of information and we want to empower consumers.

Mr. HECK. Thank you, Mr. Chairman.

Chairman ROE. Time is expired.

And Mr. Secretary, we don't want to become fiduciaries.

Mr. Takano, you are recognized for five minutes.

Secretary PEREZ. You would do pretty good at it, sir.

Mr. TAKANO. Thank you, Mr. Chairman.

Welcome, Mr. Secretary.

You mentioned a few times in your testimony that this is a simple proposal that allows for flexibility to reflect not only different business models, but also the innovation and technological advances some in the industry have made and continue to make.

How do you envision the industry reacting in terms of product offerings and tech-based solutions? And how will this help small savers?

Secretary PEREZ. Well, let me take the example of Wealthfront. Wealthfront is a California-based company. They started roughly three years ago. And this is actually a letter from their CEO.

They were built from the ground up to operate under a full fiduciary standard, despite serving small accounts and charging incredibly low fees. And they have now become a $2 billion asset management company.

They don't charge management fees for accounts under $10,000 because "we do not believe we need to make money on those in the beginning stages of saving and investing. We charge a fraction of what others charge for accounts over $10,000."

"And we know that there is a significant debate regarding ways to increase the protections and requirements around providing high-quality fiduciary service. We believe technology can dramatically aid in this front."

"Wealthfront is living proof that not only is it possible to provide fiduciary service at low cost to small investors nationwide, but that the market rewards these efforts."

"And we believe that technology can not only improve the quality of service provided to small investors, but also lower the barriers and costs that have limited their access in the past, whether they are in California"—they have a 50-state footprint. I don't know whether they are in the CNMI.

But we have spoken to folks like Wealthfront. We have spoken to individual broker dealers who are doing this on the front lines. I think technology is a real ally in this.

Mr. TAKANO. But has this been borne out, the technology? My concern is that some would say, what I have heard from people in the industry, is that this rule will disincentivize people to help the small saver. And you are saying, well, technology will help offset that problem.

And I am just wondering, so Wealthfront has been able to build a market, they have been able to reach these small savers, the $10,000-a-year savers, I am just wondering whether or not if there is a test of this technology.

Yes, go ahead.

Secretary PEREZ. Well, Wealthfront is not the only company that has figured out how technology can be your ally in helping to serve small-, mid-sized, large-sized savers. I mean, technology is, I think, a linchpin to the innovation that is enabling more people to get access to advice. And that is why I think this is so important.

An equally important fact here, and I think this is something that often gets overlooked, is a lot of people don't seek advice right now because they don't trust the advisers.

Mr. TAKANO. Okay.

Secretary PEREZ. And what we are trying to do by establishing a best-interest rule is to help bridge the trust gap that currently exists. Because there is a lot of marketing out there, but sometimes the marketing and the reality, there is a little bit of a gulf between the two.

And so when we can have, you know, increased trust by having a best-interest standard, I think we help everybody, including small savers and large savers, get access.

Mr. TAKANO. I want to talk more from the point of view about the remedies for the saver who thinks that they have been deceived or misled.

At the end of the day, this rule is about guaranteeing Americans being able to make investments to retire comfortably. Can you tell me a bit more about the process for investors if they feel they have been misled?

You talked about the mandatory arbitration. But are there other remedies besides? I mean, arbitration may be a big part of it. Under what agency would they seek redress? Is it FINRA? Who is the—

Secretary PEREZ. Well, we currently, our Employee Benefits Security Administration, EBSA, we have right now a robust docket of enforcement cases. Bernie Madoff, we were part of that prosecution team. The Enron case, we were part of that effort.

We have a steady diet of cases right now involving folks who have breached their fiduciary obligation to the detriment of individuals. And so that will continue.

In this particular rulemaking, you know, what we are trying to do is to create for the individual who has been wronged potentially a remedy through the best-interest contract. The proposition that we are putting forth here is that you now have an enforceable contract, so that looking out—

Chairman ROE. Mr. Secretary, could you go ahead and wrap that up because we have another panel also—that answer.

Secretary PEREZ. I am done, sir.

Chairman ROE. Time is expired.

Mr. TAKANO. Thank you, Mr. Chairman.

Chairman ROE. Mr. Allen, you are recognized.

Mr. ALLEN. Thank you, Mr. Chairman.

Secretary PEREZ. Good morning, sir.

Mr. ALLEN. Thank you, Mr. Secretary. Thank you for being here. Appreciate what you are doing.

You know, you talk about trust. I am from the small-business community myself and about 30 years ago recommended that our

folks participate in our 401(k) program. Of course, I am assuming that now makes me an investment adviser. I don't know.

Secretary PEREZ. Actually, it doesn't, sir.

Mr. ALLEN. It doesn't? Okay. But anyway, recommended that. And they asked me, well, why? And I said, well, you know, frankly, I can't trust that Social Security is going to be here when you retire, you know, based on if you look at the actuarials and all that of Social Security.

And so, yes, there is a trust problem out there, even with our own Social Security system. Exactly where is that going and why aren't we working on that to try to fix that and then we will start giving people advice on how to deal with their own savings?

But as far as the rule is concerned, obviously the investment business is just like my business, it is a relationship business.

You know, I have never had anybody that hired our company that went to the Internet and said, well, I am going to pick this company. You know, they would actually check out exactly our reputation in the industry.

Plus the fact, as I understand it from my friends in the investment business, it is a highly regulated industry already. And the fact that you had the Enrons and the others involved, you know, part of that problem was the fact that it was accounting that should have been long ago discovered as far as, you know, keeping two sets of books.

But as far as trying to give investment advice, I don't quite understand how you are going to make this work. I mean, say you are dealing with my business right now and you said, okay, we are going to implement this rule in your business. What would that look like?

Secretary PEREZ. Well, again, you aren't a fiduciary, sir, because you are running a business.

Mr. ALLEN. Okay.

Secretary PEREZ. If somebody is giving you advice or there is somebody, your employee, has $100,000 in their 401(k) and they want to know how to invest it and they go to an adviser and he or she gives that person advice, they simply have to look out for your best interests. Just like if you go to the doctor, they have to look out for you.

Mr. ALLEN. Let me ask you this. You know, I advised our folks to get involved in this 401(k). Well, they were all tickled to death with it until 2008 and 2009 when the market took a tumble.

And along with my investment adviser and myself, we suggested that, hey, you know, America is going to come back. We need to have the confidence the country is going to come back.

Now, I am going to tell you what, they are a happy bunch right now. But what would it look like had that not happened? And here I am and my investment adviser had given this advice, what does your rule do to me then?

Secretary PEREZ. Well, again, you have a duty to act with reasonableness and prudence, just as a lawyer has a duty to look out for their clients and a doctor has a duty to look out for her client, her patient.

Mr. ALLEN. Who determines that? Who determines what is reasonable and prudent?

Secretary PEREZ. These are rules. Reasonableness and acting with prudence, this is a construct that has been in place in the financial service industry for literally decades, just as in other contexts, whether it is, you know, in the medical malpractice context, the duty of care. That is not a new concept.

And so the notion that you have to look out for your customers' best interests isn't anything new. And in fact, you know, again, many people are already doing it.

Mr. ALLEN. Don't we already have those rules in place?

Secretary PEREZ. For some, but not for everyone. And that is why it is really confusing. Because if your constituents, when they go in, they think that everybody is looking out for them and some have a legal obligation to do it and some don't. That is a problem. That is confusing.

Mr. ALLEN. So how are you then going to mandate that people, I guess, check out their reputation or their investment advice?

Secretary PEREZ. Well, no. What we are establishing is that the adviser that they seek out has an obligation to look out for their best interests. I cannot, we do a lot of education and outreach and we hope that people will take the due diligence that they need.

But what we are doing is making sure that the people they go in to see, we are taking out the uncertainty. Is this person looking out for my best interests or does this person have other options? I don't think that is good for consumers. That is why we are doing this.

Mr. ALLEN. How can I—

Chairman ROE. The gentleman's time has expired.

Mr. ALLEN. Thank you, Mr. Chairman.

Chairman ROE. Ms. Wilson, you are recognized for five minutes.

Ms. WILSON of Florida. Thank you, Mr. Chair.

Secretary Perez, good to see you.

Secretary PEREZ. Good to see you.

Ms. WILSON of Florida. I know that you are just as concerned as I am about the economically vulnerable. I represent one of the most economically depressed districts in the country and these individuals I represent work extremely hard to provide for their families, but they struggle to make ends meet. The median household income in my district is $36,748 a year, 30 percent less than national average.

South Florida also has a high cost of living which is growing faster than the national average. These economic realities make it extremely difficult for my constituents to save at the levels that guarantees a secure retirement.

In fact, on average, south Floridians have saved 20 percent less in their 401(k) retirement accounts than the average American.

For example, as a former educator I worked with many teachers who lived on limited wages for years, but were given lump sums out of DROP, sometimes as much as a half-million dollars to last them through retirement. They did not know what to do with all of that money.

Because there is so little margin for error for those with limited savings, I want to be sure that they have access to sound advice from financial professionals, trusted.

My late husband was a financial adviser, so to speak, back in the 1980s. He sold tax-sheltered annuities to first-time people who had little money, but were able to save.

So I know there is going to be a rule. I know there is a proposed rule. And I am hoping that this rule will make sure that, when it is finalized, that people are not intimidated and will find the process access-friendly, that they will want to save and be given that sort of financial assistance.

I want to thank you for responding to my letter and extending the comment period so stakeholders have the opportunity to submit comprehensive feedback.

And under your leadership, I am confident that the department will continue to engage with stakeholders and the public and really look at the feedback that has been provided, because it is my understanding there has been a lot of feedback.

I know how committed you are to making this rule work for all investors. I have heard your life story and I know where you come from and how you have achieved.

Can you speak more about the process that will ensure that all interested parties are heard in the formation of the final rule?

Secretary PEREZ. Certainly. We are in the middle of the formal comment period. One of the things that we don't generally do, but we did here, was to have a public hearing in August so that we can take additional comments on the rule. Following that public hearing, we will publish that transcript of that hearing and invite comment on that.

We continue to do regular meetings. And I am working not only, you know, with our team, but a lot of other folks have been involved in this effort. My colleague Jeff Zients at the White House has been very helpful.

And our goal is to get it right. I think we can thread this needle. Your concerns that you have expressed about small savers, everybody, that is a concern we all share. And I actually think that small savers can least afford the consequences of conflicted advice. And you know, places like Wealthfront and others are serving every corner of this country now.

And I look forward to learning from you and others about how we can use this as an opportunity to actually enhance access to services for everyone, but in particular for small savers, because I think we can. Because when we increase trust in the people from whom you are getting the advice, then we can increase access even greater.

Ms. WILSON of Florida. Just one final comment. Technology is very intimidating to many people in our communities. It is something that we feel comfortable with because this is what we do. But people who don't have access to technology, it is intimidating. So let's be sure that we don't eliminate them from the equation because they are thrust into a pit that they don't quite understand—

Secretary PEREZ. The human element, absolutely.

Ms. WILSON of Florida.—but that when this rule is finished, they will have the same opportunities.

I want to make sure that not only people with small amounts of money, but first-time investors, people who find themselves with

DROP, a half-million dollars and not know what to do with it. These are the people I am concerned about.

Thank you.

Chairman ROE. Thank you. The gentlelady's time is expired.

Mr. Messer, you are recognized for five minutes.

Mr. MESSER. Thank you, Mr. Chairman.

Thank you, Mr. Secretary.

You use the phrases "small savers" and "first-time investors," and that is what we are here to talk about today in this hearing.

I represent a district full of those people. I represent 19 counties in east, central and southeastern Indiana, working communities, people that work in agriculture and manufacturing.

I am also the product of a single-parent family. My mom just retired from the Delta faucet factory there. She raised my brother and me on her own. She was somebody that couldn't really afford to save until she was well into her 40s and falls in the category here.

I think one of the things we have got to remember as policymakers is we aren't just accountable for our intentions, we are also accountable for our results. And we could bring forward rules with the best of intentions designed to protect people that, in the end, actually hurt the very people we are trying to protect.

I think part of the challenge of threading the needle here that you have talked about is we have looked at other countries that have tried to do it and not had much success. And so we need to be careful that with the best of intentions of protecting these investors we don't end up making their situation much worse.

Of course, the best way to avoid that is by coordinating with others who have knowledge in the field.

And I know Chairman Kline talked to you a little bit about your efforts to coordinate with the SEC. We are, of course, concerned that we haven't gotten the documentation from you that shows that coordination also at the Department of Labor.

I want to give you a quote and ask you to respond to it, Secretary Perez. In February of this year, SEC Commissioner Daniel Gallagher said the follow, "The DOL has not formally engaged the commissioners, at least not this commissioner, on its fiduciary rulemaking process and the impact it may have on investors. And despite public reports of close coordination between the DOL and the SEC staff, I believe this coordination has been nothing more than a check-the-box exercise by the DOL designed to legitimize the runaway train that is their fiduciary rulemaking."

Secretary Perez, is this true?

Secretary PEREZ. I did not coordinate with that particular commissioner because I coordinated with Mary Jo White. She was the one commissioner because she is the chair, just as when I coordinate with the EEOC I go through the chair.

And the documentation—

Mr. MESSER. All this work is done at the chair level?

Secretary PEREZ. Pardon me?

Mr. MESSER. So all this work is done at the chair level, there is no staff coordination?

Secretary PEREZ. No. If I could finish, sir. The documents, the 800 pages of documents that we have provided demonstrate the

dramatic and extensive coordination between our staffs. And you will look and see that there is, you know, page after page of documentation relating to meetings, relating to calls, relating to conversations about various aspects of the rule.

I also traveled, sir, to the U.K. because I wanted to learn from their experience as well. And what we learned, we learned a lot about how the U.K. experience can inform our judgment.

I have also spoken to the Consumer Protection—

Mr. MESSER.—specifics about what was—

Secretary PEREZ. Pardon me?

Mr. MESSER. Much of that documentation didn't include specifics about what was discussed in those meetings.

Do you care, does the Department of Labor care about the inconsistency and confusion that could result from unharmonized rules of the road in this area?

Secretary PEREZ. Well, it is interesting that the former chair of the SEC is very supportive of the Department of Labor moving forward. And actually, the current chair has indicated publicly that she thinks the best-interest standard is the right way to go for the SEC regulatory agenda.

So actually, she is saying conceptually that they should be doing the same thing that we are proposing in this rule.

Mr. MESSER. Again, I think most folks, no one would quarrel with the intention of protecting these investors. The question is, will these rules actually make matters worse for those investors?

You commented earlier about potential coordination with FINRA. And I want to give you another quote and give you the opportunity to respond. In March at the 2015 Annual Financial Industry Regulatory Authority Conference, FINRA Chairman Rick Ketchum said, quote: "I fear that the uncertainty stemming from contractual analysis and the shortage of useful guidance lead many firms to close their IRA businesses entirely or substantially constrain the clients that they will serve."

Secretary Perez, to what extent did you coordinate with FINRA and other industry analysts? And why didn't you address their concerns?

Secretary PEREZ. Well, actually, what is interesting to note, if you look at the totality of Mr. Ketchum's comments, he says now that a best-interest standard is indeed the right way to go, and I appreciate that. He says a requirement, and he talks about the solutions, requirements that firms carefully design structures and procedures to minimize conflicts, that is what we are trying to do in this rule. Adherence to existing security laws, more effective disclosures.

So actually, there is a remarkable amount of overlap between what our rule says and what he stated.

And we met with FINRA staff as recently as last week. And we met with the Consumer Financial Protection Bureau.

I personally traveled to England to meet with regulators over there and learn from them. We have done a lot of outreach and will continue to because it is important in this process.

Mr. MESSER. Thank you. And we appreciate your time.

Chairman ROE. I thank the gentleman for yielding.

Mr. Jeffries, you are recognized for five minutes.

Mr. JEFFRIES. I thank the chairman for yielding, as well as for Secretary Perez for your presence and your leadership.

The rule that we are discussing today was first put forth in 2010. Is that correct?

Secretary PEREZ. Yes, that was 2010.

Mr. JEFFRIES. And then it was subsequently withdrawn. Is that right?

Secretary PEREZ. It was withdrawn and then we re-proposed it earlier this year after a lengthy period of outreach.

Mr. JEFFRIES. And can you walk us through sort of the substantive changes that have been made from the withdrawal to the re-institution of it?

Secretary PEREZ. Sure. One of the issues that was raised was there was a concern about having a more extensive economic analysis. So this rule contains a much more extensive economic analysis.

There was a concern that Congressman Guthrie and others addressed about a provision we had in the 2010 rule about employee stock ownership plans. And the recommendation was to take that out, and we took that out.

There was a concern about giving more flexible exemptions from the rule that you have to put your clients' best interests first. And the best-interest contract exemption is the attempt to do just that, so that we have created guardrails, but not straitjackets. So that is a new feature of this rule.

We clarified the line between education and advice and we continue to take comment on that to see what the reaction is to where the line is drawn. And we have had some discussion about that today.

So those are some examples of, I think, material changes from now as opposed to 2010.

Mr. JEFFRIES. Thanks. Now, there has been some discussion about ongoing engagement with the SEC.

Secretary PEREZ. Yes.

Mr. JEFFRIES. Has that engagement resulted in any substantive changes that have either been adopted or are under consideration?

Secretary PEREZ. Well, I think the SEC, our interaction with them, especially I had interaction I think there was eight different times with Chair White, our staffs have been together innumerable times, and I can certainly tell you with confidence that I think the rule, the proposal is a better proposal as a result of that interaction. It was a soup-to-nuts interaction talking about, you know, so many aspects of this process.

Mr. JEFFRIES. Are there any specific concerns that the SEC raised that the Department of Labor has responded to in yielding the newly proposed rule?

Secretary Perez. Again, you know, we had a consistent back-and-forth. And again, we welcome that. And I had a consistent back-and-forth with Chair White. I didn't participate in the career-level meetings and those were the ones where there was a lot of good discussion and good feedback under way.

And again, I think as a result of that feedback you will see there are provisions in the rule that I think are very, very, you know, informed by our judgments and our feedback, not only from them,

but from the Consumer Financial Protection Bureau, from members of Congress, from consumer groups, from industry stakeholders.

Everybody has an expertise to bring to bear in this. And our goal was to make sure we built a big table so that we could take all that advice to bear.

Mr. JEFFRIES. Now, is my understanding correct based on your earlier testimony that the CEO of Bank of America supports the proposed rule?

Secretary PEREZ. Well, what I said before was that what Brian Moynihan said was we believe that doing what is in the best interest for your customers is absolutely the right thing to do. We have been clear that we see the industry moving and we expect to help it move there.

And so, you know, the fundamental tenet of this rule, which is that you have to act in your clients' best interest, is a tenet that has increasing support.

Now, we are getting a lot of feedback from everyone, including but not limited to B of A, about the questions of operationalizing that and making sure we give it good meaning and that we address the issues of unintended consequences, things of that nature.

But a really important part of this rule, a linchpin if you will, is making sure that when you walk in and your constituents walk in to get advice that they don't have to wonder whether that person is operating under one standard, a higher standard or a lower standard or maybe both.

Mr. JEFFRIES. Lastly, as my time is expiring, Mr. Secretary, how would you define a small investor in terms of is there a threshold, is there an amount of the investment? Who are the individuals that could potentially benefit or could potentially be harmed by this approach depending on what stakeholder you are listening to?

Secretary PEREZ. I think any investor who is going to have greater assurance that his or her person giving the advice is looking out for their best interests is going to be benefit.

And you know, small, medium, large is kind of in the eye of the beholder. You know, I have spoken to people who have clients that have $5-$10,000 in their portfolio. I have spoken to people with clients who have millions. And the rule is the same.

Chairman ROE. The gentleman's time is expired.

Mr. Grothman, you are recognized for five minutes.

Mr. GROTHMAN. Thank you very much.

My first question is with regard to fraternal organizations, okay? Fraternal organizations, okay?

Secretary PEREZ. Okay.

Mr. GROTHMAN. Fraternal organizations, first of all, are a little bit different breed because they have certain requirements under the IRS code so they are, you know, kind of highly regulated by another agency. And for that, they also disproportionately, I think, take care of smaller investors, maybe a lot of the IRAs or under $25,000, which is just kind of a unique thing as well.

And I think the combination of the fact that they have their own rules under the IRS and that they have a lot of smaller investors are going to make this much more difficult for them to implement.

Have you had discussions with these fraternal organizations? And are you prepared to have further discussions and maybe make changes so that these large organizations which have so many investors in them, including myself, are continued to be able to thrive?

Secretary PEREZ. The short answer is we have had discussions with fraternal organizations. I think that is 501(c)(8) of the Internal Revenue code.

And what we did in the rule, we ask a number of questions in the rule, and one of the questions that we ask is: do you have a unique set of circumstances that dictate that we should be taking a different approach as it relates to your circumstance? And this is an example.

The meetings that have been taking place with fraternal organizations, that is the issue that we invited. And I welcome that and we are having that discussion as we speak. And I look forward to your more specific observations about what you think should be done in relation to them.

Mr. GROTHMAN. Well, if you want, we can meet in my office. I mean, I think right now these large organizations with I am sure millions of investors and many employees are really jeopardized. And that is a problem you have whenever you have, you know, some massive new rule, some one-size-fits-all rule. Sometimes you have people who don't fit that rule.

And I am told and it makes sense to me that this would be devastating for these large organizations.

Now, do you plan on making further changes before this rule would be implemented or meeting with them again?

Secretary PEREZ. Oh, again, we have already met, we will continue to meet. And the purpose of meeting with people is to learn from people and figure out what changes are called for in a final rule.

And as you have seen, the current proposal is far different from the 2010 proposal. And that is because we sat down, we built a large table and we listened to folks. And we are continuing that process now.

And so I appreciate the fact that folks have been taking us up on it. And anyone who comes to see you to say I have a challenge, I would encourage you to send them our way because we want to listen and learn.

Mr. GROTHMAN. Good. Good. That will be good.

Next quick question, and I am kind of jumping ahead here to the testimony of somebody that is going to be speaking later, it just kind of jumps out at me that apparently there is going to be a public database of compensation, total compensation given to employees of firms or that sort of thing. Is that true?

Secretary PEREZ. There is a transparency provision that is designed to get at the following problem. Compensation schemes are very opaque right now because you can legally get your fees from different sources in this. And what we want to make sure is when consumers are making judgments they understand how much things cost and so they can make an informed judgment as to whether this is a good deal for them.

Mr. GROTHMAN. Right. Just what kind of jumped out at me was, you know, if I am making $40,000 a year, if I am making $90,000 a year, if I am making $150,000 a year, all of a sudden, am I reading this right, that all of a sudden that is going to be public knowledge? I mean, maybe it should be. I am just saying it is kind of interesting.

Secretary PEREZ. Well, the database isn't public. I think the one you are referring to is not a public database.

Mr. GROTHMAN. It says a website. No?

Secretary PEREZ. But it is not a public website.

Mr. GROTHMAN. Okay. Final question I have for you. People are permitted to earn reasonable compensation and nobody should be able to earn unreasonable compensation, of course, but who defines that and what is the definition of reasonable compensation?

Secretary PEREZ. Well, again, these are definitions that have been part of the practice for literally decades. You know, acting with reasonableness and prudence under the circumstances.

Everything is a case-specific determination, but these principles of acting prudently and looking out for your consumer, your customers' best interests have been well-established. This is not something that is drawn out of thin air.

Chairman ROE. The gentleman's time has expired.

Mr. Hinojosa, you are recognized for five minutes.

Mr. HINOJOSA. Thank you, Chairman Roe.

Can you hear me?

I want to thank you and Ranking Member Polis for holding this important hearing.

But I especially want to thank Secretary Perez for being here and for the work you and your staff have been doing in the conflicts of interest rule re-proposal.

Subcommittee Chairman Roe and I co-chair a Senior Citizens Caucus, which covers financial literacy to help these senior citizens make good financial choices in their retirement years.

So this rule that we are discussing is of great interest to both of us as chairs and to many members on both sides of the aisle, as I have heard the questions.

I think that we want to ensure access to advice at a very low administrative cost as federal employees which number probably several million get a quarter of 1 percent administrative costs for investing our Thrift Savings program investment and retirement portfolio.

I think that I really paid attention to Congressman Rick Allen from Georgia, giving us his example of investors losing a large amount back in December 2007 and the following year, 2008, which is the time of the worst recession in 50 years.

And I enjoyed listening to how you handled that. And many of us did the same. We stayed in the market.

But I will say to you, Mr. Secretary, that sometimes older men and women have good advice, simple. I remember hearing one tell me, just remember that you buy low and sell high. And so I did that. On the first week of January of 2008, I called and I changed my particular investment portfolio into Treasuries 100 percent. And that is the best thing that I could have done.

Secretary PEREZ. Why didn't you call me, sir? I could have followed suit.

[Laughter.]

Mr. HINOJOSA. I can only say that this hearing today has been very, very interesting.

And I want to ask a question or two before my time gets away.

I read Mr. Haley's written testimony which reads he claims the best-interest contract is problematic and that the rule is unworkable as drafted. Moreover, that small business and lower and middle-income investors will be harmed the most.

Mr. Secretary, in your view, do you believe this to be the case?

Secretary PEREZ. I don't, for all the reasons that I have discussed. Small investors are the ones who can least afford the consequences of conflicted advice.

Mr. HINOJOSA. I absolutely agree with you 100 percent. Let me ask you another question because we agree on many things.

I am most interested in the proposed rule's impact on the small savers and those middle-class workers who do not have hundreds of thousands of dollars to invest, but who are interested in insuring what they do have to invest, they want it to grow, and I want their savings to do that, too.

Is there any reason that they should expect to pay more for the administrative services they currently receive as in examples that I heard that are up to 4 percent of the investment?

Secretary PEREZ. Well, I think it is not going to be in your best interest. I would rather have more money in my pocket when I can get a better return. And the challenge right now is that the system is misaligned and too often advice is motivated by the fees it generates for the person giving the advice as opposed to what is in the best interest of the customer.

Mr. HINOJOSA. In my opening remarks, I said that we, federal employees, and we number in the millions, only pay a quarter of 1 percent for advice and for them to do the investments for us. And that 4 percent, as you said, is way, way too high.

So I will ask one last question before my time is up. Would you say this rule can help address the challenges in retirement savings gap many Hispanic and minorities face when it comes to saving for retirement, because they, according to the materials I have read, are amongst the highest, like 40 percent, that have very little in assets to protect and invest?

Chairman ROE. Mr. Secretary, I am going to have to ask you to hold that thought.

Secretary PEREZ. I have one sentence.

Chairman ROE. I am sorry. The time has expired.

Mr. Carter, you are recognized for five minutes.

Mr. CARTER. Thank you, Mr. Chairman.

Secretary, thank you for being here.

Mr. Secretary, I have to be quite honest. I am going to preface my questions by saying that I am deeply disturbed by this and not in favor of this at all. I will just go ahead and tell you.

But, let me ask you something. The premise for your action here seems to be that you are saying that conflicts of interest have resulted in higher fees for those that are in IRAs than are in 401(k)s

and that it is because of these conflicts of interest that it has resulted in the higher fees.

Yet the Investment Company Institute has discredited that number and said that isn't true, said that it has only increased at .16 percent and that indeed can be attributed to the fact that they get more advice and that they get a higher level of service.

So if your premise is that the conflicts of interest are the reason why we need to have contracts, and yet we have the Investment Company Institute who disputes that, what is your premise then?

Secretary PEREZ. Well, sir, we have many people in the industry who are saying that we need to have a best-interest standard because the system is misaligned. When I go in to see my doctor, I know that he or she is looking out for my best interest. I have got cancer, you are going to tell me what is best for me, you aren't going to tell me what is suitable for me.

And when I go into a doctor or when I go into a financial adviser and they are telling me what is suitable, well, what that means is that there may be four or five products that are suitable.

Mr. CARTER. But aren't you kind of painting it with a broad brush here by saying that all investment bankers or all investment consultants don't have your best interests at hand?

Secretary PEREZ. Well, with all due respect, sir, in my opening statement I explicitly said that most of the people in this business are trying to do the right thing. There are a few bad apples.

What we have is a structural systems problem. People are rational, they respond to the incentives that are there. And it is perfectly legal right now to steer someone to a product that maximizes your return as the broker dealer at the expense of the return of the individual investor.

And that is what we are trying to change. We are trying to change this malalignment and make sure that every time I walk in and every time your constituent walks in, they can have confidence that their adviser is going to do that.

Mr. CARTER. Mr. Secretary, wouldn't you agree that this is already an over-regulated field, that we have probably more regulations in this area than we have in any other area? And what you are suggesting is that more regulation will actually solve the problem.

Secretary PEREZ. The Toffel family couldn't disagree with you more, sir, because the Toffel family lost $50,000 as a result of conflicting advice.

Mr. CARTER. I understand that. But there have been many families, and I am sure you could give many situations and many examples, where just the opposite has happened where you have had advice given by advisers that has resulted in people being able to live a better retirement.

Let me give you an example. I am a small-business owner. I have owned a small business for over 27 years now. When I first went into business, I started a 401(k) within my business. And I will say that it is one of the best things I ever did, a great program. And it is one of the things that I am most proud of in my business, the fact that I can offer my employees that kind of program where they can invest, I can help match, we have profit sharing within that, they can borrow from it and they do that.

In fact, just this past week I had an employee who is actually borrowing from her 401(k) in order to pay medical bills that she is saddled with right now.

So that is something that has worked out well. And I don't think that I would have done it had I had to enter into a contract with a financial adviser. I mean, I am a pharmacist and my patients don't have to sign a contract with me before I make recommendations for them.

I am not seeing where more government regulation is going to solve this problem. This seems to me to be a solution in search of a problem.

Secretary PEREZ. Well, sir, one thing I can wholeheartedly agree with you on is we will not agree on this.

Mr. CARTER. Well, and you are absolutely right because the fact is that I am a free market person. And the fact is that I believe the free market works.

My example, unlike what you might see, is a better example and an example of where it has worked and it has worked well. And I am very proud that I was able to offer that to my employees. They are very happy with it. I am very happy with it. It provides all of us with a good retirement and it did not come about because we had a contract with a financial adviser.

Mr. Chairman, I yield back.

Chairman ROE. The gentleman's time is expired.

Mr. Scott, you are recognized for five minutes.

Mr. SCOTT. Thank you.

Mr. Secretary, what is wrong with the free market just taking place and people being able to get what it can out of transactions?

Secretary PEREZ. Well, the free market didn't quite work for the Toffel family, congressman. And it didn't work because the system right now creates incentives and it is perfectly legal for people to give advice that is motivated not by a concern first and foremost for your clients' best interests, but by the fee structures. That is what we are trying to change.

Mr. SCOTT. If you had the free market, would there be any limit to what an unscrupulous adviser could get out of a client, even if they might agree to it?

Secretary PEREZ. I fear we would have more Toffels.

Mr. SCOTT. When we are talking about pension funds, this rule only affects pension funds, is that right?

Secretary PEREZ. Well, it affects, you know, 401(k)s, it affects IRAs, it affects rollovers. Trillions of dollars is what we are talking about right now.

Mr. SCOTT. Tax-advantaged accounts.

Secretary PEREZ. Correct.

Mr. SCOTT. We made these tax-advantaged for a reason. Is there any reason that they should be treated more preciously than other funds that an investor may have?

Secretary PEREZ. Well, Congress made a judgment to give tax-preferred treatment, and that was a good judgment, that was a sound judgment. I don't think Congress made a judgment to give tax-preferred treatment so that people who are then trying to make sure they have a healthy retirement, like the Toffels, then get

themselves into the circumstances they have found themselves in, which were totally preventable.

Mr. SCOTT. We have heard about this industry being highly regulated. Did I understand you to say that if an investment adviser knows that another product may not be as good, but he can make more money on the other product, that he can sell that product to the client knowing that he is going to make more and the client's going to make less?

Secretary PEREZ. There is a suitability threshold that must be surmounted. But within that suitability threshold, you can have a number of products that have different commission or other fee structures for the person selling that.

And the current system does not prevent you from taking advantage of that incentive. And I think that is wrong, and that is what we are trying to change.

Mr. SCOTT. So if you are selling essentially an S&P 500 fund and you know that the client could get it at a much lower price, there is nothing wrong in the present system in selling the mutual fund that pays the broker more money right out of the client's pocket.

Secretary PEREZ. You would want to look at not simply price, but return and things of that nature.

Mr. SCOTT. S&P 500 fund, all of them are going to do essentially the same.

Secretary PEREZ. The premise of your question, yes, I mean, assuming all things are equal, then that is the challenge that we are trying to address in this rule is to make sure that we are putting your clients' best interests first.

Mr. SCOTT. Now, how would a client know that they are getting ripped off like this without the rule?

Secretary PEREZ. That is a huge part of the challenge that we confront, because people are unaware. You don't know what you don't know. There is a very significant inequality of information here. And that is why this rule is necessary.

Mr. SCOTT. And that is why the client went to the adviser in the first place to try to get some good advice.

Secretary PEREZ. Well, and they assumed that they were trustworthy. They read the marketing materials. And in fact, most are very trustworthy, but we are trying to do the Ronald Reagan trust but verify by having an enforceable contract.

Mr. SCOTT. What level of sophistication are we talking about? People coming to an adviser looking for the right advice, how vulnerable are many of the people to getting ripped off?

Secretary PEREZ. Well, if you are like me you don't know a heck of a lot about it. And I feel like I am a fairly educated person, but I also when I go to my financial adviser I feel the same way as when I go to my mechanic. These are two areas where I know very little about and I want to trust somebody else and I want to make sure that trust isn't misplaced.

Mr. SCOTT. Thank you, Mr. Chairman.

Chairman ROE. I thank the gentleman for yielding.

Thank you, Mr. Secretary.

And before I close, just a couple of comments. I think we all agree with the best-interest standards. I think everyone in the in-

dustry does and everyone here today does. I don't think there is any issue about that.

Also, the GAO report clearly showed that we have 29 percent of the people in this country that have saved no money over 55, that is over half the nation; 23 percent just have a small defined benefit and no savings.

So we have a huge crisis. I don't think we need to make it harder. We need to make it easier for people to invest money. Forty-five percent of people in the TSP have a default, that is just a treasury, and that is a very poor return.

And you gave an example of a very unfortunate investment advice. Let me just share, Mr. Carter shared with you some, I can share with you many of them. A $78,000 investment in November of 1996 that went through the worst economic recession since the Depression, that in March of 2015 in a broker dealer fee-based plan was $362,000 left alone and invested with that same advice. So there are great stories out there also.

And I think the question I would have to ask is, at the end, and you can think about this, does this rule make it easier? And for businesses to do this, does it make it cost less?

Can you make a commitment basically today that no one will lose their financial adviser? I mean, it is like the President said if you like your doctor you can keep it, but it didn't work out that way in reality when all the rules of the *Affordable Care Act* came in.

Will people not pay higher costs, a low-income person who very much Ms. Wilson and others over here are worried about? The small investor, will they be forced into a plan where 1 percent of $10,000, maybe three-fourths of a percent that I might pay on a managed account, are they going to have to pay that?

So those are the things I think we need to think about in the rulemaking process.

And I want to thank you for being here. You have been very forthright today. And look, for a large family like yours with five in the family, four out of five turning out okay was not bad.

Secretary PEREZ. That is pretty good. I agree.

[Laughter.]

Chairman ROE. So thanks very much, Mr. Secretary.

Secretary PEREZ. Thank you for your time, sir.

Chairman ROE. Thank you.

Secretary PEREZ. And I always appreciate your courtesy.

Chairman ROE. Thank you so much.

It is now my pleasure to invite our second panel to the witness table, please.

It is now my pleasure to introduce our distinguished panel of witnesses for the second panel. Our first witness is Mr. Kent Mason who is a partner of Davis & Harman LLP specializing in employee benefit matters. Prior to entering private practice, Mr. Mason held positions at the Joint Committee on Taxation and in the Treasury Department. He represents a broad cross-section of firms that offer and service employee benefit plans.

Mr. Jack Haley is the executive vice president, Professional Services Group, with Fidelity Investments. He has been with the company more than 30 years and currently serves on its executive

board. Mr. Haley also currently serves as president and chairman of the board of directors of Fidelity Management Trust Company.

Mr. Dennis Kelleher is the president and chief executive officer of Better Markets, Incorporated, a nonprofit organization that promotes the public interest in the capital and commodity markets. Previously he has held several senior-staff positions in the United States Senate and was a partner with the law firm of Skadden, Arps, Slate, Meagher & Flom.

Dr. Brian Reid is a chief economist at the Investment Company Institute where he leads the institute's research departments. Previously, Dr. Reid was a staff economist at Monetary Affairs Division of the Federal Reserve Board.

Lastly, Mr. Dean Harman is the founder and managing director of Harman Wealth Management. He has over 17 years of experience working with individuals and families with planning and investment management. Mr. Harman is a member of the Board of Directors of the Financial Services Institute.

Mr. Mason, you are recognized—well, before I start let me swear you in.

[Witnesses sworn.]

Let the record reflect the witnesses answered in the affirmative.

And you may take your seat.

Before I recognize you to provide your testimonies, let me briefly explain our lighting system. You have five minutes to present your testimony. When you begin, the light in front of you will turn green. When one minute is left, the light will turn yellow. When your time has expired, the light will turn red. At that point, I will ask you to wrap up your remarks as best as you are able.

And members will each have five minutes to ask questions.

Mr. Mason, you are recognized for five minutes.

STATEMENT OF MR. KENT MASON, PARTNER, DAVIS & HARMAN, LLP, WASHINGTON, D.C.

Mr. MASON. Thank you, Mr. Chairman.

My name is Kent Mason. I am a partner with the law firm of Davis & Harman and I have worked in the employee benefits area for over 30 years.

I want to thank the subcommittee for inviting me here to testify. I am testifying today on my own behalf based on extensive discussions with plan sponsors as well as numerous financial institutions.

Before turning to the meat of my testimony, I want to mention three key points. And this first one echoes, I think, what you have said here, Mr. Chairman.

The industry is absolutely fine with a best-interest standard and has been for the past four and a half years, you know? I mean, every time somebody says, well, now, there is concern from the industry, there hasn't been for four and a half years.

The concern has always related to the prohibited transaction rules. And these are the rules that make certain business models effectively illegal, such as the brokerage model; and those are the business models that provide assistance to low- and middle-income individuals and to small businesses. So that has been the issue for four and a half years and it has really not been addressed.

The second point I want to hit is, even aside from the advice issue, we have had a lot of talk this morning about education. I just want to make one thing clear. The 2015 proposal significantly cuts back on permissible financial investment education. 2010 preserved financial education; 2015 explicitly cuts back permissible financial education.

And that leads to the third point I want to hit before going to the meat of my testimony, which is I think there has been a perception that this has been an evolution. That we took the 2010 proposal and we sort of updated it and made some progress and we got to 2015 and we are going to make some more progress.

In actuality, there is a growing consensus among the industry that the 2015 proposal, and this is detailed in my written testimony, is actually much worse and much less workable than the 2010 proposal. So the trend line is going in a disturbing direction.

In the meat of my testimony, I would like to focus on two points: the effect of the re-proposal on small accounts, small IRA accounts, and the critical need for legislation.

Small accounts, there are two ways that IRA accounts can get assistance. One is the brokerage model with commissions paid and payments from the mutual funds, such as marketing fees or record keeping fees.

As I explain in detail in my written testimony, as a practical matter the proposal makes the brokerage model illegal. So really, that model is off the table.

The second way to provide investment assistance is through something called an advisory model. Now, if somebody comes to me and says I want to enter into an advisory relationship, what I owe that person is 24/7/365 fiduciary responsibility. I owe them around-the-clock fiduciary responsibility.

In exchange for that, what I get is a flat fee like 1 percent of pay. And that 1 percent of pay, the problem is that structure won't work for small accounts. Because if somebody comes to me with a $4,000 IRA, I can't provide around-the-clock, 365-day service for $40 for 1 percent of pay. So that is not available to small accounts.

Oliver Wyman found that because of this analysis, just under their study sample, over 7 million IRAs would lose access to an investment professional and as many as 360,000 fewer IRAs would be opened every year.

And a lot of the reaction to this has been, well, industry will never walk away, they will never walk away from this market. But that is exactly what happened in the United Kingdom under almost an identical rule. The industry went away from small accounts in droves.

And then the question is, when would this happen? Under the current structure, under the current timetable from the Department of Labor, millions of small accounts would be told in the fall of 2016 that their investment adviser can no longer serve them because of new government regulations. October, September of 2016, that is the message that would be delivered.

And just to wrap up, what we need here is bipartisan legislation that establishes a best-interest standard with workable rules, not the unworkable rules that are in this proposal.

[The testimony of Mr. Mason follows:]

TESTIMONY OF

KENT A. MASON

of

DAVIS & HARMAN LLP

before the

**SUBCOMMITTEE ON HEALTH,
EMPLOYMENT, LABOR AND PENSIONS**

of the

**HOUSE EDUCATION AND THE
WORKFORCE COMMITTEE**

for the hearing entitled

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

June 17, 2015

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

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

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

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

In brief, I will make the following points:

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

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

INDUSTRY SUPPORT FOR A BEST INTEREST STANDARD

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

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

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

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

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

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

HIDDEN FEE REFERENCES ARE FICTION

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

OVERALL STRUCTURE OF THE DOL PROPOSAL

The DOL proposal has three basic components:

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

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

EFFECTS OF THE DOL PROPOSAL

The DOL proposal would have the following adverse effects.

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

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

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

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

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

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

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

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

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

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

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

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

that will likely be held until retirement; it is much less expensive to pay a single commission when the security is purchased.

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

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

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

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

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

    These banks previously had entire business arms or strategies providing investment advice to investors with less assets, but just prior to the U.K.'s implementation of its new rule, HSBC, Lloyds, and Barclays completely pulled out of offering investment advice to such investors, and, as noted, Royal Bank of Scotland overhauled its offerings to target high net-worth clients. For example,

Barclays closed Barclays Financial Planning, leaving only Barclays Wealth to offer financial advice to individuals with at least $800,000 in assets.

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

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

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

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

Elimination of the ability of financial professionals to continue to provide meaningful investment education. The DOL proposal would significantly restrict the type of investment education that can be provided without triggering fiduciary status and the prohibited transaction rules. Under current law, education includes (1) guidance on the extent to which an individual should invest in different asset classes (such as large and small cap equity funds, and long and short-term bond funds) based on her age and other factors, and (2) examples of investments that fit within such asset classes. This definition of education has worked very well for nearly 20 years, ensuring that a basic level of needed assistance was widely available to retirement investors often with no cost; moreover, this definition was explicitly preserved under DOL's 2010 proposal. Under the 2015 proposal, providing examples of investments that fit

within asset classes would be fiduciary advice, not education. Thus, education would be limited to hypothetical and abstract conversations about investment theory that will simply be of little use to most retirement savers. As a result, we will have less informed plan participants who will be less able to put investment education to practical use and will be much less able to make informed decisions about investing their 401(k) account assets.

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

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

ADDITIONAL ANALYSIS AND CONCERNS

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

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

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

into contracts with tens of millions of existing customers. That will take a minimum of two years; eight months is simply not realistic.

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

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

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

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

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

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

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

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

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

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

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

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

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

THERE IS A VERY STRAIGHTFORWARD SOLUTION

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

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

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

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

Chairman ROE. Thank you, Mr. Mason.

Mr. Haley, you are recognized for five minutes.

TESTIMONY OF MR. JACK HALEY, EXECUTIVE VICE PRESIDENT, FIDELITY INVESTMENTS, BOSTON, MASSACHUSETTS

Mr. HALEY. Chairman Roe, Ranking Member, members of the Subcommittee, and thank you for the opportunity to testify.

My name is Jack Haley. I am an executive vice president at Fidelity Investments. I oversee a team of investment professionals dedicated to helping employer clients and their workers access a wide variety of high-quality investment products and services to meet their investing needs.

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

From our roots as a small mutual fund company, Fidelity has grown into a diversified financial services leader. Fidelity takes seriously the responsibility of helping employers set up and offer competitive retirement savings plans.

I appreciate the opportunity to share our experiences helping small businesses and express our concerns about the Labor Department's proposal.

First, I want to answer a call from the Department of Labor by stating directly up front Fidelity acts in the best interests of its clients and investors. We support a best interest fiduciary standard, but the details matter.

We are proud of the services, products, and choices we provide our customers, but we fear that this proposed regulation will severely restrict our ability to continue providing this assistance to small-business workers.

While the framework of the proposal would theoretically allow service models to remain when acting in the best interests of customers, its so-called best-interest contract exemption contains so many problematic conditions that the rule is unworkable as drafted. Labor's proposal effectively prohibits access to affordable financial help, even when it is in the interests of the investor.

We believe a balanced approach where savers can be protected by the best-interest standard and continue to have access and choice in their retirement products, services, and providers.

We look forward to continuing to work with the members of Congress and the administration to ensure that this balance is reached.

Small businesses remain the lifeblood of our economy. These hardworking entrepreneurs and businesspeople bring significant expertise and passion to their work. We see their desire to offer competitive, high-quality retirement savings benefits to attract and keep a highly skilled workforce.

Not surprisingly, with all they have to do to manage their businesses, there is little time, expertise, or desire to manage their retirement savings plans. That is why small businesses turn to us. We provide a range of critical services, from helping companies understand and select the right savings vehicles, to providing all of the critical functions to keep a plan running smoothly, including

record keeping, compliance testing and reporting, selection and ongoing monitoring of investment, and, most importantly, education and guidance for their employees.

Unfortunately, the DOL proposal would specifically prohibit service providers from assisting small businesses. The result would have a devastating impact on retirement coverage and savings for millions of workers employed by small businesses across the country.

I reiterate, we support a best-interest fiduciary standard, but without exemptive relief from ERISA's strict rules Fidelity would be prohibited from providing critical services to small-business clients, even when we provide help that is in their best interest.

Just as important as our small-business services is the critical education and guidance we provide to their employees. The proposed rule jeopardizes many of the ordinary, everyday conversations we have with job changers, even if the conversation is merely educational where we do not discuss investments or advice.

We are also able to help workers prepare for retirement by discussing potential product and service offerings with them. The proposal would require workers to sign a contract before a conversation would even occur. Each customer would have to have a contract with each of our phone reps, which number in the thousands, in order to get answers to basic questions.

In addition to this new contract, the rules also include burdensome, confusing disclosure requirements that do not actually disclose potential conflicts. These requirements are not in anyone's best interests and must be addressed.

These are just a few examples of the critical services we provide to small businesses and employees and how the proposal would harm the very people the rule intends to protect.

We believe a balanced approach providing investors with fiduciary best-interest protections, retaining existing service models, is achievable.

We look forward to working with you to make the necessary changes to allow individual retirement savers and businesses offering retirement plans to have choice and access to the products and services they need.

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

Thank you, and I am happy to take questions.

[The testimony of Mr. Haley follows:]

Testimony

of

John F. "Jack" Haley, Jr.

Executive Vice President, Fidelity Investments

Before a hearing of the

House Committee on Education and the Workforce

Subcommittee on Health, Education, Labor, and Pensions

June 17, 2015

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

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

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

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

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

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

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

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

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

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

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

I. **Impact on small businesses**

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

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

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

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

Fidelity provides comprehensive, end-to-end investment services for new and existing clients. From the beginning of the relationship, a prospective client is given key insights for developing and designing an

optimal plan line up for its employees. This includes a framework on how to design a plan for different levels of employee engagement, the number and types of investments to include, and how these should be structured in the plan investment lineup. For example, best practices suggest Target Date funds as the default option and starting place for most investors.

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

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

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

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

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

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

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

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

II. Why guidance matters

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

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

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

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

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

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

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

III. Contract requirement

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

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

IV. Unworkable disclosures

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

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

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

Closing

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

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

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

Chairman ROE. Thank you, Mr. Haley.

Mr. Kelleher, you are recognized for five minutes.

TESTIMONY OF MR. DENNIS KELLEHER, PRESIDENT AND CEO, BETTER MARKETS, WASHINGTON, D.C.

Mr. KELLEHER. Chairman Roe and members of the Subcommittee, thank you for the invitation to Better Markets to testify today.

I would like to discuss just a few points that are detailed in my written testimony.

First, it is unacceptable that brokers and others today are allowed to put their economic interests above their clients' best interests. That conflict of interest is costing Americans saving for retirement tens of billions of dollars every year.

Make no mistake about it. That is what is at stake here and ending that is what the Department of Labor's proposed rule is all about.

Today, tens of millions of hardworking Americans are struggling to make ends meet, provide for their families, and save a little for retirement. Figuring out how to invest those retirement savings forces many to seek investment advice from a broker, but that broker can put his or her economic interests above the client's best interests.

What does that mean?

If there are two similar investments but one pays the broker 5 percent and the other pays the broker 1 percent, then it is perfectly legal today for that broker to advise the client to invest in the product that will cost his client five times what it should be.

Making matters worse, often the products that pay the brokers more don't perform as well as similar products. That means not only has the client paid five times more up front, but he or she is also stuck with a product that doesn't perform as well over time. The client is doubly victimized.

As famed Vanguard founder Jack Bogle has called it, they are victimized by the tyranny of compounding costs.

That is what is happening every day in this country. It is costing Americans tens of billions of hard-earned dollars.

For example, the Department of Labor has detailed that these conflicts in the IRA arena only are costing savers as much as $430 billion over 10 years or $43 billion a year.

Second, the rule governing retirement investment advice is 40 years old; it is outdated and incapable of properly protecting workers and retirees in light of the dramatic and far-reaching changes in the way Americans now have to save for retirement.

When this rule was written 40 years ago, almost all retirement savings were in defined benefit plans which were run by employers and managed by investment professionals with fiduciary duties. Forty years ago, 401(k)s did not exist and IRAs had just been created. Today, 40 years later, 401(k)s have gone from zero dollars to $4.6 trillion and IRAs have gone from $3 billion to $7.4 trillion.

By 2012, 90 million Americans, more than two-thirds of all workers with retirement plans, had individual contribution plans. They are all forced to figure out their own retirement investments. This is a monumental and mind-boggling shift from 40 years ago, and

yet the rule has remained frozen in time as if nothing has changed when everything has changed.

As the world has changed, so, too, must the rule change. And the time is now for the Department of Labor to act. It has considered this proposal for years. It has sought and received input from all stakeholders, including, in particular, industry. It has addressed many of the industry's concerns and incorporated many of their suggestions into the proposal, including their priorities.

Yet they continue to object and the reason is clear: They simply do not want to change the status quo and work under a simple principle, a rule that says you must put your clients' interests first.

The industry's complaints, however, boil down to a false choice, either brokers get to put their interests above their clients' best interests or they won't serve those clients. That is a false choice.

The real choice is this: Let the DOL act to protect 100 million workers and retirees across this country or continue letting brokers and other advisers put their interests ahead of their clients'. That is the real choice.

If some brokers don't want to do that or feel that they can't make enough money doing that, then there are plenty of retirement investment advisers who are more than willing to put the clients' interests first and, frankly, today there are tens of thousands of advisers doing that right now across the country with fiduciary duties, low cost, best interest of the client, serving them today, literally hundreds of thousands.

In conclusion, we all agree we have a very serious retirement crisis in this country. Not enough people are saving for retirement and too many of those that do aren't saving enough, as the chairman said in his opening statement.

They need to keep every penny in their retirement accounts and not in their brokers' pockets. That is why updating a 40-year-old rule is so important and why putting the clients' best interests first is imperative.

Thank you, and I look forward to your questions.

[The testimony of Mr. Kelleher follows:]

Testimony of Dennis M. Kelleher
President and CEO
Better Markets, Inc.
United States House of Representatives Committee on Education and the Workforce
Subcommittee on Health, Employment, Labor, and Pensions
"Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families"
June 17, 2015

Thank you Chairman Roe, Ranking Member Polis, and Members of the Subcommittee for the opportunity to provide Better Markets' views about the Department of Labor's proposed Fiduciary Duty Rule.

Better Markets is a nonprofit, nonpartisan organization that promotes the public interest in the domestic and global capital and commodity markets. It advocates for transparency, oversight, and accountability in the financial markets. To do this, Better Markets engages in the rulemaking process, public advocacy, independent research, and litigation. For example, it has filed more than 150 comment letters with the financial regulatory agencies and it has submitted amicus briefs in numerous cases involving challenges to financial reform rules. Our website, www.bettermarkets.com, includes information on these and the many other activities of Better Markets.

I am the President and CEO of Better Markets. Prior to starting Better Markets in October 2010, I held three senior staff positions in the Senate: Chief Counsel and Senior Leadership Advisor to the Chairman of the Democratic Policy Committee; Legislative Director to the Secretary of the Democratic Conference; and Deputy Staff Director and General Counsel to what is now known as the HELP Committee. Previously, I was a litigation partner at the law firm of Skadden, Arps, Slate, Meagher & Flom, where I specialized in securities and financial markets in the U.S. and Europe. Prior to obtaining degrees at Brandeis University and Harvard Law School, I enlisted in the U.S. Air Force while in high school and served four years active duty as a crash-rescue firefighter. I grew up in central Massachusetts.

I would like to share the Better Markets perspective on three important issues relating to the DOL's proposed update to its fiduciary duty rule.

First, it is simply inappropriate that any financial adviser in this country is allowed to provide retirement investment advice to a worker or retiree that does not put the best interest of the client first. Yet that is what the current DOL rules have allowed for 40 years. As a result, advice is too often driven by conflicts of interest. Those conflicts are fundamentally unfair, they are not what investors expect or deserve from their advisers, and they are intensifying what already looms as a retirement crisis in this country.

Second, the DOL's proposed rule closes loopholes that are archaic and unjustifiable, especially in light of the massive changes that have occurred in the retirement landscape over the past 40 years. For example, IRA account owners need unbiased advice just as much as 401(k) participants, and there is no reason why the rule shouldn't afford all retirement savers the same protections. The DOL's proposal closes this and other huge gaps in the existing rule, while allowing the brokerage

industry to preserve the business model it has fought so hard to protect, based on commission compensation.

Finally, after years of meeting with and listening to the industry, the DOL's proposed rule makes many accommodation to the industry's core concerns, but the rule still faces significant industry opposition. However, the industry's arguments against the rule are simply not valid. Make no mistake: the rule will not deprive small businesses or investors—including those with modest savings—of valuable investment advice or education. Nor is there any basis for claiming that the SEC should update the fiduciary standard under ERISA. Only the DOL has that authority, and only the DOL can adopt a rule that protects all types of retirement assets, not just securities. Moreover, the SEC has not yet decided whether to embark on a rulemaking under its own statutory authority, a process that will take years in any event.

Every day that passes without a final, updated rule is costing hard-working Americans literally tens of millions of dollars in retirement savings. They should not have to wait any longer for the protections they sorely need to plan for a more secure and dignified retirement.

Conflicts of interest among financial advisers are causing massive harm to American workers and retirees.

Among the most basic and self-evident truths in financial regulation is that all investors deserve honest, conflict-free investment advice – advice that serves their best interest, not that of the broker, adviser, or anyone else. This principle applies above all to retirees, who are often highly focused on and legitimately concerned about their retirement needs; particularly vulnerable to unscrupulous sales tactics and confusing legal terms; and, most importantly, poorly positioned to recover financially if they suffer losses in their retirement accounts.

Yet, every day in this country, financial advisers are allowed to steer their clients into retirement investments that pay lucrative commissions for the adviser but saddle clients with overpriced and underperforming financial products. It is taking a massive toll on American workers and retirees struggling to prepare for an independent and dignified retirement.

The harm is real and widespread.

Consider one example, the story of a gentleman name Ed from Pennsylvania. Ed worked in various management roles following his military service. For years he received investment advice about his retirement assets from a financial adviser at a brokerage firm. Ed thought that his adviser was looking out for his best interest. However, he recently discovered that he was being charged 5 percent in commissions for every investment dollar he set aside for retirement, along with 1.0 percent to 1.5 percent annually for all the funds the broker recommended, and then another 1 percent for his so-called retirement investment advice. He decided to look for better advice, and found an adviser who works under the fiduciary standard, who charges a mere 0.70 percent in total fees. That's a vast improvement over the commissions and fees he was previously paying, and over the years, it will add up to thousands of dollars in retirement savings to would otherwise end up in the broker's pocket.

Ed is just one illustration of the problem, but millions of Americans are experiencing similar treatment at the hands of their advisers, and the collective toll is huge. Just focusing on the IRA market, the White House estimates that between $1.05 and $3.26 trillion in IRA assets are affected by such conflicted advice,[1] and as much as $33 billion is lost to IRA investors each year.[2] The DOL, in its nearly 250-page Regulatory Impact Analysis, predicts that conflicts of interest which cause this type of underperformance will cost IRA investors as much as $430 billion over 10 years if the loopholes are not closed.[3] That's $42 billion a year, every year being lost to hard-working Americans just trying to save for retirement.

The DOL rule is intended to keep that money in retirement accounts not the pockets of brokers putting their interests above their clients. That is why it is imperative for the DOL to act now.

Investors expect better.

This indefensible situation is made worse because investors may not know that these conflicts of interest are allowed to exist or that advisers may make recommendations that don't serve their clients' best interests. One study found that 49 percent of investors believed registered investment advisers were required by law to act in the client's best interest, while 59 percent believed "financial advisors or financial consultants" had the same legal requirement.[4] Sadly, they are all wrong. Only registered investment advisers have the legal duty to act in their clients' best interests while financial advisors or consultants – titles often used by broker-dealer representatives – do not. One recent study found that nearly 80 percent of respondents were concerned when told that IRA advisers are held to a different standard than defined contribution plan advisers.[5] These other advisers not subject to a best interests fiduciary standard, instead following a much weaker suitability standard, which enables advisers to put other interests—such as the promise of lucrative commissions—ahead of their clients.

Conflicts of interest are intensifying the retirement crisis.

This situation is also unacceptable because it is contributing to a retirement crisis that already threatens devastating consequences. As this Subcommittee well knows, the retirement outlook for many Americans is bleak.[6] Every day, 10,000 Baby Boomers turn 65, but many lack sufficient savings for retirement. The Government Accountability Office (GAO) issued a report just last month showing that, of households nearing retirement (age 55 to 64), only 59 percent have **any**

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1 The White House, *The Effects of Conflicted Investment Advice on Retirement Savings* (Feb. 2015), at 19, *available at* https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

2 *Id* at 20.

3 The Department of Labor, *Fiduciary Investment Advice: Regulatory Impact Analysis* (Apr. 14, 2015), at 8, *available at* http://www.dol.gov/ebsa/pdf/conflictsofinterestria.pdf.

4 ANGELA HUNG ET AL., INVESTOR AND INDUSTRY PERSPECTIVES ON INVESTMENT ADVISERS AND BROKER-DEALERS 89 (2008).

5 S. Kathi Brown, *Fiduciary Duty and Investment Advice: Attitudes of 401(k) and 403(b) Participants*, AARP (Sept. 2013), at 6-7, *available at* http://www.aarp.org/content/dam/aarp/research/surveys_statistics/general/2013/Fiduciary-Duty-and-Investment-Advice-Attitudes-of-401k-and-403b-Participants-AARP-rsa-gen.pdf.

6 House Committee on the Education and the Workforce, *Time to Modernize Multiemployer Pension System* (Apr. 29, 2015), *available at* http://edworkforce.house.gov/news/documentsingle.aspx?DocumentID=398799

retirement savings.[7] 14 percent have other resources or a defined benefit plan, but a full 27 percent of near retirement households have neither retirement savings nor a pension.

Among those households with savings, GAO reports 20 percent have saved less than $50,000, and another 19 percent have saved less than $200,000. Another study found 44 percent of Late Baby Boomers and Gen-Xers lack adequate retirement income.[8]

It is not only those in or nearing retirement who are facing a crisis; of all Americans, 36 percent report they have nothing saved for retirement.[9] 23 percent of traditional IRAs and 28.6 percent of Roth IRAs have less than $5,000.[10] In 2012, among all workers only 39.4% of workers participated in a workplace retirement plan.[11] It is these workers who are most at risk of relying on Social Security for a significant portion of their retirement income.

The retirement savings crisis, of course, affects the poorest most deeply; between 77 and 87 percent of lowest-income households are at risk for having insufficient retirement savings,[12] and only 15.4 percent of Americans in the lowest two income-quintiles have a 401(k) plan, and 14.75 percent have an IRA.[13] However, between 13 and 17 percent of the highest-income households are at risk of having insufficient savings during retirement as well.[14]

Similarly, the crisis especially impacts minorities. Only 38 percent of all African American and 31 percent of Latino households hold assets in an IRA or 401(k), compared with 64 percent for white households.[15] And, of those few minority households that do, the average black head of household has $20,000 saved for retirement, and the average Latino has just $17,600 (while the average white head of household has $112,000 in retirement savings).[16]

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[7] Government Accountability Office, *Retirement Security: Most Households Approaching Retirement Have Low Retirement Savings"* (May 2015), at 9, *available at* http://www.gao.gov/assets/680/670153.pdf.

[8] Employee Benefit Research Institute, *Retirement Income Adequacy for Boomers and Gen Xers: Evidence from the 2012 EBRI Retirement Security Projection Model* (May 2015), *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_05_May-12.RSPM-ER.Cvg1.pdf.

[9] Nanci Hellmich, *A third of people have nothing saved for retirement*, USA TODAY (Aug. 18, 2014), *available at* http://www.cnbc.com/id/101926802#_gus

[10] INVESTMENT COMPANY INSTITUTE, THE IRA INVESTOR PROFILE: TRADITIONAL IRA INVESTORS' ACTIVITY, 2007–2012, at 47 (March 2014), available at http://www.ici.org/pdf/rpt_14_ira_traditional.pdf.

[11] Miller, M. Reuters, *Column: Why minorities are losing the retirement race* (Dec. 12, 2013), *available at* http://www.reuters.com/article/2013/12/12/us-column-miller-minority-idUSBRE9BB0KJ20131212.

[12] Employee Benefit Research Institute, *Retirement Income Adequacy for Boomers and Gen Xers: Evidence from the 2012 EBRI Retirement Security Projection Model* (May 2015), at 4, *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_05_May-12.RSPM-ER.Cvg1.pdf.

[13] United States Census Bureau, *Table 2. Percent Holding Assets for Households, by Type of Asset Owned and Selected Characteristics: 2011, available at* http://www.census.gov/people/wealth/files/Wealth_Tables_2011.xlsx

[14] Employee Benefit Research Institute, *Retirement Income Adequacy for Boomers and Gen Xers: Evidence from the 2012 EBRI Retirement Security Projection Model* (May 2015), at 4, *available at* http://www.ebri.org/pdf/notespdf/EBRI_Notes_05_May-12.RSPM-ER.Cvg1.pdf.

[15] National Institute on Retirement Security, *Race and Retirement Insecurity in the United States* (Dec. 2013), at 7, *available at* http://www.nirsonline.org/storage/nirs/documents/Race%20and%20Retirement%20Insecurity/race_and_retirement_insecurity_final.pdf.

[16] *Id.*

A solution to this crisis has different components. First, of course, is encouraging and enabling American workers to set aside as much as they can for retirement. For this reason, Congress has provided preferential tax treatments for retirement accounts, in the hopes that it will encourage workers to invest for retirement. But equally important is making sure that people get the most out of what they have managed to save (on a tax advantaged basis). If financial advisers are allowed to siphon off a large portion of their clients' retirement savings, then the prospects for a secure, dignified and independent retirement become even more remote.

The loopholes in the old rule are especially damaging, in light of dramatic changes in the retirement landscape.

More than ever, retirement savers are responsible for managing their own savings.

Today, Americans saving for retirement are under immense pressure to invest their funds prudently so they have the chance to live out a comfortable and dignified retirement. However, they often lack the expertise necessary to make such complex financial decisions. It wasn't always this way.

Forty years ago, in 1975, the vast majority of all workers – 74 percent – were in large defined-benefit (DB) plans.[17] Companies like General Motors, with sophisticated investment management staff, invested on behalf of all their workers, spreading risk and reward from the market so that all employees would be assured of a comfortable retirement. In 1975, 33 million individuals participated in these DB plans, while only 11 million workers took part in defined-contribution (DC) plans.[18] Furthermore, individual retirement accounts (IRAs) had only just been created in 1974, and 401(k) plans were not yet in existence.

As of 2012, 90 million people, or more than two-thirds of workers with retirement plans, now have DC plans and are expected to manage their investments and weather the ups and downs of the market individually.[19] The growth of DC plans in the past forty years stands in stark contrast to the number of participants in DB plans, which has remained flat since 1975:

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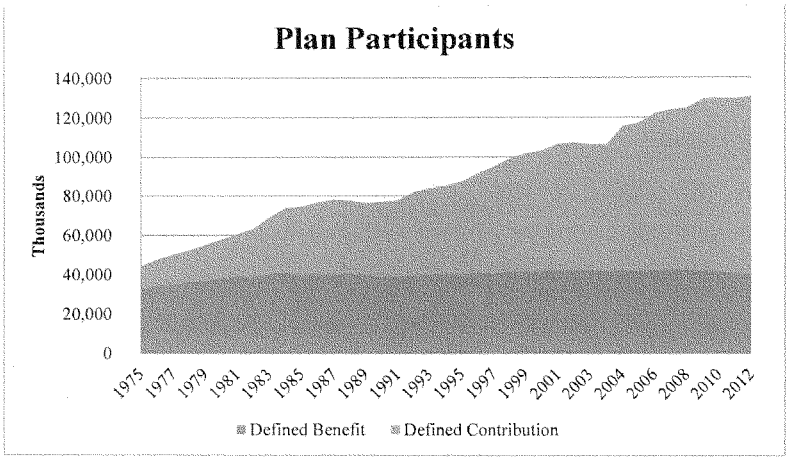
[17] U.S. Department of Labor Employee Benefits Security Administration, *Private Pension Plan Bulletin Historical Tables and Graphs 5* (DEC. 2014), *available at* http://www.dol.gov/ebsa/pdf/bistoricaltables.pdf.

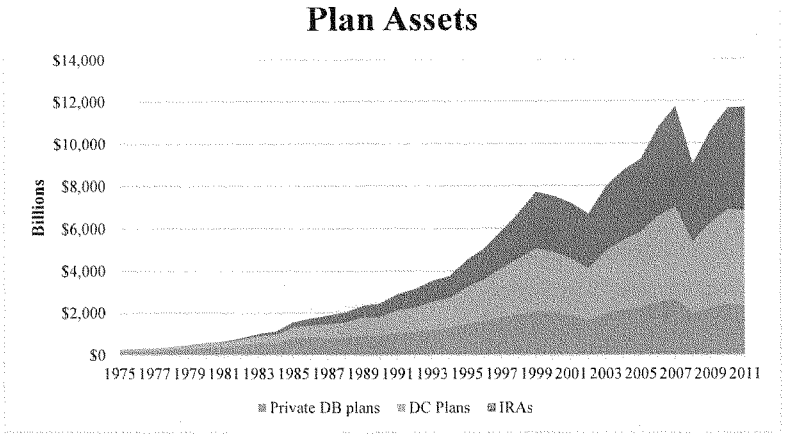
[18] *Id.* at 5.

[19] *Id.*



SOURCE: U.S. DEPARTMENT OF LABOR EMPLOYEE BENEFITS SECURITY ADMINISTRATION

Similarly, DB plans held 72 percent of retirement plan assets 1975, whereas they held only 34 percent in 2011. Including IRA assets, DB plans in 2011 held only 20 percent of private retirement assets.



SOURCE: INVESTMENT COMPANY INSTITUTE[20]

Including government pension plans and annuities, U.S. retirement assets total nearly $20 trillion.[21]

This monumental shift away from DB plans means that Americans are forced to invest their retirement assets on their own and bear the consequences of those investment decisions. The challenge is more and more daunting, as financial products become more varied and complex.

However, Americans are ill-prepared to manage trillions of dollars' worth of retirement assets on their own. Most have not received the formal education or training to qualify them to manage and invest their retirement nest egg, and, as a result, many turn to professional financial advisers for help. But under the old rule, with its loopholes, they are very likely to receive biased and self-serving advice from their advisers.

The loopholes have no justification, especially in today's world.

The Employee Retirement Income Security Act (ERISA) was enacted in 1974 to establish minimum standards of protection for retirement plan participants and beneficiaries. It provided for the accountability of plan administrators and advisers through the imposition of a best interest standard, also known as fiduciary duty. Indeed, one of the stated purposes of the Act was to protect "the interests of participants in employee benefit plans and their beneficiaries . . . by establishing standards of conduct, responsibility, and obligation for fiduciaries of employee benefit plans."[22]

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[20] Investment Company Institute, *Table 1, The U.S. Retirement Market, Fourth Quarter 2012*, *available at* www.ici.org/info/ret_12_q4_data.xls.

[21] Investment Company Institute, *2013 Investment Company Fact Book* (53d ed. 2012), at 113-14.

[22] Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829, § 2(b).

In 1975, the DOL promulgated a rule to determine who the fiduciary duty covers, still in effect today. Then, the fiduciary duty rule was designed to address the popular defined-benefit retirement plans, which pay out a certain amount upon retirement and are managed by a professional without employee input. As seen above, in recent years there has been a significant shift from defined-benefit plans to defined-contribution plans, such as 401(k)s, and IRAs, which derive their value from employer and employee contributions and provide employees and retirees with greater responsibility over investment decisions. Despite the magnitude of the shift in retirement plans, the rule, and who ERISA's fiduciary duty covers, remains as it was in 1975.

As a result, financial advisers only are held to a best interest standard for advice when they meet all five factors of the test in DOL's outdated rule. A fiduciary duty applies when a person:

(1) makes 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.

Too often, advisers exploit this test in various ways, often by simply claiming that their advice is not "individualized," is not the "primary basis" for an investment decision, is not provided on a "regular basis," or is not really "advice" at all. Accordingly, there are many instances when an adviser provides retirement advice that does not have to be in the client's best interests.

For example, if a retirement plan or beneficiary seeks one-time, individualized advice on a complex investment, the adviser has no fiduciary duty because that advice is not provided on a "regular basis."[23] Similarly, a plan or beneficiary may regularly consult with the adviser and even rely on the adviser's advice as the primary basis for investment decisions, but unless the adviser agreed or understood that the advice would serve as the "primary basis" for investment decisions, the adviser would not be considered a fiduciary.[24]

Further evidence suggests that advisers purposely exploit these and other loopholes in the five-part test. A DOL inspector general report identified an egregious example where advisers with "significant undisclosed conflicts of interest attempted to avoid meeting the criteria for ERISA fiduciary status under the current five-part test by simply stating in their adviser contract that they were not fiduciaries."[25] In addition, one ERISA attorney informed the GAO "that although service providers give investment recommendations, they will include a provision in their contract that

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[23] Testimony of Phyllis C. Borzi, Assistant Secretary of Labor, Employee Benefits Security Administration Before the House Committee on Education and the Workforce, Subcommittee on Health, Employment, Labor, and Pensions, July 26, 2011, *available at* http://www.dol.gov/ebsa/newsroom/ty072611.html.

[24] *Id.*

[25] U.S. Department of Labor, Office of Inspector General, EBSA Needs to Do More to Protect Retirement Plan Assets from Conflicts of Interest, Report No. 09-10-001-12-121, September 30, 2010.

states that the investment recommendations provided are not intended to be the primary basis for decision making" as a way of avoiding the duty.[26]

Over time, additional loopholes have developed where the law has failed to keep pace with industry abuses and savers' needs. In 1996, the DOL issued an interpretive bulletin to clarify that "education" is not "advice" sufficient to trigger the ERISA fiduciary duty.[27] But, as with the five-part test, advisers have abused this exemption, providing thinly-veiled sales pitches under the guise of "educational" information. For example, when educating workers about different financial products, a company may compare their products favorably against a competitor's products.

The DOL proposal addresses these problems, while accommodating industry concerns.

DOL is to be commended for recognizing the need to update its fiduciary duty rule, to expand its scope, and to adequately protect our current and future retirees from conflicts of interests that drain billions from their savings annually and threaten their retirement security. Its strong proposal appropriately closes many of the loopholes found in the current rule.

The proposal expands who the fiduciary duty applies to when giving retirement investment advice by replacing the five-part test with a functional definition of investment advice. Under the revised definition, a person renders "fiduciary investment advice" when he or she receives compensation for providing a recommendation that is individualized or specifically directed to a DB or DC plan.

The advice need not be provided on a regular basis, nor must there be a mutual understanding that the recommendation serve as the "primary basis" for investment decisions. The rule also applies the fiduciary duty to IRA accounts, and – very importantly – advice relating to rollovers to IRA accounts. This is a major step toward protecting retirement savers, given the enormous amount of retirement savings held in IRA accounts, now and in the future.

Covering rollovers into IRA accounts is especially important. Many savers take that step when they are nearing retirement and need to decide how best to consolidate and manage assets that have built up in a number of 401(k) accounts. This is a critical juncture, and without the new rule in place to cover advice about rollovers and IRA investments, the law will not require that new retirees get advice in their best interests. As a result, their rolled-over assets may be placed in high-cost, sub-par investments for the duration of their retirement, eating up a large portion of their savings.

These rollovers are a very significant segment of the retirement asset space. The GAO reported that "from 1996 to 2008, over 90 percent of funds flowing into traditional IRAs came from rollovers primarily from employer-sponsored retirement plans,"[28] with nearly $273 billion in

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[26] U.S. Government Accountability Office, *GAO-11-119, 401(K) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest* (2011), at 24.

[27] 29 C.F.R. 2509.96-1(d).

[28] U.S. Government Accountability Office, *GAO-11-119, 401(K) Plans: Improved Regulation Could Better Protect Participants from Conflicts of Interest* (2011), at 10, *citing* Investment Company Institute, *The U.S. Retirement Market, Second Quarter 2012, available at* http://www.ici.org/info/ret_12_q2_data.xls.

assets rolled over in 2008 alone.[29] In 2013, it is estimated that $358 billion was rolled over.[30] Over the next five years, $2.5 trillion is projected to be rolled over.[31]

The proposal also contains an important carve-out so as not to restrict the flow of bona fide financial education to investors. For example, the proposal allows advisers to continue to provide investment education to clients about financial and investment concepts – such as compound interest or the costs and benefits of IRA rollovers – while insuring that sales pitches aren't provided under the guise of "advice."

The DOL accomplished all of this while at the same time accommodating the industry's principal concern: that the rule allow them to continue charging commission-based compensation. Through the Best Interest Contract Exemption (BICE), the rule proposal would allow financial advisers to be compensated through a set fee, through a commission, or through revenue sharing, so long as the advice provided is in the client's best interest, those fees are reasonable, conflicts are mitigated, and proper disclosure is made. This preserves current business models dependent on these types of compensation, such as those used by broker-dealers and insurance agents, while also holding them to the best interest standard that all workers and retirees deserve.

The arguments in opposition to the rule are unfounded.

Led by SIFMA and other industry organizations, strong opposition to the rule persists. However, there are many baseless and even misleading claims being circulated and it is important to set the record straight.

The Rule will not deprive low income savers of valuable financial advice.

Some opponents argue that extending the fiduciary duty broadly and fairly to all advisers will raise costs and thus reduce the availability of such financial advice, to the detriment of low and middle income savers. There are many reasons that this claim is baseless.

- First, brokerage firms don't actually serve small account holders now. For example, many brokerage firms require their reps to focus exclusively on pulling in large accounts with at least $100,000 or more.
- Second, evidence that shows that the imposition of a fiduciary duty on brokerage firms and others does not in fact cause them to abandon their clients. One study demonstrates that the application of a fiduciary duty to broker-dealers has little, if any, effect on the availability of investment advice to clients, including those with moderate levels of income or assets.[32] That, of course, makes sense: just because a business cannot extract excessive profits due to undisclosed conflicts does not mean they will not "settle for" making reasonable compensation for providing conflict-free advice.

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[29] Investment Company Institute, The IRA Investor Profile: Traditional IRA Investors' Activity, 2007-2011 (2013), at 9, *available at* http://www.ici.org/pdf/rpt_13_ira_investors.pdf.

[30] Jason Zweig, *Who's Training Your Retirement Navigator?*, The Wall Street Journal, Feb. 14, 2014.

[31] Cerulli Associates, "Retirement Markets 2014: Sizing Opportunities in Private and Public Retirement Plans," (2014).

[32] Michael Finke & Thomas Langdon, *The Impact of the Broker-Dealer Fiduciary Standard on Financial Advice* (Mar. 9, 2012), http: //ssrn.com/abstract=2019090.

- Third, conflicted advice isn't worth preserving in the marketplace, and it isn't actually cheaper than "best interest" advice, when you factor in the large hidden commissions along with the higher annual fees that typically go along with the investments that brokers are incentivized to recommend.
- Finally, and most important, even if the brokers or insurance agents can't or won't help small savers under the best interest standard, other advisers will step in. For years, in fact, many advisers have embraced the fiduciary duty and are perfectly happy to work with modest savers, to provide them with advice under the best interest standard, and charge reasonable fees. Moreover, a new generation of innovative advisory firms – including for example Rebalance IRA, Wealthfront, and Personal Capital – is emerging that uses technology to reach more workers and retirees with low-cost, high quality advice as fiduciaries.

In fact, since the inception of financial regulation in the United States, bankers, broker-dealers, and other members of the financial services industry have issued dire warnings that regulation will choke the life out of our financial markets, financial products, and, indeed, consumers of those products. Yet the industry has not only adapted to new regulations again and again, but has thrived in the process. Moreover, whenever profitable opportunities arise (for example if brokers refuse to provide their clients with conflicted-free advice), then other market participants enter the market, fill the otherwise unmet need and make the profits. Entry has been a hallmark of our financial markets from the beginning and there is every reason to expect that would happen here.

The Best Interest Contract Exemption (BICE) is a reasonable and workable accommodation to industry.

Some commenters have also claimed that the proposal's Best Interest Contract Exemption is unworkable. The BICE – the part of the proposal which allows advisors to receive commissions and other forms of payments – requires anyone providing advice to plans or IRAs sign a contract with their clients stating they will provide advice in the client's best interests, adopt policies and procedures designed to minimize conflicts of interest, provide enhanced disclosures, and limit investments to those considered relatively transparent and liquid. This provisions allow clients to receive fiduciary advice and permit advisers to receive compensation for their services in a manner of their choosing.

Some have argued that the BICE will make clients wary as they have to sign a contract before providing advice.[33] Others have stated that the mere act of signing a BICE contact would be confusing to clients, as it is not something they are used to. These claims border on the absurd. Suffice it to say that the financial services industry has never been shy about asking clients to sign reams of account documents as a condition of providing their services when it serves the adviser's interest in locking in the client to a host of waivers and stipulations. Moreover, investors will

[33] Think Advisor, *FINRA's Ketchum Blasts DOL Fiduciary Plan; White House Says 'Work With Us'* (May 27, 2015), *available at* http://www.thinkadvisor.com/2015/05/27/finras-ketchum-blasts-dol-fiduciary-plan-white-hou.

likely be pleased to receive the written commitments set forth in the BICE, which are designed to protect the clients' best interest.[34]

In addition, some have asserted that smaller advisers who charge commissions would not be able to meet the requirements of the BICE. However, if a small adviser chooses to offer investors a menu of reasonably priced, high quality investments, albeit limited in number, then they should be able to meet these requirements. Under the exemption, advisers could still recommend higher risk products like variable annuities, so long as they fit within the client's best interest.

There is no basis for predicting a surge in litigation against advisers under the rule.

The industry also has pointed to a possible onslaught of litigation should advisers become subject to the fiduciary standard. This is unfounded. Advisers who already abide by the best interest standard have simply not been subject to unreasonable litigation liability. Further, the rule clearly states that recommendations are assessed for compliance on the circumstances prevailing at the time advice is rendered—not based on future performance of the product sold. The rule also allows advisers to insist on mandatory arbitration clauses, a forum that is well-known to favor industry over claimants and to reduce liability risk. The bottom line is this: If an adviser violates his or her obligation to serve the best interest of the client, and damages result, then the client deserves a remedy and the adviser should be held accountable.

The SEC lacks the ability and the intention to address conflicts of interest, even among brokers.

Some have said the Securities and Exchange Commission (SEC) should take the lead on setting fiduciary standards prior to the DOL taking action. This ignores the DOL's unique mandate under the law to ensure retirement assets are well-protected by requiring those who advise Americans saving for retirement to act as fiduciaries. ERISA intentionally sets higher standards for retirement accounts than those existing under securities laws administered by the SEC, reflecting the importance of and preferential tax treatments for retirement nest eggs. Furthermore, only DOL, through ERISA, has jurisdiction to apply a fiduciary duty to advisors of *all* retirement assets, including insurance products. Any SEC rule will only cover securities transactions.

SEC Chair Mary Jo White has affirmed these distinct missions, stating during her recent testimony before the Senate Financial Services and General Government Subcommittee several weeks ago that the DOL and SEC "are separate agencies with separate statutory mandates."[35] Chair White has additionally noted that the agencies have had extensive communication during the rulemaking process, with the SEC "providing extensive technical assistance" to the DOL since the beginning of the process, especially about the "broker-dealer model" and about "the impact that various ways of defining a fiduciary duty could have on the availability of reliable reasonably priced services."

This argument is really about delay. The SEC hasn't even decided whether to propose a rule, and if they do eventually tackle the problem, it will take years for the process to unfold. Meanwhile, Americans are losing literally millions of dollars in retirement savings every day. They can't

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[34] The BICE applies only to retirement accounts and plans. It does not apply to any other investments.

[35] U.S. Senate Committee on Appropriations, *FSGG Subcommittee Hearing: FY16 Budget Requests for the SEC and CFTC* (May 5, 2015), *available at* http://www.appropriations.senate.gov/webcast/fsgg-subcommittee-hearing-fy16-budget-requests-sec-cftc.

afford to wait, and the DOL has the solution. We should strongly support the DOL rule, not stand in its way.

Conclusion

Thank you again for the opportunity to appear before you today. I look forward to answering your questions.

Chairman ROE. Thank you, Mr. Kelleher.
Dr. Reid, you are recognized.

TESTIMONY OF DR. BRIAN REID, PH.D., CHIEF ECONOMIST, INVESTMENT COMPANY INSTITUTE, WASHINGTON, D.C.

Mr. REID. Thank you, Chairman Roe and Ranking Member.
I am Brian Reid, chief economist of the Investment Company Institute, a leading global trade association representing mutual funds and other regulated funds in the United States and around the globe.
I am here today to discuss the economic analysis that the Department of Labor uses to justify its proposed rule defining fiduciary duty for retirement advice and services.
I have spent a lot of time on the DOL's regulatory impact analysis. I regret to say that it is fatally flawed. Its analysis is an exercise in storytelling, crafted more to support the Department's agenda than to measure accurately the proposal's impact on retirement savers.
In fact, the economic analysis raises the question of whether the DOL fully understands the market for retirement advice.
The DOL justifies its proposed rule by claiming that this market suffers from a substantial market failure resulting in serious harm for retirement savers who invest through broker dealers. But the Department's assertions don't stand up when tested against actual data and experience. Even worse, the DOL's proposal could actually have significant net social harm.
I have five points to explain why.
First, the DOL's analysis is flawed when it claims that retirement savers will lose as much as $1 trillion over the next 20 years without its rule. The DOL reaches this number by arguing that brokers who are paid commissions through front-end loads on mutual funds are directing their investors into funds that under-perform.
But a simple test, with data drawn directly from the market since 2007, shows just the opposite. Investors who own mutual funds with front-end loads actually bought funds that outperformed, not underperformed, the average return for their fund category.
This one finding eliminates almost all of the rationale that the DOL uses to justify its proposal.
Second, the DOL ignores market realities and the fact that investors may end up paying more, not less for advice under its proposal. The DOL predicts that its rule will drive down brokers' fund commissions by almost two-thirds, but will not drive brokers from the retirement market. That seems highly unlikely to me.
Furthermore, the DOL ignores the costs that investors will face if brokers do exit the market. The DOL estimates that investors are paying up to 28 basis points a year in front-end loads, but advisers charge, on average, almost four times as much for alternative, fee-based accounts.
If the DOL rule forces savers into fee-based accounts, savers may end up paying more, not less.
Third, none of the academic studies that the DOL uses addresses the core question: whether an investor's performance is different

when her adviser is a fiduciary compared to when her adviser isn't a fiduciary. Thus, the DOL does not actually measure and cannot measure, based on these studies, whether an investor will get better results using a fiduciary adviser.

Fourth, the DOL fails to identify and analyze the significant harm to savers that could likely result from this proposal. With the new burdens created by the DOL's proposed rule, the high minimum balances typically required for fee-based accounts, it is inevitable that many IRA investors would no longer be able to obtain advice at all. Retirement savers will be worse off if they do not have access to assistance and advice.

Finally, data show that IRA investors are concentrated in lower-cost funds, not higher-cost funds. The White House Council of Economic Advisers has widely promoted an estimate that IRA investors lose $17 billion a year through under-performance largely stemming from excess fees.

The CEA report uses a hypothetical calculation to argue that, on average, IRA investors pay 1 percentage point a year more in fund fees than do 401(k) investors.

If we put actual fund data into the CEA's calculation, the difference between what IRA investors pay and what 401(k) investors pay is 85 percent less than what the CEA assumes.

Now, let me be clear. The ICI has long supported the principle behind the DOL proposal that financial advisers should act in the best interests of their clients when they offer personalized investment advice. Unfortunately, the DOL's proposed rule is hopelessly complex, confused, and unworkable.

As the subcommittee recognizes, this issue is vitally important to American workers and their families. Research by ICI and others show that the U.S. retirement system is working to help deliver a secure future for millions of Americans. But those successes depend on workers' access to advice and services.

Any policy that impairs retirement savers' ability to get the help that they need will significantly harm the prospects of millions of workers. Unfortunately, the DOL proposal will do just that.

I look forward to your questions.

[The testimony of Dr. Reid follows:]

Statement of the Investment Company Institute

Brian Reid, Chief Economist

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

Subcommittee on Health, Employment, Labor, and Pensions

Committee on Education and the Workforce

United States House of Representatives

June 17, 2015

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

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

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

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

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

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

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

The DOL's Regulatory Impact Analysis Is Fundamentally Flawed

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

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

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

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

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

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

[5] *Id.*

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

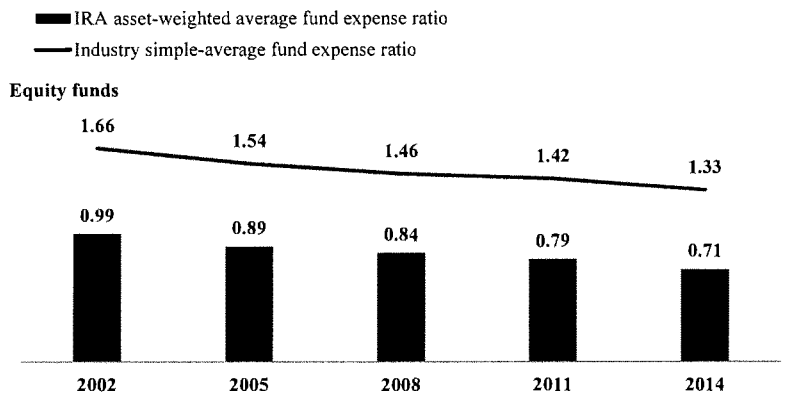
Actual data show that the CEA's illustration is far off the mark. The average fee paid by IRA investors in stock funds in 2014 was only 71 basis points. The average fee paid by 401(k) investors for investing in stock funds was actually 54 basis points. So the real difference in fees, based on what investors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

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

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

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

IRA Investors Pay Below-Average Fees



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

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

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

The DOL's rule proposal is confusing and convoluted.

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

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

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

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

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

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

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

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

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

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

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

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

Conclusion

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

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

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

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

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

1. Bergstresser, Chalmers, and Tufano (2009)

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

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

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

2. Del Guercio and Reuter (2014)

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

The CEA acknowledges that a limitation of both the Bergstresser and Del Guercio studies is that such comparisons cannot incorporate differences other than the involvement of an intermediary versus a "direct sale" of the mutual fund. It explains, for instance, that "investors purchasing funds through intermediaries may be more risk-averse and less experienced with investing than

those buying direct-sold shares from a mutual fund sponsor" and that "[f]ailing to account for such differences may potentially overstate or understate losses due to conflicts of interest."[17]

3. Chalmers and Reuter (2014)

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

4. Christoffersen, Evans, and Musto (2013)

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

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

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

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

[17] CEA Report, at p. 11.

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

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

Chairman ROE. Thank you, Dr. Reid.

Mr. Harman, you are recognized for five minutes.

TESTIMONY OF MR. DEAN HARMAN, CFP, MANAGING DIRECTOR, HARMAN WEALTH MANAGEMENT, THE WOODLANDS, TEXAS

Mr. HARMAN. Good afternoon, Mr. Chairman, Ranking Member Polis, and members of the Subcommittee.

I am Dean Harman, founder and managing director of Harman Wealth Management in The Woodlands, Texas.

I am here representing the Financial Services Institute. FSI advocates on behalf of independent financial advisers and independent financial services firms. FSI is a strong supporter of a uniform fiduciary standard. But, unfortunately, the Department of Labor's proposal is unworkable, complex, and costly.

Let me make it plain. This proposal will harm retirement investors.

Let me start by sharing one of the ways this proposal is unworkable. For a client to be able to pay for my services using a commission model, my firm would have to comply with the requirements of the best-interest contract exemption known as BICE.

BICE requires that we give clients an estimate of all investment costs for one, five, and 10-year periods. In order to do this, I would need to predict investment performance. This will put me in direct conflict with SEC and FINRA rules.

These projections may also create unrealistic expectations for investors.

The proposal is also too complex. For example, BICE requires that firms maintain a machine-readable public website and update it quarterly. This website would disclose compensation received by the adviser, the firm, and any affiliates for every investment product sold.

In the independent investment model, financial advisers have access to a wide variety of investment options. All of these investment products have unique pricing structures. Every single mutual fund family may offer as many as 500 or more versions of its fund. Compiling, presenting, and maintaining the required Internet disclosures would be a massive undertaking.

This complexity of the project could lead to inadvertent errors which may result in litigation. More importantly, the complexity may confuse investors and discourage them from saving for retirement.

This proposal is also too costly for investors seeking retirement services. They may encounter high costs as financial advisers are faced with a mountain of regulatory burdens that lead advisers to institute or raise asset minimums on retirement accounts.

Because of this, investors of moderate means will find it difficult to gain access to valuable retirement advice and products. I do not want to turn away a potential client who needs my advice, but that will be the consequence of this proposal.

That last point is so important. Let me give you an example from my own practice. I manage about $200 million in assets for 618 clients. Of those total assets, $10 million are held by 331 clients with

an average balance of $30,000. These clients are mainly lower net worth, elderly, or young professionals just starting out.

For these individuals, an advisory fee model does not make sense. A commission-based model is appropriate for them because it eliminates the out-of-pocket costs and provides a way to pay for the advice, products, and services that these clients need.

I want to ensure that any written rule by the Department of Labor will make it easier for these investors to continue receiving high-quality retirement services from a trusted financial adviser, but this proposal fails them.

In conclusion, FSI supports a uniform fiduciary standard. We will continue to work with the Department of Labor to protect investors and expand access to retirement advice. Unfortunately, the current proposal is unworkable, it is complex, and it is costly.

Thank you, and I look forward to any questions that you may have.

[The testimony of Mr. Harman follows:]

VOICE OF INDEPENDENT FINANCIAL SERVICES FIRMS
AND INDEPENDENT FINANCIAL ADVISORS

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

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

On

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

June 17, 2015

Introduction

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

FSI Supports a Uniform Fiduciary Standard

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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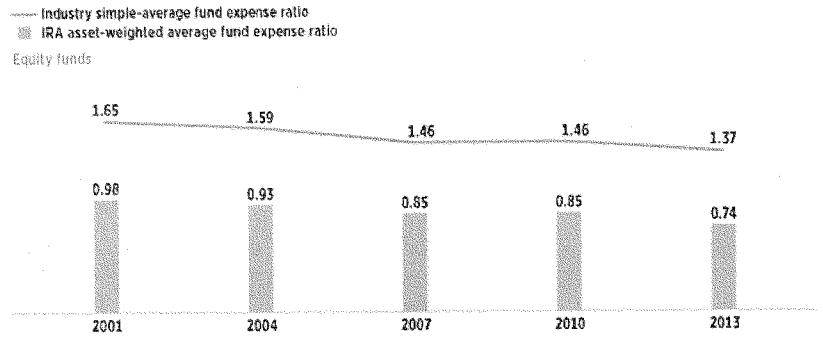
[4] Council of Economic Advisers, *The Effects of Conflicted Investment Advice on Retirement Savings* (February 2015), *available at* https://www.whitehouse.gov/sites/default/files/docs/cea_coi_report_final.pdf.

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

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



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

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

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

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

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

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

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

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[7] Cockerline, Jon, *New Evidence on the Value of Financial Advice*, The Investment Funds Institute of Canada, 2012, *available at* https://www.ific.ca/wp-content/uploads/2013/08/New-Evidence-on-the-Value-of-Financial-Advice-November-2012.pdf/1653/.

[8] ING Retirement Research Institute, *Working with an Advisor, Improved Retirement Savings, Financial Knowledge and Retirement Confidence!*, 2010, p. 6, *available at* http://voyacdn.com/file_repository/5151/help_wanted_wp.pdf.

[9] Quantria Strategies, *Access to Call Centers and Broker Dealers and Their Effects on Retirement Savings*, April 2014, *available at* http://quantria.com/DistributionStudy_Quantria_4-1-14_final_pm.pdf.

[10] LIMRA, *Advisors Positively Influence Consumers' Behavior and Sentiment Toward Preparing for Retirement*, July 2012, *available at* http://www.limra.com/Posts/PR/News_Releases/LIMRA_Advisors_Positively_Influence_Consumers_Behavior_and_Sentiment_Toward_Preparing_for_Retirement.aspx.

- A 2010 study by Prudential found that African Americans with a financial advisor were significantly more likely to participate in employer sponsored retirement plans, have a savings account, life insurance, long-term care insurance, annuities, and mutual funds. That same study also found that African Americans who worked with a financial advisor were more financially confident than those who did not.[11]

- A 2013 Morningstar study found that by working with a financial advisor, a retiree can be expected to generate 22.6% more certainty-equivalent[12] income. This has the same impact on expected utility as an annual return increase of 1.59%, which represents a significant improvement in portfolio efficiency for a retiree.[13]

- A 2012 study conducted by the Investment Funds Institute of Canada found that households working with an advisor have substantially higher investible assets than non-advised households, regardless of household income level, because advisors helped investors choose the right plans and asset mix to fit their individual circumstances, objectives, and risk tolerance.[14]

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Problems with the Pre-Advice Contract:

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

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

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

Problems with BICE's "Approved Assets" List:

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

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

[18] As per the proposal, the approved list of assets "includes only the following products: bank deposits, certificates of deposit (CDs), shares or interests in registered investment companies, bank collective funds, insurance company separate accounts, exchange-traded REITs, exchange-traded funds, corporate bonds offered pursuant to a registration statement under the Securities Act of 1933, agency debt securities as defined in FINRA Rule 6710(l) or its successor, U.S. Treasury securities as defined in FINRA Rule 6710(p) or its successor, insurance and annuity contracts, guaranteed investment contracts, and equity securities within the meaning of 17 CFR 230.405 that are exchange traded securities within the meaning of 17 CFR 242.600." The proposal also specifically excludes "any equity security that is a security future or a put, call, straddle, or other option or privilege of buying an equity security from or selling an equity security to another without being bound to do so."

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

Problems with the Mandated Point of Sale and Annual Disclosures:

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

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

Problems with Internet Disclosures:

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

Problems with Data Retention and Production Requirements:

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

As can be seen from the above summary of the data retention and production request requirements, this will not be an easy task for the industry to undertake. I am no expert

regarding the logistical, technical, and financial resources that would be required in order to put the proper systems in place to manage these requirements, so I will leave that to others to expound upon. That being said, I have no doubt that this will be a huge undertaking that will come at great costs to the industry. These new compliance burdens will come with astronomical costs that will inevitably be passed down to financial advisors and impact the consumer. For BICE to be a workable exemption, these requirements must be greatly scaled back so that the costs of compliance are reasonable.

Problems with "Levelizing" Compensation:

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

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

Problems with a New Private Right of Action:

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

the advisor or the firm for any violation of the contract's terms. That being said, the contract may allow for arbitration of individual investor claims.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

Conclusion

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

FSI and I want to ensure that Americans are well-prepared to make decisions regarding their retirement savings. This will require that our retirement savings landscape continue to evolve so that it is easier for investors to receive high-quality, individualized investment advice from a trusted advisor. As a result, we support the adoption of a carefully-crafted, uniform fiduciary standard of care applicable to all professionals providing personalized investment advice to retail clients. Unfortunately, while well-intentioned, the current DOL proposal will make it harder for all Americans to receive such retirement advice. This is because it is based on flawed assumptions that lead it to be too complex, too cumbersome, and too costly, thus resulting in a

proposal that will leave small- and mid-sized investors without affordable access to much-needed retirement advice and products. FSI believes that there are alternatives to the current DOL proposal, including a uniform fiduciary standard and better, more concise disclosures. We stand ready to continue our engagement with the DOL and any other interested parties to try and develop a final rule or other proposal that will protect investors and ensure that all Americans have access to the retirement advice, products, and services that will help them achieve the dignified retirement that they deserve.

About Dean Harman, CFP ®

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

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

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

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

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

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

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

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

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

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

Chairman ROE. Thank you, Mr. Harman.

Thank you to all of the panel for your testimony.

I will now recognize Dr. Foxx, for five minutes.

Dr. FOXX. Thank you very much, Mr. Chairman. I appreciate it.

You gentlemen were all here and you heard the Secretary. Of course, we never have enough time to ask the questions and get answers that will be helpful. But I intend to ask him this question in follow up and hope I can get some kind of a specific answer.

He kept saying that it is a structurally flawed system, but he never truly identifies what that is except saying he doesn't think the best interests of the clients is always done.

I would like to ask, and I would love each of you to respond, maybe perhaps not today, but I would like to get an answer from each of you.

But I am going to ask Mr. Mason and Mr. Harman if you would answer. Can you tell from what the Secretary has said exactly what the structurally flawed part of the system is? And would this fix that? I think you have said no already. But does it work except for very bad actors that might violate any system that is put into place?

Mr. Mason?

Mr. MASON. Yes. I think just on your last point, a lot of the horror stories that we hear that are really just upsetting to hear and, you know, are illegal under current law; so, I mean, so in terms of is this a structural flaw of present law, some of these horror stories, absolutely not. A lot of these things are illegal under current law.

The only thing that I got out of it, and you know, I don't speak obviously for the Secretary, but the thing that I got out of it today was the core principle that advisers should act in the best interests of their clients. And that is an issue in which there is, you know, in terms of the people who have spoken both up there and back here, there has been unanimity.

The one disagreement is essentially that they have come up with this exemption from the prohibited transaction rules that you have to go through in order to provide help to small accounts, I talk to dozens of financial institutions and there isn't one who can use it.

So the issue they are either trying to correct, best interest, that is fine; the way they went about it doesn't work.

Dr. FOXX. Mr. Harman, before you answer, I would like to say what I got from his comments is that they want equality of outcomes, they want guaranteed outcomes for everyone. It seems to me that is it. They want maximum benefit. Well, all of us want that, for heaven's sake. But there are risks associated.

So Mr. Harman, if you would, if you have any additional comments to what Mr. Mason said.

Mr. HARMAN. I think Mr. Mason's points are right on point. Currently, advisers are highly regulated as it is. So we have had this current structure for many years. I don't think it is broken. I think we need to have the ability to provide multiple solutions for clients based on what their individual needs are.

So I don't think the current structure is broken at all. And in fact, the current structure allows us to serve clients in different ways based on different needs, especially the moderate-and lower-

income clients, their needs are oftentimes different than what we would consider to be high-net-worth clients. And the options and products that they need available also need to be preserved.

Dr. FOXX. I also think there is a problem with, again, who will ultimately decide what is in the best interest of the client. And I truly believe that is just going to result in a lot of lawsuits, because you pretend this eight-ounce cup has four ounces of water in it, is it half empty or half full? Who defines what the best interest is, is I think, ultimately, going to be decided in the courts and by expensive trials.

So thank you all very much.

I yield back.

Chairman ROE. I thank the gentlelady for yielding.

Mr. Scott, you are recognized for five minutes.

Mr. SCOTT. Thank you. Thank you, Mr. Chairman.

Mr. Mason, you mentioned the $4,000 fund and said a 1 percent fee would be insufficient to make it worth your while to give advice. How much money would you have to get out of that fund to make it worth your while?

Mr. MASON. Well, I am not in the business, but different financial institutions set different minimums in terms of how much they will require for an advisory account like that. Some of them, for example, are $100,000 or $50,000.

In order to accept 365-day liability and responsibility, you really can't do it for $40. It is not economically sound.

Mr. SCOTT. But basically—

Mr. MASON. I am sorry, go ahead.

Mr. SCOTT. Basically, the $4,000 fund amount would be problematic whatever you are doing.

Mr. MASON. No, no, see, actually not because under the brokerage model what happens is it is a completely different relationship. Suppose I have to act in the best interest, but I am on the brokerage model. And Jack were to come to me and ask me for help. I could give him help on that particular transaction, but I would have no ongoing duty to counsel him with respect to what to do tomorrow or the next day.

That is a transactional model that has worked very well to help the low- and middle-income individuals on a much less expensive basis get the assistance they need. So it is a completely different model. And that is why the advisory model doesn't work.

Mr. SCOTT. Now, under the rule, if you are doing just a transaction, are you covered by the best interest?

Mr. MASON. Absolutely. In other words, again, Jack comes to me and asks me for my advice under our sort of scenario and under the Department of Labor's, you would have to give advice that is in the best interests and we would support that, absolutely.

Mr. SCOTT. Okay.

Mr. Kelleher, if you are doing a single transaction and somebody comes to you for the transaction, are you subject to the best interest under this rule?

Mr. KELLEHER. Yes.

Mr. SCOTT. On a single transaction?

Mr. KELLEHER. I am sorry?

Mr. SCOTT. On a single transaction?

Mr. KELLEHER. One of the loopholes in the current rule is that if it is not on a regular basis, then it falls outside of a fiduciary duty. And one of the things the new rule is intended to do is to capture actual substantive retirement advice, even if it is only one time.

Mr. SCOTT. Okay. But if you just ordered the mutual fund, you wouldn't be subject to it, right?

Mr. KELLEHER. It depends on the context. As I understand the rule, if you were giving substantive retirement advice—

Mr. SCOTT. You are giving advice.

Mr. KELLEHER. Right.

Mr. SCOTT. Okay.

Mr. KELLEHER. It is very clear on education and call centers. Not every person that works in a call center is going to become an adviser. In fact, there is a very broad description as to all sorts of advice that people can use at call centers and elsewhere.

And in fact, the rule on that point is specifically tailored to the input by the industry on this very issue. It hasn't taken away their complaints, notwithstanding they have been addressed rather extensively.

Mr. SCOTT. Okay. Now, Chairman Roe mentioned an investor who was very satisfied because the size of their investment went up over the years. He didn't say how the investment measured compared to an S&P 500 fund. If you can evaluate advice over the years, what should you compare it to?

Mr. KELLEHER. Well, one of the things that this is focused on is if you put the clients' best interests first, then you can actually evaluate on a level playing field the Chairman's example as well as the Secretary's example. The problem now is that with the very low suitability standard, which allows the broker or the adviser to act in their own best interests above the best interests of their clients, you don't actually know whether the—and I can't remember the chairman's example, I think it was $365,000 the account grew to—that may or may not be actually a good return.

If it is a return and the broker ended up getting 5 percent at the front end and they lost, as Jack Bogle would say, the tyranny of compounding costs and every year he lost x percent where a similar product he could have been put into, he well could have had $495,000, $500,000 or more. You don't know because no one is required currently to act in their best interest.

And that is the core of the problem. Many of the problems and complaints go away if everyone is required to put the clients' best interests first.

Mr. SCOTT. And let me ask Mr. Haley a question. As I understand your testimony, you are comfortable with the best-interest rule, you just want it administered in a way that can be easily administered. Is that right?

Mr. HALEY. That is correct.

Mr. SCOTT. And can you help write the language where the best-interest standard is used, but it does not have the complications that you see in the present rules?

Mr. HALEY. Yes.

Mr. SCOTT. I yield back.

Chairman ROE. Thank the gentleman for yielding.

Just for clarification, that IRA was my wife's.

[Laughter.]

It did beat the S&P. And I happen to know it very closely because it was in my own family.

Mr. Allen, you are recognized for five minutes.

Mr. ALLEN. Well, just for the record, I am a little nervous that a department of the federal government that owes more than $18 trillion would be working on a rule that overreaches about fiduciary responsibilities. That would make us all nervous, I think, sitting here.

But Mr. Harman, as you said in your testimony, as an investment adviser, based on this rule, you would have to predict what your client would earn?

Mr. HARMAN. Yes. It is my understanding under the current BICE exemption that in order to be able to predict fees on an account for a 1-, 5-, and 10-year period, you also have to make assumptions as to the returns that the asset allocation—

Mr. ALLEN. So basically under the current interest rate policy of this government, you would have to recommend that your folks have a 60 basis point earnings in their programs.

Mr. HARMAN. You would have to—

Mr. ALLEN. To guarantee.

Mr. HARMAN. Yes, you would have to come up with some assumption that the portfolio would return at a certain rate.

Mr. ALLEN. And Mr. Mason, if this rule eliminates the brokerage side of the business, how big is that business? What percentage of the total financial industry, can you guess on that?

Mr. MASON. Ninety-eight percent of the IRAs under $25,000 are held in brokerage accounts. So the damage that would be done to the small investor is incalculable; 98 percent of the IRAs under $25,000.

Mr. ALLEN. That is unconscionable to me that—I mean, I sit here and I just cannot believe. You know, I wish you all had gone first because I think I am a little more educated about what really is going on here.

[Laughter.]

Mr. Haley, you said that, again, you answered the question as far as support of best-interest regulatory rule. In your mind, did the Department of Labor come to any industry experts and ask them what they thought about what might be in the best interests of the investor in this situation?

Mr. HALEY. I am not aware of that. We have had conversations with them in response to their proposed regulations.

Mr. ALLEN. The rules.

Mr. HALEY. And we are waiting to hear what their response is.

Mr. ALLEN. Okay. So you have any idea what—I guess I should ask the Secretary of Labor. That is why I wish he had gone last. Where did they come up with this rule? Does anybody know that? I mean, who wrote this thing? If it was not the industry, who is actually responsible for this?

Mr. MASON. I think that what happened was back in 2010 they thought that, well, these rules are out of date. And I think that the one piece that was really overlooked in this calculation was essen-

tially, and again, I hate to use this term, but the prohibited transaction rules, they are also out of date.

Mr. ALLEN. Right.

Mr. MASON. Because it is those rules that prohibit the brokerage model from functioning. And so what happened is they updated one piece of it and updated it in a way in which we have very grave concerns about. And then they really haven't updated the prohibited transaction rules and those are the rules that cut off low- and middle-income individuals and small businesses from help.

So if they could update those to accommodate the new system, that is how we can achieve the best of both worlds, a best-interest standard with workable rules that allow access to low- and middle-income individuals.

Mr. ALLEN. So the consensus would be is that the rule does need to be updated?

Mr. MASON. I don't think the industry has any concerns about updating a rule to ensure a broader best-interest standard. We are absolutely fine with that. It is really if that is going to be the case, we absolutely have to update the prohibited transaction rules to make them workable for the world that does exist today. Because right now, this would, just as you said, I mean, this would be a terrible development for the small accounts and the small businesses.

Mr. ALLEN. Mr. Haley, how do we solve this problem?

Mr. HALEY. Well, the first thing is the exemptive relief under the BICE does not apply to small businesses. So if you think about Fidelity, how do we serve small businesses? Number one, we have over 8,000 small businesses with less than $100 million in assets or less than 100 employees.

Today when that 401(k) comes to us, they give us a request for a proposal. They are looking for the lowest fees. They are also looking for a prototypical document.

We do that. They ask us, what type of investments would you like, you know, in the portfolio? We are an open-architecture firm, so when you think about it, one of our divisions is Fidelity's Funds Network. That is the largest mutual funds supermarket in the world. We have $1.4 trillion on our platform of non-Fidelity assets. So I am not conflicted. We give them a lineup.

I actually like to tell the story. I am the largest distributor of Pimco's mutual funds, okay? In addition to being—

Chairman ROE. Mr. Haley, Mr. Allen's time is expired.

Mr. ALLEN. I yield the time I don't have.

[Laughter.]

Chairman ROE. Ms. Bonamici, you are recognized.

Ms. BONAMICI. Thank you very much, Mr. Chairman.

And thank you to the witnesses. You have been here a very long time and I am glad you are all here. It has been a very enlightening conversation.

I have always found that consumer confidence is really an important part of economic growth. It is good for businesses large and small when their customers know that they are being treated fairly and honestly.

If you look back at the history of where the SEC came from, you know, after the Great Depression the SEC was formed and those

securities rules were written in order to bring that confidence back to the market. So it is a critical part, that consumer confidence.

And it is important as we have this conversation about the critical issue of retirement security that consumers have that confidence in their advisers and their transactions.

So I am really glad to hear of industry's support for the best-interest standard.

And let me just clarify something real quickly, because I want to make sure I am understanding what you are saying. Some of you have said the best-interest standard and some of you have said the best-interest fiduciary standard. Does everybody agree that the best-interest standard is a fiduciary standard? Does anybody not agree with that?

Mr. MASON. I think we agree.

Ms. BONAMICI. Okay, great. That is really helpful.

And I want to ask a couple of questions and save time for Mr. Kelleher.

But Mr. Mason, you and Mr. Harman sort of brought up the same thing. I thought maybe for a minute you were law partners, you were like Mason & Harman.

[Laughter.]

Mr. HARMAN. There is no relation.

Ms. BONAMICI. So Mr. Mason, you said something about the brokerage model doesn't work under this rule for small accounts.

And Mr. Harman, you basically said the same thing, that this proposal will, I think you said, fail the lower-net-worth clients who pay on commission. And I am confused about why, because the Secretary sat here and said commissions will be—there will be the ability to charge commissions under this rule.

So can you briefly tell me why you say that the brokerage model won't work? And then I want to save time for a question for Mr. Kelleher.

Mr. MASON. I am happy unless you want to—

Ms. BONAMICI. Go ahead, Mr. Mason. Go ahead.

Mr. MASON. Okay. I am happy to do it. Briefly, it is going to be a challenge because what it is there is a long, long list of requirements that essentially are unworkable. I will give you one example.

I think there was a great discussion this morning on the contract rule about how you have to enter into a contract before you even enter into a relationship and then the secretary indicated openness to sort of work on that.

Ms. BONAMICI. Right.

Mr. MASON. But I will mention one other that was mentioned by one of the members here this morning, which is one of the disclosures is to provide detailed information on every piece of direct and indirect compensation earned by the adviser, the financial institution and every affiliate on every single asset that could be purchased by any retirement investor in the country.

Well, there are thousands and thousands of different mutual funds.

Ms. BONAMICI. Of course.

Mr. MASON. Did you want to say something?

Ms. BONAMICI. No. I just wanted to make sure that I have time left.

Mr. MASON. Yes, I apologize.

Ms. BONAMICI. And thank you for pointing out that.

Mr. MASON. But that is one of, say, 10 things.

Ms. BONAMICI. I am going to reclaim my time for some other questions.

Mr. MASON. Go ahead.

Ms. BONAMICI. That was very helpful.

And Mr. Haley, you brought up the contract before the conversation. But that is not what Secretary Perez said.

So Mr. Kelleher, you heard the discussion both with the Secretary and the discussion here today about this problem that has been raised or this issue that has been raised about the best-interest contract exemption would require signed contracts before any conversations. But that isn't what the Secretary said.

So it seems like we are talking about two different things here.

Mr. KELLEHER. Well, I mean, first, let's look at the facts. In 2010 the Department of Labor proposed a rule and the industry says we are for best-interest standards and they killed the rule. And here we are again.

What they said at the time is the rule is unworkable, withdraw it, consider our input and re-propose it. The Department of Labor did exactly, and I could give you the quotes from 2010, 2011, and 2012, from the titans of the industry who said that; so they withdrew the rule. They have done extensive outreach, unprecedented outreach over the years with the industry.

They have accommodated the industry. The industry said the world will end if we can't charge commissions. So working with the industry, the Department of Labor for years has figured out how to accommodate that complaint.

They could have done what the U.K. did, ban commissions. And by the way, the statement earlier about the U.K. isn't accurate in terms of the response of the industry to that fiduciary standard without commissions. But they have accommodated the commission interest here. And yet, nonetheless, the industry is against it.

So they say they are for a fiduciary standard, but they are never actually for the one that is pending.

And it is interesting because every major labor, consumer, investor, and senior citizen group supports this rule. And a letter went to the chair and ranking member of this committee today from I don't know how many, 40 or 50 of them, detailing that support.

And you started with trust and confidence of the American people and investors. That is what this goes to. Put their best interests first and you will restore trust and confidence.

Ms. BONAMICI. And I see my time is expired. I just wanted to note that there are other areas where there is a fiduciary duty that we can get this done. And if you are all in agreement that we need to have this fiduciary standard, I don't see any reason why we can't make this happen.

Thank you, Mr. Chairman.

Chairman ROE. Thank you for yielding.

Mr. Grothman, you are recognized.

Mr. GROTHMAN. Sure. Well, I have two short questions, keep it short here.

The first one—and I had another committee hearing, so maybe I missed if you dealt with it, Mr. Harman.

I had a little discussion about an hour ago with the Secretary as to whether or not compensation paid to people was going to wind up on a public website. And I was citing your testimony here and it was our testimony. Yes, this testimony that it wouldn't be.

Could you comment on that? Or do you believe that under this rule, you know, kind of an interesting thing, that, say, if I worked for a brokerage firm or whatever, that someone can get on a website and see how much I am making?

Mr. HARMAN. I am sorry. Could you repeat it again? I was having a hard time hearing it.

Mr. GROTHMAN. Okay, this is the deal.

Mr. HARMAN. Thank you.

Mr. GROTHMAN. I asked a question before of the Secretary, and I asked a question off of your expected testimony. It appears to me in your testimony here that you are under the belief that if this rule goes into effect you will be able to get on a website and see how much individual people are making. If you want to look on page 18, the website must be in machine-readable format and include the direct and indirect compensation payable to the firm, each individual adviser and each individual affiliate of the firm for each asset available the last year.

Okay, which looks to me like if I am an employee of, you know, you name it, somebody can get on a website somewhere, has the chance to get on a website somewhere and see I made $40,000 last year, $140,000 last year, whatever I am making.

Now, the Secretary implied that is going to be confidential and the website is only for, I don't know, not public use.

But could you give me your opinion as to what is going on there?

Mr. HARMAN. Yes, absolutely. Thank you for the question.

I guess one of the concerns about the website, my understanding is that it would be public under BICE. But one of the big concerns is context and information around context. I am concerned that this will create additional confusion for investors because they don't know necessarily how to interpret this data and that.

Then the other thing from a performance reporting standpoint that is concerning is every client has different objectives. And so back to kind of benchmarking that was mentioned earlier today, it is difficult to know one client from the next whether that was successful or not based on the fact that different people have different goals and different objectives for their portfolio. And their portfolios are managed differently to achieve those goals.

Mr. GROTHMAN. Okay. And when I read your testimony, I take it to mean if I am an agent for a captive industry or whatever, somebody can get on a website, and maybe that is fine, maybe we should all know what everybody else is making. It is just kind of an interesting thing, the proposal is, that I can get on a website and see that John Jones made X amount of dollars last year. Is that the way you read that?

Mr. HARMAN. I do. And again, the public nature of that has been, you know, concerning from a confidentiality standpoint.

Mr. GROTHMAN. That is just an interesting thing.

Now, my other question will be for Dr. Reid and then we will let you guys be.

The administration claims that advice is costing $17 billion a year. Could you elaborate one more time as to how that figure is arrived at or whether you think it is accurate?

Mr. REID. Both the Council of Economic Advisers and the Department of Labor have argued based on their reading of the academic literature that individuals in brokerage accounts are underperforming by at least a full percentage point a year, the Department of Labor says perhaps 2 percentage points.

This is actually a fairly easy task. You can go into the Morningstar data, you can look and see where the assets are holding for the types of funds that they are talking about in their analysis, you can actually find that the assets are concentrated in low-cost funds that outperform their Morningstar average.

And so the claim that they do under-perform by this 1 percentage point is not based in data or in actual experience.

Mr. GROTHMAN. Thank you.

I yield the rest of my time.

Chairman ROE. I thank the gentleman for yielding.

Mr. Sablan, you are recognized for five minutes.

Mr. SABLAN. Thank you very much.

Mr. Harman, you actually got me there in your testimony. But then the statement that investors would be under-served because they don't really know where to go to, who is that investor you are talking about?

Mr. HARMAN. Which investors am I talking about? I am talking about lower net worth and midsize clients, midsize investors as well. So people—

Mr. SABLAN. How much wealth do they have invested?

Mr. HARMAN. Really, anyone with less than $50,000.

Mr. SABLAN. Okay. I am just curious because I was very pleased with the response Mr. Haley provided Ranking Member Scott that there could be a way to work this thing out. After, Mr. Kelleher—Mr. Kelleher, right—said that actually the Department, this isn't the first time we have had this, I just got into the subcommittee, but that 2010, 2011, or 2013, so that every time—why don't the industry get together with the Department of Labor and work something out that works for all of us?

I mean, I don't think any one of you will say that you don't want to be known as not having the best interests of your client. But then why is it so difficult to get there when Mr. Haley says that we can without actually without writing a rule that doesn't—it makes negligible any offenses to it. I am just curious.

I am from the Pacific islands, so I don't really know these things. Educate me, please.

Mr. KELLEHER. The way to align that would be to support a best-interest rule. There are a lot of people running around saying we support the best interest, we just don't want it to be in the rule. And they don't say it that way, and that is the problem.

You know, today there are 90,000 certified financial planners, there are 10,500 registered investment advisers with the SEC representing 200,000 individuals, all of whom provide services in the clients' best interests.

The sky hasn't fallen. They are making plenty of money. They are doing right by their clients. And it proves, the market proves that is not only possible for the client to thrive, but for the business to thrive.

And we also have these new entrants that were mentioned earlier. Rebalance IRA, Wealthfront, Personal Capital, their entry is coming in from small businesses across the country, technology and otherwise, to serve small savers, small businesses as well as large savers and large retirement accounts with a fiduciary duty.

The only question is, is the rule going to put the clients' interests first of the brokers' interests? That is what we are talking about. That is the choice.

And if everybody is going to say I support the best-interest rule for my clients, then stop saying it, step up and support a rule that actually does it.

Five-plus years of warfare against the rule doesn't quite coincide with the pretty words.

Mr. SABLAN. But now, let me get this straight. We have spent five years trying to work out this rule. And whose fault is it that it isn't yet a rule?

Mr. KELLEHER. Well, I think if you look at what—the Department of Labor has undertaken unprecedented outreach. Better Markets has participated outreach. Better Markets has participated in the rulemaking process across—

Mr. SABLAN. I have another question, Mr. Kelleher. This is just out of curiosity because, again, I need an education to catch up on all of this. How much exactly is it costing the industry for government oversight over this investment? How much is the cost of government oversight to the industry that they have to get their lawyers paid so that they could make sure everybody is following the rules?

Mr. KELLEHER. You mean how much today?

Mr. SABLAN. Yes. Say, is there an average on industry standards, say, 10 percent, 15, whatever?

Mr. KELLEHER. I don't know if anybody has put a number on it. But I think everybody has conceded that it is a very highly regulated industry, and I think everybody concedes it is appropriate to be a highly regulated industry when you are dealing with people's retirement money—

Mr. SABLAN. Oh, sure.

Mr. KELLEHER.—which isn't only tax-advantaged, but incredibly hard-earned.

Mr. SABLAN. Yes.

Mr. KELLEHER. And so it is appropriate that we have for everybody the right rules and the right laws in place so that the money from hardworking Americans is treated appropriately in their best interests where they get the best return, lowest cost, best outcome.

Mr. SABLAN. All right. And again, you know, I am just afraid that Mr. Haley's agent will close shop if he is concerned about, yes, the additional cost for defaulting—

Mr. KELLEHER. There is also a cost, by the way, of no oversight. A rule that puts the brokers' interests first is costing the American people a fortune.

Mr. SABLAN. I understand that.

Mr. KELLEHER. So there is actually a cost for poor regulation or no regulation.

Mr. SABLAN. I understand. I think the five-years spent, you know, time spent on trying to come to an agreement and we have no agreement. So I agree.

I yield back.

Chairman ROE. Thank the gentleman for yielding.

We have mentioned, I will finish the questions briefly, we have mentioned the word "trust" and the secretary did. And all due respect to the Secretary, who do I trust more, the Department of Labor or my financial adviser? And I can guarantee you it is my financial adviser who is looking after my interests a lot more because he just texted me during this hearing.

[Laughter.]

I just got a text from him. So I do, and I sincerely mean that. I have great trust in him, and I have a great relationship, a 20-year relationship with my financial adviser. And we will continue to do so as long as he is doing that business, and I am doing it.

I think a few of the things I think we agreed on today, and I think this has been a great hearing by the way, from the Secretary is the best-interest standards and to update the rules that will make it, and Mr. Sablan mentioned this, about making this happen. I think this can happen, I really do. I think everybody here at this hearing thinks it needs to be updated.

It ought to be done, but it also ought to accommodate without the onerous—I mean, look, do you ever read, that is where the details are, not the little one sentence, but this is where the rubber hits the road. Believe me, as a doctor having to deal with Medicare—and by the way, I wish the Secretary would ask Medicare to be as transparent as he is asking these financial people to be. That would help me a lot in my work.

But I think that I heard Mr. Carter say it, I have heard others say it here is that we don't want this to get so unmanageable because somebody pays the bills here and it is always me, the client, that does that.

And I want Mr. Harman to answer this question if he would, just a second ago. And he mentioned a minute ago that confused me a little bit. In the new rule, it says you have to predict future earnings. And every time I have ever picked up any mutual fund or looked at it at all—in full disclosure, Fidelity has some of my retirement account, I will make that public—past performance doesn't predict future returns. I hear it every time.

Is that a conflict? Or how do you reconcile those two things?

Mr. HARMAN. It is a tremendous conflict, I think. And you mentioned trust in your statement here. And that has the potential to significantly undermine trust, simply that alone by putting that in there. Because as we know, things are not static, they don't always end up 10 years from now exactly as we might think they would today, even though we are making the best recommendation for the client at that point. So that is problematic.

And it is problematic that it crosses current FINRA and SEC regulations as well.

Chairman ROE. I think it absolutely does. I think you cannot now go out and my adviser can't go and say, yes, I am going to guar-

antee you or you are going to probably make this much money. He has never said that, in my life I have never heard him say that.

The market is volatile. We certainly saw it in—look, I have been through the recession of 1981, through the later recession of the later 1980s, in 2000, and it will come again. This is not the last recession we will have. Hopefully it won't be as bad.

Let me ask one other question. Is it true that higher-cost plans, Dr. Reid, always yield a lower cost?

And Mr. Kelleher mentioned a minute ago about it happened to be a family member's IRA that was a managed account like that. Look, I don't care if I pay 3 percent on a load if I make 12 and my net is 9. I am looking at my net return and not just what I pay in a fee because I may get a better return, I may not.

Is there data out there in the industry to show that?

Mr. REID. So Mr. Chairman, I think this obsessive focus on fees alone, and even a fiduciary standard doesn't say that it has to be the lowest-cost fund, can really be blinding so much so that the train can leave the station and you are not on it.

And what do I mean by that? What I mean is that investors who were not properly allocated to the market, who didn't have enough equity exposure completely missed the market run-up since 2008.

We have been in the most vigorous, bull market in the stock market probably in the last 100 years, and yet as one of the panelists has indicated, 45 percent of government employees in the TSP are in the G Fund, which basically makes just enough to get above inflation.

That is evidence, when you don't get help and advice, how much you can lose out. It is a cheap alternative, it is low cost, but they missed the train.

Chairman ROE. But someone just mentioned briefly the website. That was confusing me what the Secretary said. Who would have access to this website with all this data? Would you have to sign the contract? Is that how we would get access to the website? How does that work? Because you heard him say that.

Mr. MASON. For example, every participant in an entire plan, so if you have 100,000 participants in a plan, every single participant would have access to the information that is stored.

Chairman ROE. In that website.

Well, I want to thank you all very much for your participation. You have been very patient sitting through a long first panel.

And I will yield to Ms. Bonamici for closing remarks.

Ms. BONAMICI. Thank you very much, Mr. Chairman.

And first, I would like to enter into the record the letter referenced by Mr. Kelleher dated June 16, 2015, from various organizations in support of the rule. I would like to enter that into the record.

[The information follows:]

June 16, 2015

Hon. John Kline
Chairman
Committee on Education
and the Workforce
U.S. House of Representatives
Washington, D.C. 20515

Hon. Bobby Scott
Senior Democratic Member
Committee on Education
and the Workforce
U.S. House of Representatives
Washington, D.C. 20515

Dear Chairman Kline and Ranking Member Scott:

As organizations that want to see protections for retirement savers strengthened, we write to express support for the Department of Labor's proposed rule -- now out for public comment -- that would close loopholes and update the standards for retirement investment advice under the Employee Retirement Income Security Act (ERISA).

Americans who save and invest for a secure and independent retirement should be able to trust that the retirement investment advice they receive is in their best interest. Workers and retirees are more dependent than ever on financial professionals to help them navigate the complex decisions they must make to fund a secure and independent retirement. Unfortunately, because of loopholes in rules specifying who is a "fiduciary" under ERISA, many of the financial professionals whom retirement savers rely on for advice are legally allowed to put their own financial interests ahead of the interests of their customers. While many of these professionals nonetheless seek to do what is best for their customers, others take advantage of gaps in the regulations to steer their clients into high-cost, substandard investments that pay the adviser well but eat away at retirement savers' nest eggs over time. This is a particular problem for small savers who are disproportionately served by nonfiduciary advisers and receive conflicted advice.

After years of thoughtful analysis and consultation with all stakeholders, the Department of Labor has drafted a comprehensive proposal that closes loopholes in the definition of investment advice so that anyone who provides individualized investment recommendations to retirement savers -- whether they are saving through a traditional or defined contribution pension plan, such as a 401(k), or an Individual Retirement Account (IRA) -- would be required to provide best interest advice to their clients. Importantly, the proposed rule would eliminate outdated requirements that advice must be 'regular' or serve as the 'primary basis' for an investor's decision, before the best interest standard applies. In a significant improvement over the 2010 proposal, it covers advice about recommendations to roll money out of a pension or 401(k) plan and into an IRA. This is the most important financial decision many people will ever make, with a potential to seriously affect their standard of living in retirement, and is a special area of concern given extremely troubling practices identified in a GAO report.

By updating these standards and closing these loopholes, retirement savers will undoubtedly experience better investment outcomes. At the same time, the proposed rule would provide sufficient flexibility for financial professionals and their firms so they can continue to charge commissions and other sales-based compensation. This reflects a balanced approach that preserves the broker-dealer business model while ensuring that retirement investors of all incomes and portfolio sizes will receive advice that is in their best interest.

We encourage you to stand with your constituents – who are saving for retirement and deserve to have the best financial advice for their future– and support the Department of Labor's rulemaking process as it moves forward.

Sincerely,

AARP
AFL-CIO
Alliance for a Just Society
Alliance for Retired Americans
American Association of University Women (AAUW)
American Federation of Government Employees (AFGE)
American Federation of State, County and Municipal Employees (AFSCME)
Americans for Financial Reform
Better Markets
Center for Economic Justice
Center for Responsible Lending
Certified Financial Planner Board of Standards
Consumer Action
Consumer Federation of America
Consumers Union
Demos
Financial Planning Association
Fund Democracy
Garrett Planning Network, Inc.
International Association of Machinists and Aerospace Workers
International Brotherhood of Electrical Workers
International Federation of Professional
& Technical Engineers (IFPTE)
International Union of Bricklayers and Allied Craftworkers
International Union, United Automobile, Aerospace & Agricultural Implement Workers of America (UAW)
Justice in Aging
Iota Phi Lambda Sorority, Inc.
Latinos for a Secure Retirement
Leadership Conference on Civil and Human Rights
Lynn Turner, Former SEC Chief Accountant
NAACP
National Active and Retired Federal Employees Association (NARFE)
National Consumers League
National Council of La Raza
National Employment Lawyers Association
National LGBTQ Task Force Action Fund
National Women's Law Center
Pension Rights Center
Personal Capital
Public Citizen
Public Investors Arbitration Bar Association
Rebalance IRA
SumOfUs

The Committee for the Fiduciary Standard
U.S. PIRG
Wider Opportunities for Women

Cc: Members, Education and the Workforce Committee

Chairman ROE. Without objection, so ordered.

Ms. BONAMICI. Thank you very much, Mr. Chairman.

And I am going to give the opening statement on behalf of the Ranking Member. But I want to say that I am an optimistic person. And when I hear everyone has the same goal, the best-interest fiduciary standard, and there are some definitional differences about how we get there, I am confident that we can get this done. And I get to say this because I also serve on the Science Committee, it is not rocket science to get this done.

[Laughter.]

So we are a long way, 40 years away from the days when most people had traditional pensions to rely on in retirement. This shift away from defined benefit plans has exacerbated retirement insecurity in this country. And the proposal we discussed at length today modernizes this outdated fiduciary rule that was developed when the defined benefit plans were the standard, which is certainly not like today.

At the end of 2014, $7.4 trillion in U.S. retirement assets could be found invested in IRAs. Much of that had been in ERISA-covered plans before being rolled over. And $6.8 trillion could be found in private, employer-sponsored, defined contribution plans like a 401(k).

Individuals with little to no financial expertise must determine their own retirement strategy as well as make complicated investment decisions in order to prepare for retirement.

Too many middle class and working families are worried about saving enough for retirement, and it is critical that when these individuals seek advice from professionals they receive recommendations and advice that is in their best interest rather than conflicted advice that is in the best financial interest of their adviser.

Unfortunately, conflicted advice has been permitted under the standard we have been operating under for the past 40 years.

The Department's proposal, which they have been working on for years with input from the industry, is reasonable and affords participants the access to all the necessary information available to help them make informed retirement decisions.

We look forward to continuing to work with the Department to ensure that the final rule appropriately addresses concerns.

Thank you very much to the witnesses for such an enlightening hearing.

Chairman ROE. Thank you very much for yielding.

And in conclusion, we do have a situation in America today where not enough people save for retirement. We know that. Twenty-nine percent of people over 55 don't have any savings at all. That is frightening when you think about it. It means they are going to have to—and life expectancies are going up and up and up, so it puts great strain on social services.

So we need to, and I believe this, the day I started practice we had a pension plan for every employee that was in our practice, and we still do to this day. And many of you, and certainly, Mr. Harman, you do have individuals, small investors.

Fidelity is a huge company; you are a smaller business, of course. But you provide a tremendous service for people and advice that help people who are not sophisticated investors gain knowledge

about how to invest their money and how to save for the future and give them a lot of confidence about how they are going to live when they get older.

I can assure you, having a mother that will be in assisted living right now, and knowing those costs and so forth, you can't save enough money. I don't know if anybody ever said they have saved too much money. And that is obviously a challenge that we all have.

We have a big problem that we worked through on multi-employer pension plans. You remember, that is still a serious problem we haven't completely solved. So saving for our future and for our retirement is a national problem. We need to make that easier, not harder.

I certainly heard very encouraging things here today from the secretary and from industry about the best-interest fiduciary standard. I think all of you support that. No one supports conflicted advice, no one that I know of does.

So I think we need to hopefully work this out. And the BIC exemption is not workable. I mean, I have tried to sit down and figure it out, and I have already heard from Mr. Haley—again, full disclosure—our small business isn't going to be able to get advice because Fidelity is our brokerage service for our business.

And I just realized when he said what he said that we won't be able to get advice from Fidelity with this new rule. That is ridiculous for a group that is trying to do the right thing by employees and its folks that work for them.

So I thank you all. This was a great hearing.

[An additional submission by Secretary Perez follows:]

Transcript Inserts
Subcommittee on Health, Employment, Labor, and Pensions
Committee on Education and the Workforce
U.S. House of Representatives

Thomas E. Perez, Secretary
U.S. Department of Labor

Thank you for the opportunity to submit these two transcript inserts to clarify my responses to questions posed during the Subcommittee's June 17, 2015 hearing regarding the Department's proposed rule to protect workers from conflicts of interest in retirement investment advice.

Proposed Best Interest Contract Exemption

In the course of the June 17 hearing, a Subcommittee member asked whether any financial adviser choosing to rely on the Best Interest Contract Exemption would be required to publicly disclose his or her individual total annual compensation. I want to be clear that nothing in the proposed exemption would require such disclosure. In this regard, there are two conditions in the proposed exemption that I would like to explain.

The first is the proposed web page disclosure. Financial institutions would be required to post to a public web page the direct and indirect compensation payable for services provided in connection with investment recommendations they make. The disclosure focuses on compensation arrangements to the firm, its advisers, and any affiliates rather than specific amounts received. The proposal would permit the compensation payable to be expressed as a monetary amount, formula or percentage of the assets involved in the investment transaction. However, it would not require public disclosure of any individual adviser's total compensation.

The proposed web page disclosure is intended to increase transparency regarding advisers' and firms' financial incentives in providing investment advice. It would allow financial information companies to analyze and provide information comparing the compensation practices of different advisers and financial institutions, and allow consumers to evaluate these practices. There is no proposed requirement that any individual adviser be named on the web page or that anyone's total annual compensation be disclosed.

The proposed data retention requirement, on the other hand, is intended for the Department to have data to use in evaluating the effectiveness of the exemption in reducing conflicts of interest in the investment advice marketplace. It would require financial institutions to retain, and provide to the Department upon request, for each asset, the aggregate value bought, sold and held by a firm's clients and compensation received by the financial institution and its affiliates aggregated for each asset. It would also require firms to retain and provide to the Department upon request data needed to calculate the average return of accounts advised by each adviser. Although the Department proposes to reserve the right to make some of the data public, it limits such data to the investment returns on an aggregated basis and not any compensation earned.

The Role of Employers in Providing Investment Education and Advice

In the course of the June 17 hearing, a Subcommittee member asked about investment education and how the proposed rule seeks to preserve investment education for employers and employees.

It's important to recognize that employers don't generally receive compensation, direct or indirect, for giving participants advice. As a result, they would generally not be considered fiduciary investment advisers under the rule, as the rule would define a fiduciary advisor as someone who receives compensation in connection with the advice before being treated as fiduciary. In addition, the rule would create four broad categories of non-fiduciary education, which would not be treated as fiduciary advice under the rule. Accordingly, employers could readily provide a wide range of information and materials on: plan information; general financial, investment and retirement information; asset allocation models; and, interactive investment materials -- without acting as fiduciary advisers.

[Questions for the record and there responses follow:]

COMMITTEE ON EDUCATION
AND THE WORKFORCE
U.S. HOUSE OF REPRESENTATIVES
2176 RAYBURN HOUSE OFFICE BUILDING
WASHINGTON, DC 20515-6100

October 16, 2015

Mr. Jack Haley
Executive Vice President
Professional Services Group
Fidelity Investments
245 Summer Street
Boston, MA 02210

Dear Mr. Haley:

Thank you for testifying at the June 17, 2015, Subcommittee on Health, Employment, Labor, and Pensions hearing entitled "Restricting Access to Financial Advice: Costs and Consequences for Working Families and Retirees." I appreciate your participation.

Enclosed are additional questions submitted by Committee members following the hearing. Please provide written responses no later than October 30, 2015, for inclusion in the official hearing record. Responses should be sent to Callie Harman of the committee staff, who can be contacted at (202) 225-7101.

Thank you, again, for your contribution to the work of the Committee.

Sincerely,

Phil Roe

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

Question from Congressman Guthrie (KY)

Over the course of the past few years, the United Kingdom's Financial Conduct Authority (FCA) moved forward with a rulemaking somewhat similar to the Department of Labor's (DOL) proposed rulemaking that banned commissions for those involved in marketing and selling retirement products. My understanding is that many middle-market workers and retirees in the U.K. now have very limited choice in terms of turning to someone for financial advice due to this development. Are you familiar with the FCA rule?

If yes, could you describe the level of success the FCA's rule has had in weeding out bad actors from the industry? How have any benefits compared to the costs of reducing access to advice for workers and retirees? Could you speak to how developments in the U.K. can inform our discussion of the DOL proposal?

Questions from Congressman Curbelo (FL)

I understand from a few large brokerages catering to self-directed investors that their customers are increasingly using exchange-traded options in their IRA accounts to manage the risk associated with owning stock, with the ultimate goal of increasing their retirement savings. The proposal would take away their ability to do so.

Given your experience, what are your thoughts about limiting financial product choices for investors? Do you think investors will be better served with fewer products to choose from?

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October 16, 2015

Mr. Dean Harman, CFP
Managing Director
Harman Wealth Management
24 Waterway Avenue
Suite 775
The Woodlands, TX 77380

Dear Mr. Harman:

Thank you for testifying at the June 17, 2015, Subcommittee on Health, Employment, Labor, and Pensions hearing entitled "Restricting Access to Financial Advice: Costs and Consequences for Working Families and Retirees." I appreciate your participation.

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October 16, 2015

Mr. Dennis Kelleher
President and CEO
Better Markets
1825 K Street, NW #1080
Washington, DC 20006

Dear Mr. Kelleher:

Thank you for testifying at the June 17, 2015, Subcommittee on Health, Employment, Labor, and Pensions hearing entitled "Restricting Access to Financial Advice: Costs and Consequences for Working Families and Retirees." I appreciate your participation.

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Sincerely,

Phil Roe

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

Question from Congressman Curbelo (FL)

As you know, investors are increasingly saving for retirement through retirement accounts such as IRAs. Many choose to do so by making their own investment decisions through brokerage firms that serve self-directed investors. Not only does the DOL proposal have the effect of potentially taking away this self-directed model of saving for retirement, it also limits the products that investors can use to save for retirement.

Do you think it is appropriate for the government to limit the products investors can use to save for retirement, and if so, why?

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October 16, 2015

Mr. Kent Mason
Partner
Davis & Harman LLP
1455 Pennsylvania Avenue, NW
Suite 1200
Washington, DC 20004

Dear Mr. Mason:

Thank you for testifying at the June 17, 2015, Subcommittee on Health, Employment, Labor, and Pensions hearing entitled "Restricting Access to Financial Advice: Costs and Consequences for Working Families and Retirees." I appreciate your participation.

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Subcommittee on Health, Employment, Labor, and Pensions

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WASHINGTON, DC 20515-6100

October 16, 2015

Dr. Brian Reid, Ph.D.
Chief Economist
Investment Company Institute
1401 H Street, NW
Washington, DC 20005

Dear Dr. Reid:

Thank you for testifying at the June 17, 2015, Subcommittee on Health, Employment, Labor, and Pensions hearing entitled "Restricting Access to Financial Advice: Costs and Consequences for Working Families and Retirees." I appreciate your participation.

Enclosed are additional questions submitted by Committee members following the hearing. Please provide written responses no later than October 30, 2015, for inclusion in the official hearing record. Responses should be sent to Callie Harman of the committee staff, who can be contacted at (202) 225-7101.

Thank you, again, for your contribution to the work of the Committee.

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Subcommittee on Health, Employment, Labor, and Pensions

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WASHINGTON, DC 20515-6100

October 16, 2015

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

Dear Secretary Perez:

Thank you for testifying at the June 17, 2015, Subcommittee on Health, Employment, Labor, and Pensions hearing entitled "Restricting Access to Financial Advice: Costs and Consequences for Working Families and Retirees." I appreciate your participation.

Enclosed are additional questions submitted by Committee members following the hearing. Please provide written responses no later than October 30, 2015, for inclusion in the official hearing record. Responses should be sent to Callie Harman of the committee staff, who can be contacted at (202) 225-7101.

Thank you, again, for your contribution to the work of the Committee.

Sincerely,

Phil Roe

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

Questions from Congressman Roe (TN)

1. The DOL's proposal amending the definition of fiduciary would be effective eight months after finalized, as drafted. Stakeholders have argued this deadline is functionally impossible: systems will need to be built for the vast new disclosure requirements that will take years to build. What analysis has the Department performed regarding a realistic timeframe for implementation?

2. In your testimony, you suggested "robo-advisors" and online wealth management services could be used as a primary source of advice if the proposed regulation restricts access to in-person financial guidance and education. Should online tools replace in-person financial guidance and education? Will the proposed rule force low income investors to rely on the Internet as their primary source of financial guidance and advice?

3. During the hearing, numerous witnesses and Members of Congress expressed support for a best interest standard of care, but raised concerns with the proposed rule. You pledged to address some of these concerns. Will you commit to sharing your proposed changes with industry stakeholders and Members of Congress before the rule is finalized?

4. The "best interest contract" (BIC) exemption does not apply to advice given to plan sponsors of small participant-directed plans. As a result, many financial professionals will be prohibited from assisting small businesses with choosing a menu of investment options. In fact, the National Federation of Independent Business (NFIB) expressed concerns that the proposal could restrict small business access to affordable advisory services. Will you modify the proposed rule to protect access to advice for small businesses?

5. During the hearing, witnesses testified that DOL's regulatory impact analysis does not support the administration's claims of cost savings. Did the regulatory impact analysis examine whether investors achieved better outcomes if they used fee-based advisors instead of commission-based advisors?

6. The administration has claimed investors are the victims of "hidden fees." Can you explain which fees specifically are hidden from disclosure under current securities law?

Questions from Congressman Polis (CO)

1. As you know there have been several legislative attempts that would prohibit the Labor Department from finalizing and implementing the proposed rule. Could you tell us why these attempts would be harmful for hardworking families and retirees?

2. Many of my constituents have written to me and told me stories of how hard they work just to keep up, paycheck to paycheck. I appreciate all the work you have done as Labor Secretary to increase wages and get more Americans into higher-paying jobs. It seems the next logical step is getting more Americans to save for retirement – something that is a struggle for too many. I keep hearing over and over again that this rule is going to be disruptive for people with small account balances, but currently how many people who

are saving for retirement are seeking advice now? What is the reason for this relatively low number and how will the rule address the issues that impact the number?

3. The DOL included more than 170 questions concerning its proposal or matters left open in the proposal and you have been meeting with stakeholders and receiving feedback. Are there any specific changes you are planning to make based on the feedback you have received so far?

   Even proponents of the rule acknowledge there are countless areas that don't work in their current forms. Has consideration been given to publishing an interim final rule so everyone could see what they have fixed and what still doesn't work? If so, what form would such guidance take and what commitments might the Department make about potential modifications in advance of the final rule?

   Would you consider allowing service providers, upon whom the success or failure of the rule will depend, to see a revised rule before it is finalized to ensure that all the necessary fixes to this complicated rule have been made? Will the Department go final with questions still outstanding? Is there any consideration for the Department to either re-propose the regulation for comment on how you answered those questions?

4. Some critics of the proposal have stated that the Department should not move forward with a rule at this time. Instead, they state a uniform standard of care is developed for all asset categories and advisory models is the best path forward. How do you respond to this criticism?

   In the context of the seller's carve out, the Department has invited comments on, among other things, whether the plan size limitation of 100 plan participants in the proposal is an appropriate condition or whether other conditions would be more appropriate proxies for identifying persons with sufficient investment related expertise to be included in a seller's carve-out. Why did the Department limit the "seller's carve-out" to only large plans? Do you have any concerns that this will limit the distribution of retirement plans to small business owners? Are you concerned that small 401(k) plan sponsors will be unable to obtain needed investment guidance regarding their plan's investment options without having to expend the additional cost to hire an independent investment advisor? How would a small 401(k) plan sponsor obtain investment advice with regard to the types of investment alternatives it should make available to its participants? Are you concerned that this prohibition will prevent small employers from sponsoring 401(k) plans for their employees?

   Would the Department be open to the seller's carve out being extended to plan fiduciaries, regardless of size or assets, who can somehow prove they are a "Sophisticated Investor," that is, they must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment?

   There is a widespread concern that the lack of seller's exception for small businesses runs directly counter to the structure of ERISA and DOL enforcement positions which place a fiduciary duty on small employers to make prudent fiduciary decisions? Do you believe

this will have an impact of raising the costs for small businesses looking to offer their employees retirement savings plans? Who in particular within the small business community did the DOL consult on this point and can we see the specific analysis performed?

5. The BIC exemption requires a large amount of disclosure at the point of sale, annually and on an ongoing basis through a website. Some argue investors are already overwhelmed and confused by the amount of disclosure they receive. Are you willing to consider changes to the disclosure regime for the BIC exemption so that the BIC exemption is more useful to investors and more workable for advisers? One consideration is how individual participants benefit from the public website individuals and companies will be using to disclose? Do you believe they will be able to navigate through the vast amounts of information required on there that may not apply to them? Has there been consideration to requiring providing 404 type disclosure to participants?

6. One of the potential consequences that has been raised regarding this rule is that the proposed fiduciary rule could make it very difficult for those who provide annuities – the only guaranteed form of retirement income – to actually educate individuals about this important product and would likely result in decreased availability of guaranteed income annuity products on 401(k) investment menus.

   Currently, firms that provide retirement plans have very clear guidance in a 1996 Interpretive Bulletin on the line between fiduciary advice and non-fiduciary education. But this proposal seems to move the line so that a lot of what is now deemed non-fiduciary education will become fiduciary advice.

   Considering the DOL's focus on lifetime income, I'd like your perspective on whether it was the Department's intention in the re-proposal to make it harder for savers to consider annuities – or was this simply an oversight and something DOL would be willing to correct in future drafts of the proposal? In addition, I would appreciate it if you could comment on the status of DOL's rulemaking on requiring a lifetime income disclosure on benefit statements?

7. At a Senate Banking Committee hearing, Mary Jo White indicated that changes to fiduciary standards in the retail space could harm access to affordable guidance and education. Rick Ketchum of FINRA has indicated the rule would make it difficult for people with small account balances to get advice. If the epitome of the DOL's concern is that someone who has worked their entire life in a middle of the road income job still have the opportunity to have a nice nest egg for herself, how can you assure us that this proposal won't harm those very lower- and middle-income investors who may not have high enough account balances to go to a registered investment advisor? What is your response to criticism that this rule in effect creates a two-class investor system, whereby people of means will be able to pay the higher fees for good financial advice while those with fewer assets under management will be forced to rely on the Internet?

8. People are now changing jobs 11 times over the course of a career. And a growing number of people take the money and run when changing jobs, a move that can obviously have a drastic impact on retirement readiness, especially among younger workers. For

those with relatively small balances, many would now be unwilling or unable to pay higher upfront fees for the help they need and desire. With 1 in 3 employees cashing out within 5 years of leaving a job, do you have concerns that this will severely limit transitioning employees' access to critical investment education and only make this problem worse?

9. I have been told that the best interest contract exemption is unworkable for many reasons. One reason is because the financial advisor has to enter into a contract with someone before advice is given. Where do you see a practicable line when a contract must be signed before an advisor can help them?

   How would this work in 401(k) plans where millions of workers in plans would have to enter into contracts with phone reps before a phone rep can help them with a basic question? How would this impact a small business owner who is simply shopping around for a financial advisor?

   Under this exemption, whenever a plan sponsor seeks responses to an RFP (request for proposal) and asks for a suggested portfolio as part of that RFP, no firm can respond without becoming a fiduciary by responding. Did you intend this effect? Do you believe this will make it more difficult for small businesses to establish retirement plans for their employees? Can you commit to fixing this logistical problem?

10. Some concerns have been raised as to whether the effect of the re-proposal would be to make personalized retirement investment assistance unavailable to small accounts and small businesses. In response, some supporters of the rule have specifically cited the advantages of so-called robo advisers, or online wealth management services that provide automated, algorithm-based advice without the use of human financial planners. Mr. Secretary, you yourself have touted the need for face-to-face interaction, and not technology, because there are some workers who are going to need the face-to-face assistance moving forward. It certainly may be true that automated investment tools can play a critical role in providing assistance to certain investors who understand their limitations and may not need face to face interactions, but do you believes this creates a problem for those who need investment assistance through face to face interaction?

11. It seems to me that the importance of this debate is underscored by a recent study from the Boston College Center for Retirement Research, which found that individuals prematurely withdraw nearly $200 Billion annually from their retirement savings. For the sake of argument, isn't the DOL's own estimate of $17B in savings that investors would realize under the new rules far eclipsed by the $200B in retirement savings that exits the system each year? Do you believe that the negative cost impact takes into account the critical assistance of a financial advisor?

12. The proposed "Best Interest Contract Exemption" requires a "point of sale" disclosure prior to the execution of an investment transaction. The disclosure must provide the all-in cost and anticipated future costs of recommended investments in a summary chart. It would include the "total investment of the dollar amount recommended by the adviser, and reasonable assumptions about investment performance, which must be disclosed. Do you believe there is an issue with the point of sale disclosure requirement regarding

making it difficult for investors to be able to have typical one-on-one conversations with service providers about potential investment options, which necessarily involve a great deal of back-and-forth and discussion about multiple and varied potential investments, and how they may work together in a portfolio itself composed of multiple investments? Wouldn't the requirement that the provider prepare and provide the investor with real-time detailed calculations for each potential investment option or multiple investment options that may compose an investor's portfolio make such interactive conversations very difficult? Only a few years ago, we debated the pros and cons of retirement investor disclosures leading to your agency issuing disclosure rules under sections 408(b)(2) and 404(a) of ERISA. How were those included in the consideration of disclosure rules?

Your agency issued this rule in February 2012. This required advisors to disclose to plan sponsors: 1) the services they provide, 2) whether these services are provided in a fiduciary or brokerage capacity, and 3) the fees charged for such services. What studies and analysis have you done on the effects of these regulations in the marketplace? My understanding is that in firms offering both brokerage services (commission) and advisory services (fee-only), there has been a trend towards fee-only services since these regulations were recently finalized, while some consumers still choose to use advisors in a brokerage capacity—especially when solutions are needed that manage longevity risk and offer guaranteed retirement income. In other words, it seems that fiduciary advice is increasing in the retirement space while consumer choice is being preserved. Has the data of these recently finalized regulations been analyzed so we can understand their effects, and build on them with even clearer and more concise client disclosure of conflicts and compensation if necessary?

13. The DOL has limited the types of investments that could be accessed by an IRA investor. Has the DOL prepared any analysis that analyzes how many IRA investors could be forced to transfer assets from their current IRA to a new IRA? How much more in additional costs would investors incur if they need to maintain multiple IRAs? The analysis should also explain how DOL balanced the cost to investors in less ability to access investments that don't directly correlate with the capital markets vs. the benefits the DOL believes exists by limiting access to investments, that are legally permitted for IRAs.

14. Some have said this rule will result in "level fees" at the firm level. Is that your understanding? If so, wouldn't that appear to be setting prices?

15. I'm concerned that the DOL's proposed fiduciary rule conflicts with other initiatives of the Administration. Specifically, last year it seems there was consensus around the need to offer lifetime income streams in ERISA plans due to the steep decline in traditional defined benefit plans and the lack of access retirees have to guaranteed income streams in retirement. This culminated in the passing of final Treasury Department regulations on the use of Qualified Longevity Annuity Contracts (QLACs).

Unfortunately, it appears this proposed fiduciary rule will make the recommendation of a QLAC a prohibited transaction in most instances, reducing consumer choice by making it difficult for retirement savers to access critical guaranteed income products.

Did the problems cited by the Treasury Department already go away? Has the DOL conducted any study or analysis that would show the impact of retirement savers losing access to guaranteed income products?

16. The Department's fiduciary proposal states that in order to provide advice in the "best interest" of the owner of a retirement plan or IRA and meet the requirements of the "Best Interest Contract Exemption" (BICE) and the Impartial Conduct Standards included in revised PTEs, the adviser must provide advice that:

"Reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor, *without regard to the financial or other interest of the adviser, financial institution, any affiliate or other party.*"

This definition, particularly the provision that such advice would need to be provided "without regard to the financial or other interest of the adviser, financial institution, any affiliate or other party" would seem to conflict with the Department's goal of preserving current business models and more specifically, permitting the sale of proprietary products and receipt of differential compensation. This language would seem to establish a potentially unachievable standard for those that sell proprietary products or receive commission based compensation. Given that the Department has stated that this was not their intent in drafting its proposal, is the Department considering language clearly articulating the fact that the sale of proprietary products and receipt of differential compensation are consistent with the impartial conduct standard and/or removing the "without regard" language from the proposal?

17. Is the proposed rule intended to impact employee welfare benefit insurance products without an investment component?

As I understand it, the proposed rule is intended to align an adviser's interests with the interests of the investor – whether a plan sponsor, participant, or IRA account owner. An adviser whose compensation does not vary with the investments chosen is conflict-free with regard to investment recommendations, and the rule generally encourages such a level compensation arrangement. However, when it comes to rollover transactions from a qualified retirement plan to an IRA, the proposed rule would require a level-compensation advisor to comply with the same contract and disclosure requirements as a conflicted advisor. Further, if the level-compensation adviser has any discretion over the IRA account – like the ability to rebalance the portfolio – the advisor would be completely prohibited from working with the participant on the rollover.

Under the proposed rule plan advisers are prohibited from increasing compensation as a result of a transaction involving retirement assets. Unless compensation does not increase when a rollover from an employer-sponsored plan to a rollover IRA occurs (which I understand is uncommon due to the customized services being provided within the rollover IRA), advisers will only be allowed to work with participants on the rollover if they comply with the "Best Interest Contract" (BIC) exemption.

Subjecting a level compensation adviser to the BIC exemption requirements effectively penalizes the adviser for engaging in the rollover transaction. Would you consider a solution such as a new "Level to Level Compensation" Exemption that would cover the decision to rollover from a qualified retirement plan into an IRA, and the provision of investment advice (or discretionary management) to the IRA, where the adviser's compensation on both sides of the transaction will be level, assuming certain conditions?

18. One thing I think it would be helpful to clarify is the cost of inaction. I believe both the CEA report and the economic analysis you released contain this kind of information, but what does that mean for our constituents?

1) **Over the course of the past few years, the United Kingdom's Financial Conduct Authority (FCA) moved forward with a rulemaking somewhat similar to the Department of Labor's (DOL) proposed rulemaking that banned commissions for those involved in marketing and selling retirement products. My understanding is that many middle-market workers and retirees in the U.K. now have very limited choice in terms of turning to someone for financial advice due to this development. Are you familiar with the FCA rule?**

Can you describe the level of success the rule has had in weeding out bad actors from the industry? How have any benefits compared to the costs of reducing access to advice for workers and retirees? Could you speak to how developments in the U.K. can inform our discussion of the DOL proposal?

Yes, I am familiar with the FCA rule, but Fidelity Investments does not have direct experience with the impact it has had in the U.K. Our understanding of the rule and the impact it has had is informed by various media articles we have read about the rule and the subsequent actions of the U.K. government.

It is our understanding that the FCA rule, which took effect on January 1, 2013, attempts to mitigate perceived "conflicts of interest" by banning third-party payments to financial advisors. According to several articles, the rule has severely restricted the availability of affordable investment advice in the United Kingdom. For example, the U.K.'s large banks have restricted investment advice to higher net-worth individuals with larger account balances. Some financial institutions have established large minimum account balances or increased their fees for investment advice. Others have stopped offering face-to-face investment advice altogether.

The restriction in the availability of affordable investment advice has reportedly led to serious concerns among policymakers. On August 3, 2015, the Economic Secretary to the Treasury of the U.K. government initiated a review to determine how the FCA rule has impacted the availability of investment advice to customers with smaller account balances.

The proposed DOL rule does not "ban" commissions and other types of compensation. However, the proposed rule will likely have a similar effect to the U.K. rule because certain types of compensation can be received only if the financial advisor can comply with a very complicated and burdensome "Best Interest Contract" exemption. Fidelity Investments believes the requirements of the exemption will be exceedingly difficult to meet.

The experience in the U.K. suggests that banning certain business models could have a dramatic impact on the availability of investment advice for average investors. As a result, it is critical that the Best Interest Contract exemption is substantially revised and simplified so that it achieves the intended purpose of preserving commissions and other types of compensation that are common in the industry.

2) I understand from a few large brokerages catering to self-directed investors that their customers are increasingly using exchange-traded options in their IRA accounts to manage the risk associated with owning stock, with the ultimate goal of increasing their retirement savings. The proposal would take away their ability to do so.

Given your experience, what are your thoughts about limiting financial product choices for investors? Do you think investors will be better served with fewer products to choose from?

Providing investors with product choices has significantly increased competition and driven down investors' costs over the past decade. If the proposed DoL rule limits financial product choices by excluding certain products from the Best Interest Contract exemption, the result could increase fees, erode gains, and deprive many investors of valuable investment products. We believe regulators should take a product-neutral approach and should not favor certain products over others. Picking winners and losers may slow product innovation and deprive retirement savers of the choice and flexibility we feel they need. "One-size-fits-all" retirement solutions cannot meet the diverse and individualized needs of savers. We believe that restricting the range of investment products is unnecessary if financial advisors are required to act in the best interest of their customers. Retirement savers will be best served if they have choices to meet their individual needs. As a result, any final rulemaking should include a broad, principles-based exemption that does not favor certain products and business models over others.

October 30, 2015

The Honorable Phil Roe, M.D., Chairman
Subcommittee on Health, Employment, Labor and Pensions
2176 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Roe:

I am responding to your letter of October 16th requesting additional information about my testimony before the June 17, 2015, Subcommittee on Health, Employment, Labor, and Pensions hearing entitled "Restricting Access to Financial Advice: Costs and Consequences for Working Families and Retirees."

Your October 16th letter asked me to provide my understanding of the impact of the United Kingdom's Financial Conduct Authority's (FCA) rule and to speak about how the developments in the UK can inform your discussion of the Department of Labor (DOL) proposal. Please see my responses below.

1. Are you familiar with the FCA rule?

Yes, I am familiar with the FCA Rule. The FCA rule led to serious negative consequences to low- and moderate-income investors in the UK.

2. If yes, could you describe the level of success the FCA's rule has had in weeding out bad actors from the industry?

There was a significont drop in the number of independent financial advisors in the UK during the implementation period of the FCA's rule. As a result of the new Retail Distribution Review rules, advisors were forced to focus on higher net-worth clients, leaving smaller net-worth clients to receive lower quality, less personalized services. To my knowledge, there is no evidence of bad actors being weeded out from the industry by virtue of the FCA's rule change.

3. How have any benefits compared to the costs of reducing access to advice for workers and retirees?

While the cost of financial products in the UK has fallen as a result of the FCA's rule, the cost of financiol advice has increased, leaving low and moderate net-worth investors with lower quality advising options. As smoller firms and advisors find it increasingly difficult to serve clients with smaller portfolios, larger firms have begun to take on those lower net-worth clients, but are only offering these individuals access to a select number of investment options and little to no advice from professional financial advisors.

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4. Could you speak to how developments in the UK can inform our discussion of the DOL proposal?

Based on the UK's experience with regulations similar to DOL's proposal, there is a clear indication that the proposal will harm the ability of low and moderate net-worth investors to save properly for retirement. Therefore, it is critical that the US learn from these foreign experiences and avoid regulations that will prevent Americans from having a dignified retirement.

Thank you for allowing me to testify before your subcommittee and I appreciate your request for additional answers to help you continue the discussion on a very important issue that would have a huge impact on the clients we serve and my industry.

Sincerely,

Dean Harman, CFP
Managing Director
Harman Wealth Management

cc: The Honorable Robert C. "Bobby" Scott, Ranking Member

Question from Congressman Curbelo (FL)

As you know, investors are increasingly saving for retirement through retirement accounts such as IRAs. Many choose to do so by making their own investment decisions through brokerage firms that serve self-directed investors. Not only does the DOL proposal have the effect of potentially taking away this self-directed model of saving for retirement, it also limits the products that investors can use to save for retirement.

Do you think it is appropriate for the government to limit the products investors can use to save for retirement, and if so, why?

Response from Dennis Kelleher, President and CEO of Better Markets

The DOL rule will not limit the products that investors can use to save for retirement.

Contrary to what some have said about the DOL proposal, it will not prevent investors from using or selecting any types of investments for their retirement accounts. All it will do is reasonably limit what some advisers may **recommend** to their clients under some circumstances. But it will not prohibit retirement savers from **purchasing** any investments they want. Here are the key points to remember.

First, any advisers who decide to charge fees instead of conflicted commission payments would not be subject to any limits whatsoever on the specific investments they can recommend, providing of course that their recommendations otherwise comply with the best interest or fiduciary standard.

Second, only advisers who want to continue receiving conflicted commission compensation are subject to any limits on the types of investments they can recommend. Those limits are set forth in the Best Interest Contract exemption (BIC), which allows advisers to continue charging commissions for their advice subject to a number of common sense conditions. Those restrictions on permitted investments are not only reasonable, but also necessary to ensure that investors receive adequate protections under the BIC.

- The list of permitted investments is very broad and varied, and it includes every class of asset that the vast majority of retirement savers would ever want or need to save and invest for retirement. The permitted investments that commission-compensated advisers can recommend include stocks, corporate bonds, municipal bonds, U.S. treasuries, mutual funds, insurance products (including annuities), exchange-traded funds, and even exchange-traded REITs. The DOL has reasonably decided to exclude more risky, opaque, or illiquid investments, since given the adviser's conflict of interest arising from commission compensation, those products may pose a heightened risk of harm to investors.

- Under the Employee Retirement Income Security Act of 1974 (ERISA), the DOL is required to impose conditions—such as limits on permitted investments—when it

decides to accommodate industry concerns and create an exemption. Those conditions are necessary to ensure that even with the exemption in place, plans and plan participants will receive adequate protections from conflicts of interest as Congress intended. That's what the DOL did in this case. It reasonably decided to allow brokers and other advisers to continue receiving commission compensation that inevitably creates conflicts of interest, provided they comply with a number of common sense requirements. For example, the adviser must agree to abide by the best interest standard and it must disclose the fees and other payments they receive from the recommendations they make. The generous limits on the asset classes that advisers may recommend to their clients under the BIC are part of those common sense conditions.

Third and finally, even clients who are working with a commission-compensated adviser can still invest in any financial products they want for their retirement accounts. They can do this by simply seeking out and purchasing those more exotic products based on their own knowledge, expertise, and judgment about what they think will best serve their needs. The DOL simply does not prohibit that.

The DOL will not take away the self-directed model of saving for retirement.

The QFR suggests that the DOL may "potentially" take away the "self-directed model of saving for retirement" through brokerage firms. In fact, the DOL proposal will **preserve** this model, by allowing advisers at brokerage firms to continue giving advice to retirement savers for commission compensation, provided they adhere to the common-sense conditions set forth in the BIC.

Conclusion

The DOL has proposed a long-overdue rule that will protect workers and retirees from the conflicts of interest that drain away their hard-earned savings through inflated commissions and poor returns. The damage is conservatively estimated at over $17 billion per year, and may exceed $43 billion annually. To solve this problem, the proposal will require all advisers to put the best interests of their clients ahead of their own. It will achieve this objective through a balanced and reasonable approach, one that accommodates industry's strong desire to preserve their commission-based compensation model. After studying the issue for years, developing a thorough economic analysis, consulting with stakeholders from all points of view, providing an unprecedented 163-day comment period, and convening days of public hearings, the DOL is entitled to finalize its rule so that all American workers and retirees can finally receive the protections they expect and deserve—and that Congress always intended under ERISA.

Davis & Harman LLP

August 4, 2015

U.K. LAUNCHES REVIEW OF "ADVICE GAP" FOR SMALL ACCOUNTS FOLLOWING A 2013 RULE CHANGE WITH EFFECTS IDENTICAL TO WHAT DOL NOW PROPOSES

While U.K. government shines brighter light on advice gap for middle- and lower-income indviduals, DOL denies U.K. advice gap exists

On August 3, 2015, the United Kingdom government initiated a review of the extent to which investment advice for holders of accounts with small balances is being diminished following a 2013 rule change that has an effect identical to what the Department of Labor ("DOL") is proposing here. DOL has denied what is widely accepted in the U.K., i.e., that, following a 2013 rule change, middle- and lower-income savers in the U.K. are being cut off from investment advice. Yet this move by the U.K. government signals that the advice gap for individuals with the greatest need to save has become a major concern.

Critical need for change to DOL proposal. It is critical that the DOL alter the provisions in its proposal that would have the same unintended effect on savers with low account balances in the U.S. as the rule change in the U.K. has had on low-balance savers there. Specifically, that would mean making DOL's proposed Best Interest Contract Exemption workable.

The specific issue. The DOL's proposed fiduciary definition rule would have the effect of banning third-party payments to advisors. The reason that this is true is that the only way for an advisor to accept such payments is to use the proposed Best Interest Contract Exemption, which to my knowledge no financial institution can or will use.

Effective January 1, 2013, the U.K. adopted a rule directly banning such third-party payments to advisors, i.e., the U.K. rule has exactly the same effect as the DOL proposal. The U.K. rule triggered a massive exodus of advisors from the small account market in the U.K., as documented below.

DOL has strongly contended that the U.K. rule has not created an advice gap for small savers. ***In fact, as of August 3, 2015, the U.K. has launched a major review of exactly that advice gap.***

DOL's position. In its economic analysis of its proposed rule, DOL maintained that "there is little evidence that investment advice has decreased significantly" in the U.K. In fact, just last month, Secretary Perez testified on the DOL proposal and responded to a question from Senator Cassidy regarding the U.K. situation:

> **Senator Cassidy**: I am told that United Kingdom put in laws similar to this in 2013 and that banks stopped offering investment advice to customers with less than 80K in assets. Now that, you know, may be that the answer to Senator Warren's question is that this model worked for those lower and moderate income people, or at least those with moderate assets. So just comment on that. Again, I don't know whether it is true or not – just your thoughts on that.
>
> **Secretary Perez**: It's not true, and let me give you the facts. After the U.K. put in place their regulation – and by the way, their regulation bans commissions, we don't ban commissions – there were – advisors dropped 310,000 clients and 820,000 new clients came into the market so there was a net delta increase after the regulation of over half a million.[1]

[1] According to a U.K. study, there are enough advisors to serve all potential customers. But this study, *commissioned by the U.K. regulator itself*, makes two key points. First, the study concludes that there is insufficient

Investors with low balance accounts continued to be served – because you were concerned about that. And, here's the most interesting data point about the U.K. – and I traveled there personally to meet with them because I heard that feedback a lot – the most interesting point about what happened in the U.K., Senator, is that more and more people are now getting in lower cost funds. . . . So the U.K. experience, I welcome further inquiry into it because there's been a fair amount of incorrect information surrounding it.

Facts from the U.K. Here are the facts from the U.K.:

- ***Outgoing head of the U.K. regulator (the "FCA") that instituted the 2013 rule admits that there is an advice gap.*** Martin Wheatley, the head of the FCA, is stepping down from his position in September after his contract was not renewed. In late July, Wheatley reportedly was asked what the most significant outstanding issue for the FCA was. He responded that more needs to be done to address the financial "advice gap" for those with less complex advice needs. Wheatley stated:

  > The gap is for the relatively smaller sized pots, as to whether – with all the liability that comes with giving advice – there is enough provision of service for those with simpler needs and less to invest. That's the gap which we are committed to doing some more work on.

- ***As of August 3, 2015, the U.K government launched a broad new review focusing on "the advice gap for those people who want to work hard, do the right thing and get on in life but do not have significant wealth."*** This major review was launched by the Economic Secretary to the Treasury and will be led by the new interim head of the FCA. The object is to put forth a package of reforms.
  - Widely accepted data shows that roughly two-thirds of U.K. advisors refuse to provide services to individuals with less than $31,200 in savings (the 2015 equivalent of £20,000).

- ***As noted, the DOL proposal effectively bans all third-party payments to advisors (referred to in the U.K. as commissions, which is why the Secretary referred to commissions in the above quote).*** Under the DOL proposal, third-party payments to advisors are generally only permitted under the Best Interest Contract Exemption. Since no financial institution that I am aware of can use that exemption, the DOL proposal effectively bans such payments, just like the U.K. rule.

- ***Facts about the $80,000 figure that Senator Cassidy asked about:*** In anticipation of the new U.K. rule, the following practices were adopted:
  - **U.K.'s "big four" banks (an important source of investment advice in the U.K).**
    - **HSBC:** provided investment advice only for customers with at least $80,000[2] in total assets or $160,000 of annual income.
    - **Lloyds:** provided face-to-face investment advice only for customers with at least $160,000 in assets.

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data to conclude that small accounts are receiving needed advice. Second, however, the study states that anecdotal evidence suggests that the large number of advisors for the *entire market* does not help the small savers, where the availability of advice appears to have been reduced. See also page 2 for a discussion of the fact that two-thirds of advisors refuse to serve accounts under $31,200. [This note is not part of the Secretary's quote.]

[2] The dollar references in this part of the document are based on 2013 pound to dollar conversion rates.

- **Royal Bank of Scotland:** charged $800 to set up a financial plan, and made changes to gear investment advice services to high net-worth clients.
- **Barclays:** provided investment advice only for customers with at least $800,000 in assets.

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

For any questions related to this paper, please contact Kent Mason, Davis & Harman LLP at 202-662-2288 or kamason@davis-harman.com.

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Response to Question for the Record for Dr. Brian Reid
Subcommittee on Health, Employment, Labor, and Pensions
Committee on Education and the Workforce
United States House of Representatives
"Restricting Access to Financial Advice: Evaluating the Costs and Consequences for Working Families and Retirees"
Hearing date: June 17, 2015

Question from Congressman Guthrie (KY)

Over the course of the past few years, the United Kingdom's Financial Conduct Authority (FCA) moved forward with a rulemaking somewhat similar to the Department of Labor's (DOL) proposed rulemaking that banned commissions for those involved in marketing and selling retirement products. My understanding is that many middle-market workers and retirees in the U.K. now have very limited choice in terms of turning to someone for financial advice due to this development. Are you familiar with the FCA rule?

If yes, could you describe the level of success the FCA's rule has had in weeding out bad actors from the industry. How have any benefits compared to the costs of reducing access to advice for workers and retirees? Could you speak to how developments in the U.K. can inform our discussion of the DOL proposal?

Response

ICI does not maintain specific data on the advice situation in the U.K. We are aware, however, that following the FCA's rulemaking, an asserted advice gap prompted the U.K. government to launch the Financial Advice Market Review (FAMR) in August this year. Among various points of review mandated by the FAMR is an examination of the effect of regulation on the availability of advice and the extent to which it creates barriers to consumers seeking advice. Consistent with the concerns raised about an asserted advice gap in the U.K., the ICI has repeatedly urged policymakers to recognize the effect of the likely advice gap that will result if the Department of Labor adopts its proposed regulatory expansion of the fiduciary rules without very substantial changes. As stated in its comment letters to the Department and in testimony before Congress, the Institute estimates that retirement investors' returns could be reduced by $109 billion over 10 years as a result of the cost of moving to fee-based advisors, and from the additional fees and lost returns they will incur due to the resulting advice gap.

Questions for the Record from Rep. Phil Roe (R-TN), Subcommittee Chairman
June 17, 2015, HELP Subcommittee Hearing: "Restricting Access to Financial Advice: Costs and Consequences for Working Families and Retirees"

1. The DOL's proposal amending the definition of fiduciary would be effective eight months after finalized, as drafted. Stakeholders have argued this deadline is functionally impossible: systems will need to be built for the vast new disclosure requirements that will take years to build. What analysis has the Department performed regarding a realistic timeframe for implementation?

   Response: The Department recognizes the concerns that exist with respect to the implementation timeline. Equally important are concerns about delaying the effectiveness of critical consumer protections. We are working to find an appropriate period that protects working and middle class families saving for retirement with minimal disruptions to the many good practices adopted by advisers who are acting in their clients' best interest.

   In order to affirmatively address these concerns, the Department suggested in the preamble to the rulemaking that a path to implementation would not require all aspects of the new rule to be in place all at once, allowing fiduciaries to put in place the various new requirements on a staged basis. We asked for comments on that approach and specifically asked that commenters suggest a timetable for implementation that might facilitate compliance. The Department will consider all other public comments on the proposal.

2. In your testimony, you suggested "robo-advisors" and online wealth management services could be used as a primary source of advice if the proposed regulation restricts access to in-person financial guidance and education. Should online tools replace in-person financial guidance and education? Will the proposed rule force low income investors to rely on the Internet as their primary source of financial guidance and advice?

   Response: People would still be able to have a personal interaction with an individual adviser. That wouldn't change. Technology-based solutions can be an option for some, or a support and supplement to traditional advice. Technology is helping to make quality advice more affordable, whether it is delivered face-to-face, by telephone or video chat, on-line through a pure "robo" advice interface, or in some combination. Under the Department's proposal, regardless of the form in which the investors seek advice, those offering this advice will be required to provide advice that is in the best interest of investors.

3. During the hearing, numerous witnesses and Members of Congress expressed support for a best interest standard of care, but raised concerns with the proposed rule. You pledged to address some of these concerns. Will you commit to sharing

your proposed changes with industry stakeholders and Members of Congress before the rule is finalized?

Response: The Department has received feedback on our proposal from thousands of commenters. Over the course of five years, we have heard from hundreds of thousands of members of the public. Emails, petitions, hand-delivered comments and hearing testimony have all been submitted in this process. The proposed rule that we published in April of this year was much improved over the version we put out in 2010. The Department is focusing its energies on addressing the feedback we have received. We expect any final rule to include changes needed to address important questions and to take into consideration all relevant factors.

4. The "best interest contract" (BIC) exemption does not apply to advice given to plan sponsors of small participant-directed plans. As a result, many financial professionals will be prohibited from assisting small businesses with choosing a menu of investment options. In fact, the National Federation of Independent Business (NFIB) expressed concerns that the proposal could restrict small business access to affordable advisory services. Will you modify the proposed rule to protect access to advice for small businesses?

Response: Under the Department's proposal, there is a special carve-out from the scope of the fiduciary definitions for platform providers. Small plan sponsors typically work with such providers in establishing and maintaining plans, and the proposed carve-out provides a simple mechanism for employers to obtain such "off the shelf" plans without triggering fiduciary status. In addition, under current law and the proposal, the Department would permit providers to give plans a broad range of educational assistance and information without triggering fiduciary status.

Thus, for example, under the proposal a fund provider could describe the terms of investments and potential fund options, such as risk and return characteristics, historical return information, expenses, and the like without acting as a fiduciary. Similarly, under the proposal, the provider could also identify investment alternatives that meet criteria specified by the small business (e.g., expense ratios, size of fund, type of asset, credit quality), without acting as a fiduciary, and could provide objective financial data and comparisons with independent benchmarks to the plan fiduciary, without triggering fiduciary status. The proposal would not prohibit these activities from being funded by commissions.

Additionally, advisers can always give advice on an un-conflicted basis. For example, they can simply negotiate an up-front fee for advisory services with the plan, or they could receive indirect payments as long as they establish the fee up-front with the plan sponsor and offset third party payments against the fee, as established in a previous Advisory Opinion (AO 97-15).

Finally, the Department specifically asked for comments on whether to cover advice to small participant-directed plans in the scope of the Best Interest Contract Exemption, and is considering all comments on such an expansion along with all other public comments on the proposal.

Small businesses are among those most harmed by the status quo. When they are running their plans, they need investment advice, and they frequently hire professionals, just like individuals do. Far too often, when they are hiring a professional to provide investment advice, they think they are hiring someone to provide advice that is in their best interest, when, in fact, the adviser has no such obligation.

That means that if there's a lawsuit or a loss, the small business itself is held responsible – even though they paid for, and relied, in good faith, on the advice they were given. You'll notice a lot of parallels to the stories we hear about individuals who are harmed by the current rules. That's why the proposal includes provisions that would ensure that the people who provide investment advice to plans and IRAs are fiduciaries.

5. During the hearing, witnesses testified that DOL's regulatory impact analysis does not support the administration's claims of cost savings. Did the regulatory impact analysis examine whether investors achieved better outcomes if they used fee-based advisors instead of commission-based advisors?

Response: The preliminary regulatory impact analysis (RIA) focused on the negative impact of conflicts of interest on investment advice, and concluded that conflicts of interest cause billions of dollars in underperformance. The Department's proposal directly targets the investment errors attributable to these conflicts of interest. Under the proposal, advisers would either have to refrain from giving conflicted advice, or they would have to take advantage of exemptions specifically designed to mitigate conflicts of interest. The proposed RIA focuses on the fraction of conflicted transactions involving front-end load mutual funds in the IRA marketplace, and estimated that even if one focuses on just this one segment of the marketplace, the NPRM could save IRA investors more than $40 billion over 10 years.

For investors who wish to pay by commissions for investment advice, the proposed Best Interest Contract Exemption would facilitate such advice. The proposed exemption would permit advisers to receive payments, such as commissions, based on investment recommendations. As a condition of receiving such conflicted payments, however, the proposed exemption would require the adviser to make an enforceable commitment to give advice that is in the customer's best interest. This

and other conditions would significantly enhance consumer protections, and ensure that the harmful impact of conflicts of interest is mitigated.

6. The administration has claimed investors are the victims of "hidden fees." Can you explain which fees specifically are hidden from disclosure under current securities law?

   Response: Although there are rules requiring various types of investment fees to be disclosed, some disclosures are buried in forms and documents that are not read by many typical investors and are disclosed in terms that are not easy for many typical investors to translate into a dollar impact on their investments. In the case of certain types of "revenue sharing" arrangements, whether the individual adviser an investor is dealing with is in fact getting paid revenue sharing fees and how much may not be disclosed at all. Moreover, not all types of investments held in retirement accounts or by brokers and other advisers who sell them are subject to FINRA or SEC rules.

   Everyone deserves advice that is in their best interest – including small savers. In fact, small savers can least afford to have their savings dissipated by unnecessarily high hidden fees and poor performing investments. Improved transparency is part, but not all, of the solution.

Questions from Congressman Polis (D-CO)

1. As you know there have been several legislative attempts that would prohibit the Labor Department from finalizing and implementing the proposed rule. Could you tell us why these attempts would be harmful for hardworking families and retirees?

   Response: For your constituents and hardworking families and retirees across our Nation, the cost of inaction by the Department is too high: the Council of Economic Advisers estimates that conflicted retirement advice costs Americans $17 billion per year. Hardworking Americans deserve access to retirement advice that ensures that their best interests are put before their retirement advisers' profits.

2. Many of my constituents have written to me and told me stories of how hard they work just to keep up, paycheck to paycheck. I appreciate all the work you have done as Labor Secretary to increase wages and get more Americans into higher-paying jobs. It seems the next logical step is getting more Americans to save for retirement - something that is a struggle for too many. I keep hearing over and over again that this rule is going to be disruptive for people with small account balances, but currently how many people who are saving for retirement are seeking advice now? What is the reason for this relatively low number and how will the rule address the issues that impact the number?

Response: We believe that rather than making advice less available to such small investors, our proposal could improve the likelihood that small and middle-income investors will seek retirement advice because they will know they can trust that regardless of whether they use a broker, insurance agent, or other type of adviser, all will be required to put their clients' best interests first. It will also make the cost of advice more transparent, so savers of all sizes can make better decisions about how much advice to buy.

Everyone deserves advice that is in their best interest – including small savers. In fact, small savers can least afford to have their savings dissipated by unnecessarily high hidden fees and poor performing investments.

3. (a) The DOL included more than 170 questions concerning its proposal or matters left open in the proposal and you have been meeting with stakeholders and receiving feedback. Are there any specific changes you are planning to make based on the feedback you have received so far?

Response: We are still reading and analyzing the thousands of comments we have received, so it would be premature to identify specific changes we have under consideration. In determining the next steps in this rulemaking process, we will take into consideration the full range of public comments received. The Department is focusing its energies on addressing the feedback we have received. We expect any final rule to include changes needed to address important questions and to take into consideration all relevant factors.

(b) Even proponents of the rule acknowledge there are countless areas that don't work in their current forms. Has consideration been given to publishing an interim final rule so everyone could see what they have fixed and what still doesn't work? If so, what form would such guidance take and what commitments might the Department make about potential modifications in advance of the final rule?

Response: The Department has undertaken incredibly thorough and extensive public outreach over the past five years, culminating in an extended public comment process, four days of public hearings, and an additional public comment period that ended on September 24, 2015. Accordingly, the public was given approximately 140 days to comment upon and suggest changes to the proposed rule and exemptions issued in April, 2015. All of these comments are posted on the Department's Employee Benefits Security Administration website.

In determining the next steps in the rulemaking process, we will consider all relevant factors and thoughtfully balance the public input we have received.

(c) Would you consider allowing service providers, upon whom the success or failure of the rule will depend, to see a revised rule before it is finalized to ensure that all the necessary fixes to this complicated rule have been made? Will the Department go final with questions still outstanding? Is there any consideration for the Department to either repropose the regulation for comment on how you answered those questions?

Response: The Department has received feedback on our proposal from thousands of commenters. Over the course of five years, we have heard from hundreds of thousands of members of the public. Emails, petitions, hand-delivered comments and hearing testimony have all been submitted in this process. The proposed rule that we published in April of this year was much improved over the version we put out in 2010. We are still reading and analyzing the thousands of comments we have received, so it would be premature to commit to any particular course of action at this point. In determining the next steps in this rulemaking process, we will take into consideration the full range of public comments received. The Department is focusing its energies on addressing the feedback we have received. We expect any final rule to include changes needed to address important questions and to take into consideration all relevant factors.

4. (a) Some critics of the proposal have stated that the Department should not move forward with a rule at this time. Instead, they state a uniform standard of care is developed for all asset categories and advisory models is the best path forward. How do you respond to this criticism?

Response: ERISA gave retirement investments uniquely tax-favored status and special fiduciary protections from advisers' conflicts of interest. These tax benefits promote retirement savings and the fiduciary protections protect the workers who rely on these assets for their retirement security. In addition, there are many transactions involving retirement savings (such as advice to purchase some insurance annuity and bank products) to which Federal securities laws do not apply, but ERISA and the Internal Revenue Code (IRC) do. We want to make sure that people who provide fiduciary investment advice can comply with all the rules and their obligations and have therefore designed a proposed rule that will neither undermine nor contradict the securities laws. Our aim is for consumers to receive the full protection of ERISA, the IRC and the securities laws.

(b) In the context of the seller's carve out, the Department has invited comments on, among other things, whether the plan size limitation of 100 plan participants in the proposal is an appropriate condition or whether other conditions would be more appropriate proxies for identifying persons with sufficient investment related expertise to be included in a seller's carve-out. Why did the Department limit the "seller's carve-out" to only large plans? Do you have any concerns that this will limit the distribution of retirement plans to small business owners? Are you concerned

that small 401(k) plan sponsors will be unable to obtain needed investment guidance regarding their plan's investment options without having to expend the additional cost to hire an independent investment advisor? How would a small 401(k) plan sponsor obtain investment advice with regard to the types of investment alternatives it should make available to its participants? Are you concerned that this prohibition will prevent small employers from sponsoring 401(k) plans for their employees?

Response: With respect to your concerns on the limitations of the seller's carve out, the 2010 proposal included a general seller's carve-out from fiduciary status for sales pitches. The new proposal would limit this carve-out to large plans and large money managers in light of their financial expertise. This proposed change is in response to public comments we received on the 2010 proposal that differentiating investment advice from sales pitches is very difficult in the context of investment products and, unless the advice recipient is a financial expert, structuring the carve-out as broadly as we proposed in 2010 would have created a loophole that would fail to protect small plans and typical 401(k) and IRA investors.

Under the Department's proposal, there is a special carve-out from the scope of the fiduciary definitions for platform providers. Small plan sponsors typically work with such providers in establishing and maintaining plans, and the carve-out would provide a simple mechanism for employers to obtain such "off the shelf" plans without triggering fiduciary status. In addition, under current law and the proposal, the Department would permit providers to give plans a broad range of educational assistance and information without triggering fiduciary status.

Thus, for example, under the proposal a fund provider could describe the terms of investments and potential fund options, such as risk and return characteristics, historical return information, expenses, and the like without acting as a fiduciary. Similarly, under the proposal, the provider could also identify investment alternatives that meet criteria specified by the small business (e.g., expense ratios, size of fund, type of asset, credit quality), without acting as a fiduciary, and could provide objective financial data and comparisons with independent benchmarks to the plan fiduciary, without triggering fiduciary status. The proposal would not prohibit these activities from being funded by commissions. Additionally, advisers can always give advice on an un-conflicted basis.

It is important to remember that small businesses are among those most harmed by the status quo. When they are running their plans, they need investment advice, and they hire professionals, just like individuals do. Far too often, when they are hiring a professional to provide investment advice, they think they are hiring someone to provide impartial advice that is in their best interest, when, in fact, the adviser has no such obligation. When something goes wrong, the "fiduciary" they relied on for the advice may say they are no such thing and disclaim fiduciary status.

And if there's a lawsuit or a loss, the small business is held responsible – even though they paid for, and relied, in good faith, on the advice they were given. You'll notice a lot of parallels with small businesses to the stories we hear about individuals who are harmed by the current rules. That's why it is critical that the proposal includes provisions to ensure that the people who provide investment advice to plans and IRAs are fiduciaries.

(c) Would the Department be open to the seller's carve out being extended to plan fiduciaries, regardless of size or assets, who can somehow prove they are a "Sophisticated Investor," that is, they must have sufficient knowledge and experience in financial and business matters to make them capable of evaluating the merits and risks of the prospective investment?

Response: As the Department moves forward, we are committed to using the input provided by stakeholders and the regulated community in written comments, hearing testimony and meetings to improve the final regulation. We will carefully consider and evaluate the comments, testimony and suggestions we have received while pursuing our objective to protect retirees and plan participants from biased and imprudent investment advice.

(d) There is a widespread concern that the lack of seller's exception for small businesses runs directly counter to the structure of ERISA and DOL enforcement positions which place a fiduciary duty on small employers to make prudent fiduciary decisions? Do you believe this will have an impact of raising the costs for small businesses looking to offer their employees retirement savings plans? Who in particular within the small business community did the DOL consult on this point and can we see the specific analysis performed?

Response: The Department did an analysis of the costs of the proposed rule and the proposed exemptions to small employers. Those costs are discussed in the preliminary regulatory impact analysis and the Regulatory Flexibility Act section. The proposed regulatory package would give firms the flexibility to figure out how to structure their business in order to provide quality advice that is in their client's best interest. We also engaged with members of the small business community.

5. The BIC exemption requires a large amount of disclosure at the point of sale, annually and on an ongoing basis through a website. Some argue investors are already overwhelmed and confused by the amount of disclosure they receive. Are you willing to consider changes to the disclosure regime for the BIC exemption so that the BIC exemption is more useful to investors and more workable for advisers? One consideration is how individual participants benefit from the public website individuals and companies will be using to disclose? Do you believe they will be able to navigate through the vast amounts of information required on there that may not

apply to them? Has there been consideration to requiring providing 404 type disclosure to participants?

Response: As proposed, the web disclosure would be available to customers who want more information, but is expected to be reviewed and analyzed primarily by financial information companies on behalf of consumers. The Department believes certain types of disclosure can be helpful to consumers and has sought public comment on each of the disclosures that are proposed in the rule so that we can better evaluate whether and to what extent additional disclosure can improve customer awareness and decision making. The proposal included several questions and other requests for comment about the disclosure requirements, and the Department is considering all public comments as it moves forward.

6. One of the potential consequences that has been raised regarding this rule is that the proposed fiduciary rule could make it very difficult for those who provide annuities - the only guaranteed form of retirement income - to actually educate individuals about this important product and would likely result in decreased availability of guaranteed income annuity products on 401(k) investment menus.

   Currently, firms that provide retirement plans have very clear guidance in a 1996 Interpretive Bulletin on the line between fiduciary advice and non-fiduciary education. But this proposal seems to move the line so that a lot of what is now deemed non fiduciary education will become fiduciary advice.

   Considering the DOL's focus on lifetime income, I'd like your perspective on whether it was the Department's intention in the re-proposal to make it harder for savers to consider annuities - or was this simply an oversight and something DOL would be willing to correct in future drafts of the proposal? In addition, I would appreciate it if you could comment on the status of DOL's rulemaking on requiring a lifetime income disclosure on benefit statements?

   Response: The financial services industry plays an important role in providing retirement and investment education to workers and retirees. And the proposed rule carefully draws a line between non-fiduciary investor education and fiduciary advice. In fact, the proposal expands the 1996 guidance to include a carve-out from fiduciary status for providing investment education to IRA owners, and not just to plan sponsors and plan participants as under the 2010 proposal. Moreover, the proposed rule updates the definition of education to include retirement planning and lifetime income information. In addition, it strengthens consumer protections by classifying materials that reference specific products that the consumer should consider buying as advice.

   The proposed regulation also confirms most of what was in the 1996 guidance and recognizes among other matters that non-fiduciary education includes both:

1) Information and materials that describe investments or plan alternatives without specifically recommending particular investments or strategies. Thus, for example, under the proposed rule, a firm/adviser would not act as a fiduciary merely by virtue of describing the investment objectives and philosophies of plan investment options, mutual funds, annuities, or other investments; their risk and return characteristics; historical returns; the fees associated with the investment; distribution options; contract features; or similar information about the investment; and

2) General financial, investment, and retirement information. Similarly, under the proposed rule, one wouldn't become a fiduciary merely by providing information on standard financial and investment concepts, such as diversification, risk and return, and tax deferred investments; historic differences in rates of return between different asset classes (e.g., equities, bonds, cash); effects of inflation; estimating future retirement needs and investment time horizons; assessing risk tolerance; general strategies for managing assets in retirement.

Of course, nothing in our proposal would stop an adviser from providing specific product recommendations — they would just have to act as fiduciaries and make recommendations in their client's best interest.

Where a recommendation regarding annuity products is investment advice under the proposal, the Department has proposed to preserve an existing prohibited transaction exemption (PTE 84-24) for commissions on annuity products that are exempt securities under Federal securities laws, and the proposed Best Interest Contract Exemption would provide broader relief for all annuities. To further facilitate access to lifetime income products, we solicited comments on how to make the Best Interest Contract Exemption more usable by insurance companies and we are considering such comments, along with all other comments received.

7. At a Senate Banking Committee hearing, Mary Jo White indicated that changes to fiduciary standards in the retail space could harm access to affordable guidance and education. Rick Ketchum of FINRA has indicated the rule would make it difficult for people with small account balances to get advice. If the epitome of the DOL's concern is that someone who has worked their entire life in a middle of the road income job still have the opportunity to have a nice nest egg for herself, how can you assure us that this proposal won't harm those very lower- and middle-income investors who may not have high enough account balances to go to a registered investment advisor? What is your response to criticism that this rule in effect creates a two-class investor system, whereby people of means will be able to pay the higher fees for good financial advice while those with fewer assets under management will be forced to rely on the Internet?

Response: Rather than making advice less available to such small investors, our proposal could improve the likelihood that small and middle-income investors will seek retirement advice because they can trust that regardless of whether they use a broker, insurance agent, or other type of adviser, all will be required to put their clients' best interests first. Everyone deserves advice that is in their best interest – including small savers. In fact, small savers can least afford to have their savings dissipated by unnecessarily high hidden fees and poor performing investments.

Further, technology-based solutions can be an option for some, or a support and supplement to traditional advice. Technology is helping to make quality advice more affordable, whether it is delivered face-to-face, by telephone or video chat, on-line through a pure "robo" advice interface, or in some combination. In today's marketplace, low- and middle-income small savers are not generally offered the types of full-service personalized financial advice from large investment firms that clients with larger accounts receive; rather they are often steered to call centers or online services. Under the Department's proposal regardless of the form in which the investors seek advice, those offering this advice will be required to provide advice that is in the best interest of investors.

8. People are now changing jobs 11 times over the course of a career. And a growing number of people take the money and run when changing jobs, a move that can obviously have a drastic impact on retirement readiness, especially among younger workers. For those with relatively small balances, many would now be unwilling or unable to pay higher upfront fees for the help they need and desire. With 1 in 3 employees cashing out within 5 years of leaving a job, do you have concerns that this will severely limit transitioning employees' access to critical investment education and only make this problem worse?

   Response: The proposal would not prevent small investors, such as younger workers, from obtaining sound professional advice. Instead, small investors who change jobs often would have access to affordable advice that is in their best interest. The proposal would make advice more reliably trustworthy, and that could encourage more small savers to seek advice they know they can trust. It would also make the cost of advice more transparent, so savers of all sizes can make better decisions about how much advice to buy.

9. (a) I have been told that the best interest contract exemption is unworkable for many reasons. One reason is because the financial advisor has to enter into a contract with someone before advice is given. Where do you see a practicable line when a contract must be signed before an advisor can help them?

   Response: The proposed Best Interest Contract Exemption is the embodiment of the simple goal of creating an enforceable commitment on the part of advisers and their

firms to provide advice in consumers' best interests. We understand the important and legitimate concerns related to operationalizing this requirement, and we have indicated our intent to provide flexibility on operational issues such as timing and required signatories. The Department considers it important for the best interest commitment to cover all instances of investment advice by an adviser. We are considering all other comments received on this proposal.

(b) How would this work in 401(k) plans where millions of workers in plans would have to enter into contracts with phone reps before a phone rep can help them with a basic question? How would this impact a small business owner who is simply shopping around for a financial advisor?

Response: The proposed carve-out from the fiduciary investment advice definition for investment education provides guidelines under which call center staff and other employees providing similar investor assistance services may not become fiduciaries. The proposed fiduciary definition is intended to apply broadly to all persons who engage in the activities set forth in the regulation, regardless of job title or position, or whether the advice is rendered in person, in writing or by phone. If, in the performance of their jobs, call center employees make specific investment recommendations to plan participants or IRA owners under the circumstances described in the proposal, they, and possibly their employers, would be treated as fiduciaries unless they meet the conditions of one of the carve-outs.

To the extent such call center employees and their employers intend to rely on the proposed Best Interest Contract Exemption, we have indicated our intent to provide flexibility as to operational issues such as timing and the required signatories. The Department considers it important for the best interest commitment to cover all instances of investment advice. It is not our intent to chill developing advice relationships or prevent customers from shopping around.

(c) Under this exemption, whenever a plan sponsor seeks responses to an RFP (request for proposal) and asks for a suggested portfolio as part of that RFP, no firm can respond without becoming a fiduciary by responding. Did you intend this effect? Do you believe this will make it more difficult for small businesses to establish retirement plans for their employees? Can you commit to fixing this logistical problem?

Response: The proposed rule is not intended to prevent people from recommending themselves to serve as advisers or investment managers, as some have suggested. The proposal draws a line between an adviser's marketing of the value of his own advisory services, on the one hand, and making recommendations to retirement investors on how to invest their savings, on the other. In other words, under the proposed rule, you can recommend that a retirement investor enter into an advisory relationship with you, without acting as a fiduciary. But, when you

recommend that the investor hire someone else, pull money out of a plan, invest in a particular fund, or pursue a particular investment strategy, you give that advice in a fiduciary capacity. We are considering all comments received on this proposal.

10. Some concerns have been raised as to whether the effect of the re-proposal would be to make personalized retirement investment assistance unavailable to small accounts and small businesses. In response, some supporters of the rule have specifically cited the advantages of so-called robo advisers, or online wealth management services that provide automated, algorithm-based advice without the use of human financial planners. Mr. Secretary, you yourself have touted the need for face-to-face interaction, and not technology, because there are some workers who are going to need the face-to-face assistance moving forward. It certainly may be true that automated investment tools can play a critical role in providing assistance to certain investors who understand their limitations and may not need face to face interactions, but do you believe this creates a problem for those who need investment assistance through face to face interaction?

    Response: Under the proposed rule, people would still be able to have a personal interaction with an individual adviser. That wouldn't change. What would change is the peace of mind that comes with knowing that your adviser is acting in your best interest. Technology-based solutions can be an option for some, or a support and supplement to traditional advice.

    Also *see* Answer to Polis Question #7.

11. It seems to me that the importance of this debate is underscored by a recent study from the Boston College Center for Retirement Research, which found that individuals prematurely withdraw nearly $200 Billion annually from their retirement savings. For the sake of argument, isn't the DOL's own estimate of $17B in savings that investors would realize under the new rules far· eclipsed by the $200B in retirement savings that exits the system each year? Do you believe that the negative cost impact takes into account the critical assistance of a financial advisor?

    Response: The Department is considering both the benefits of professional advice and the costs of premature cash-outs. The proposed rule seeks to mend serious flaws in the market for advice on retirement investing, and thereby enhance the benefits of advice and help preserve retirement savings.

    The Department shares your concern about the estimated $200 billion in retirement savings that exits the system each year. The decision to withdraw retirement savings early is often a serious mistake. Good advice can help prevent bad decisions and preserve retirement savings. But consumers should not have to sacrifice an extra $17 billion to Wall Street each year in order to get help preserving their retirement savings.

Today investment advice often is not required to honor investors' best interests. Advisory conflicts cost consumers $17 billion in retirement savings each year. This can erode consumers' trust in advisers. By requiring all advisers to act in their customers' best interests, the Department's proposed rule aims to boost confidence, so more consumers will seek and follow professional advice – and that will help preserve retirement savings.

It should be noted that the authors of the Boston College leakage study, Alicia Munnell and Anthony Webb, have publicly supported the Department's efforts to curb advisory conflicts, and recommended even stronger reforms. According to their written testimony submitted for the Department's August 6 hearing on this topic, the two "strongly support the DOL's proposed regulation, viewing it as carefully crafted, workable, and likely to substantially reduce the harm caused by conflicted advice." They go on to argue that the estimated $17 billion lost to advisory conflicts each year is understated.

12. The proposed "Best Interest Contract Exemption" requires a "point of sale" disclosure prior to the execution of an investment transaction. The disclosure must provide the all-in cost and anticipated future costs of recommended investments in a summary chart. It would include the "total investment of the dollar amount recommended by the adviser, and reasonable assumptions about investment performance, which must be disclosed. Do you believe there is an issue with the point of sale disclosure requirement regarding making it difficult for investors to be able to have typical one-on-one conversations with service providers about potential investment options, which necessarily involve a great deal of back-and-forth and discussion about multiple and varied potential investments, and how they may work together in a portfolio itself composed of multiple investments? Wouldn't the requirement that the provider prepare and provide the investor with real-time detailed calculations for each potential investment option or multiple investment options that may compose an investor's portfolio make such interactive conversations very difficult? Only a few years ago, we debated the pros and cons of retirement investor disclosures leading to your agency issuing disclosure rules under sections 408(b)(2) and 404(a) of ERISA. How were those included in the consideration of disclosure rules?

Your agency issued this rule in February 2012. This required advisors to disclose to plan sponsors: 1) the services they provide, 2) whether these services are provided in a fiduciary or brokerage capacity, and 3) the fees charged for such services. What studies and analysis have you done on the effects of these regulations in the marketplace? My understanding is that in firms offering both brokerage services (commission) and advisory services (fee-only), there has been a trend towards fee-only services since these regulations were recently finalized, while some consumers still choose to use advisors in a brokerage capacity – especially when solutions are needed that manage longevity risk and offer guaranteed retirement income. In other

words, it seems that fiduciary advice is increasing in the retirement space while consumer choice is being preserved. Has the data of these recently finalized regulations been analyzed so we can understand their effects, and build on them with even clearer and more concise client disclosure of conflicts and compensation if necessary?

Response: With respect to your question regarding the Department's 2012 regulations, the 408(b)(2) regulation requires certain service providers, including fiduciary investment advisers, to pension plans to disclose direct and indirect compensation (e.g., from third parties) that they were receiving in connection with plan investments and services rendered to the plan. The rule did not require disclosure to plan participants, plan beneficiaries, or IRA owners. The 404(a)(5) regulation required disclosures from 401(k) type participant-directed individual account plans to participants that focused on information about the plan and investment alternatives available under the plan. It did not require disclosures from fiduciary investment advisers to participants, and it did not cover IRAs at all.

By comparison, the Conflict of Interest rulemaking is trying to address a broader problem – compensation for fiduciary investment advice that involves conflicts of interest, particularly where those conflicts affect plan participants, beneficiaries and IRA owners.

The Best Interest Contract Exemption's proposed point of sale disclosure is intended to highlight certain simple points – which may not be widely understood – that ongoing investment costs can impact investment earnings over time and that there may be significant costs associated with selling or surrendering certain investments. In our proposal, we requested comment on this disclosure and posed a number of specific questions regarding its design, feasibility and impact. In addition, we asked whether the disclosure would provide information that is more useful to consumers than other similar disclosures that are required under existing law. We will consider all comments received on this proposal.

13. The DOL has limited the types of investments that could be accessed by an IRA investor. Has the DOL prepared any analysis that analyzes how many IRA investors could be forced to transfer assets from their current IRA to a new IRA? How much more in additional costs would investors incur if they need to maintain multiple IRAs? The analysis should also explain how DOL balanced the cost to investors in less ability to access investments that don't directly correlate with the capital markets vs. the benefits the DOL believes exists by limiting access to investments, that are legally permitted for IRAs.

Response: The proposal does not limit the universe of investment choices available to IRA customers. Customers could continue to make independent investment

decisions and obtain the service of a financial professional to execute any investment transaction.

Likewise, fiduciary investment advisers may advise IRA customers about any investment as long as the adviser is not compensated in a way that creates a conflict of interest.

For advisers who would rely on the proposed Best Interest Contract Exemption, it is important to keep in mind just how expansive the proposed exemption is and just how many categories of assets are covered by the proposed exemption. This is, by no means, a narrow list of assets; the list includes bank deposits, certificates of deposit (CDs), shares or interests in registered investment companies (i.e., mutual funds), bank collective funds, insurance company separate accounts, exchange-traded REITs, exchange-traded funds, corporate bonds offered pursuant to a registration statement, agency debt securities, U.S. Treasury securities, insurance and annuity contracts, guaranteed investment contracts, and exchange-traded equity securities. In other words, the proposed list covers essentially everything that ordinary retail investors would expect to include in their portfolios.

We are considering all comments received on this proposal.

14. Some have said this rule will result in "level fees" at the firm level. Is that your understanding? If so, wouldn't that appear to be setting prices?

Response: The proposal does not require the receipt of level fees at the firm level. To the extent firms receive variable compensation based on investment recommendations, however, they would possibly need to comply with conditions in the Best Interest Contract Exemption designed to mitigate conflicted compensation structures applicable to individual advisers. The proposal does not provide specific rules as to compensation or employment structures that must be adopted. Instead, it would afford firms the flexibility to develop approaches that work best for their business models. We clearly and specifically stated in our preamble that level fees are not required to comply with these conditions.

15. I'm concerned that the DOL's proposed fiduciary rule conflicts with other initiatives of the Administration. Specifically, last year it seems there was consensus around the need to offer lifetime income streams in ERISA plans due to the steep decline in traditional defined benefit plans and the lack of access retirees have to guaranteed income streams in retirement. This culminated in the passing of final Treasury Department regulations on the use of Qualified Longevity Annuity Contracts (QLACs).

Unfortunately, it appears this proposed fiduciary rule will make the recommendation of a QLAC a prohibited transaction in most instances, reducing

consumer choice by making it difficult for retirement savers to access critical guaranteed income products. Did the problems cited by the Treasury Department already go away? Has the DOL conducted any study or analysis that would show the impact of retirement savers losing access to guaranteed income products?

Response: The Department's proposal is fully consistent with the Administration's initiatives related to lifetime income streams. Although the payment of a commission on an annuity purchase does raise prohibited transaction issues under existing law, the Department has, since 1977, provided an exemption for annuity commissions, thereby facilitating access to these investments. The proposal would preserve this exemption (PTE 84-24) for insurance products that are exempt securities under Federal securities laws, and the proposed Best Interest Contract Exemption would provide broader relief for all annuities. We solicited comments on how to make the Best Interest Contract Exemption more usable by insurance companies and we are considering all comments received.

16. The Department's fiduciary proposal states that in order to provide advice in the "best interest" of the owner of a retirement plan or IRA and meet the requirements of the "Best Interest Contract Exemption" (BICE) and the Impartial Conduct Standards included in revised PTEs, the adviser must provide advice that:

> Reflects the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent person would exercise based on the investment objectives, risk tolerance, financial circumstances, and needs of the retirement investor, *without regard to the financial or other interest of the adviser, financial institution, any affiliate or other party.*

This definition, particularly the provision that such advice would need to be provided "without regard to the financial or other interest of the adviser, financial institution, any affiliate or other party" would seem to conflict with the Department's goal of preserving current business models and more specifically, permitting the sale of proprietary products and receipt of differential compensation. This language would seem to establish a potentially unachievable standard for those that sell proprietary products or receive commission based compensation. Given that the Department has stated that this was not their intent in drafting its proposal, is the Department considering language clearly articulating the fact that the sale of proprietary products and receipt of differential compensation are consistent with the impartial conduct standard and/or removing the "without regard" language from the proposal?

Response: The standard utilized in the proposed Best Interest Contract Exemption requires that when providing advice, advisers act "without regard to" the financial or other interests of the adviser, financial institution, or other party. It would not require that the adviser and financial institution have no interest in the transaction,

only that the advice not take into account that interest. Therefore, the standard would not interfere with the sale of proprietary products or the receipt of differential compensation. We are considering all comments received on this proposal.

17. (a) Is the proposed rule intended to impact employee welfare benefit insurance products without an investment component?

Response: Some have asserted that the proposed rule provision that covers recommendations as to the advisability of "acquiring, holding, disposing or exchanging securities or other property" somehow reaches health and disability insurance policies. Although the purchase and holding of such policies by a plan is subject to ERISA's fiduciary standards, the proposed rule does not apply to recommendations as to the advisability of acquiring, holding, disposing, or exchanging any such insurance contract that does not have any investment component.

(b) As I understand it, the proposed rule is intended to align an adviser's interests with the interests of the investor – whether a plan sponsor, participant, or IRA account owner. An adviser whose compensation does not vary with the investments chosen is conflict-free with regard to investment recommendations, and the rule generally encourages such a level compensation arrangement. However, when it comes to rollover transactions from a qualified retirement plan to an IRA, the proposed rule would require a level compensation advisor to comply with the same contract and disclosure requirements as a conflicted advisor. Further, if the level-compensation adviser has any discretion over the IRA account – like the ability to rebalance the portfolio – the advisor would be completely prohibited from working with the participant on the rollover.

Under the proposed rule plan advisers are prohibited from increasing compensation as a result of a transaction involving retirement assets. Unless compensation does not increase when a rollover from an employer-sponsored plan to a rollover IRA occurs (which I understand is uncommon due to the customized services being provided within the rollover IRA), advisers will only be allowed to work with participants on the rollover if they comply with the "Best Interest Contract" (BIC) exemption.

Subjecting a level compensation adviser to the BIC exemption requirements effectively penalizes the adviser for engaging in the rollover transaction. Would you consider a solution such as a new "Level to Level Compensation" Exemption that would cover the decision to rollover from a qualified retirement plan into an IRA, and the provision of investment advice (or discretionary management) to the IRA, where the adviser's compensation on both sides of the transaction will be level, assuming certain conditions?

Response: The decision to roll over assets from an employer-sponsored plan to an IRA is a critical one for the customer. It also has the potential to generate significant increases in compensation to the adviser and its affiliated firm. The Department is of the view that, like other transactions covered under the proposed Best Interest Contract Exemption, a recommendation to roll over assets should occur pursuant to an enforceable commitment on the part of advisers and their firms to provide advice in consumers' best interests.

We are considering all comments received on this proposal.

18. One thing I think it would be helpful to clarify is the cost of inaction. I believe both the CEA report and the economic analysis you released contain this kind of information, but what does that mean for our constituents?

Response: Based on extensive review of independent research, the CEA analysis found that conflicts of interest result in annual losses of about 1 percentage point for affected retirement savers – or about $17 billion per year in total. To demonstrate how this would impact an average investor: A 1 percentage point lower return could reduce an investor's investment savings by more than a quarter over 35 years. In other words, instead of a $10,000 retirement investment growing to more than $38,000 over that period after adjusting for inflation, it would be just over $27,500.

The Department's preliminary regulatory impact analysis estimates that the proposed regulatory package could save investors over $40 billion over 10 years, even if one focuses on just one small subset of transactions that have been the most studied. The real savings are potentially larger as conflicts and their effects are both pervasive and well hidden.

If there are no further comments, the hearing is adjourned.
[Whereupon, at 1:21 p.m., the Subcommittee was adjourned.]

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