TRANSCRIPT OF PROCEEDINGS

U.S. DEPARTMENT OF LABOR
EMPLOYEE BENEFITS SECURITY ADMINISTRATION

IN THE MATTER OF:)
)
CONFLICT OF INTEREST)
PROPOSED RULE, RELATED)
EXEMPTIONS AND REGULATORY)
IMPACT ANALYSIS HEARING)

Pages: 350 through 681

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BEFORE THE U.S. DEPARTMENT OF LABOR
EMPLOYEE BENEFITS SECURITY ADMINISTRATION

In the Matter of:)
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PROPOSED RULE, RELATED)
EXEMPTIONS, AND REGULATORY)
IMPACT ANALYSIS HEARING)
)

Main Auditorium
Frances Perkins Building
200 Constitution Avenue, N.W.
Washington, D.C.

Tuesday,
August 11, 2015

The parties met, pursuant to the notice, at

9:02 a.m.

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On behalf of National Association of Insurance and Financial Advisors (NAIFA):

JULI McNEELY
NAIFA President
JENNIFER KNOLL, DDS

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On behalf of PIABA:

JOE PEIFFER
President, PIABA
Peiffer Rosca Wolf Abdullah Carr & Kane, PLC

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JOE PEIFFER, PRESIDENT PIABA, PIABA, PEIFFER ROSCA WOLF ABDULLAH CARR & KANE, PLC 659

1 P R O C E E D I N G S

2 (9:02 a.m.)

3 MR. HAUSER: I think we'll probably get
4 started in just a minute, so if people could turn off
5 their cell phones, and maybe if the first panel can
6 come on up.

7 (Pause.)

8 MR. HAUSER: Good morning. Welcome to the
9 second day of the hearings on the conflict of interest
10 proposals. As was true yesterday, I have some
11 logistics to go through, and then we'll get on with
12 the substance of the program. I'll try to be a little
13 more succinct than yesterday.

14 Probably the most important thing to know is
15 that we have a series of panels testifying today. The
16 panelists will be allowed 10 minutes to present their
17 testimony. Let me emphasize the importance of
18 sticking to that schedule. We have a very full agenda
19 with four days of hearings, and we're going to be
20 strict in enforcing the 10-minute time allotment.

21 We plan to have the panelists present the
22 testimony. Then the government panel members will be
23 afforded an opportunity to ask the panel members
24 questions. We will not accept questions from the
25 audience.

1 With regard to panel questions, the
2 government panel members are interested in developing
3 the public record as fully as possible. We're likely
4 to ask a lot of questions. We're likely to frame them
5 in a variety of ways. You really shouldn't assume
6 based on the way we frame a particular question or
7 even the content of the question that you can guess
8 where we'll end up on the rule. So don't draw any
9 inferences or conclusions on the basis of our merely
10 asking a question.
11 The hearing is being transcribed, and the
12 hearing transcript will be made available to the
13 public on EBSA's website, hopefully within about two
14 weeks following the close of the hearing. Witnesses
15 will testify in the order in which they appear on the
16 hearing agenda, and we have a few requests for those
17 testifying.
18 First, if before you testify you could
19 identify yourself and the organization you're
20 representing, if any.
21 Second, please, and I'm being repetitive,
22 but limit your remarks to 10 minutes. And there is a
23 timer, which I can't see but I trust is over there,
24 which will assist in monitoring time.
25 Third, please remember to speak into the

1 microphone. That's of particular importance so that
2 our folks can accurately transcribe the hearing, and
3 it also just helps the people in the audience. So, if
4 you could do that, I'd much appreciate that.
5 This is being streamed live, so we'd love to
6 have you stay all day, but if you want to go watch it
7 on your computer or on your cell phone, feel free, and
8 the site for that is http://www.dol.gov/live.
9 So I think at the conclusion of this, all
10 public comments and written testimony will be made
11 available on our public website. As we announced
12 yesterday, we've reopened the comment period. You
13 should submit your comments in accordance with the
14 methods that we set out in the June 18 *Federal*
15 *Register* notice of the hearing.
16 We plan to break for lunch at 1:15 today. I
17 know that's late. At 12:15, your natural impulse is
18 going to be to get up and head for lunch. That's okay
19 with me, but you'll miss a really great panel, so you
20 might want to wait 'til 1:15. For your convenience,
21 there's a cafeteria located on the sixth floor of the
22 building which is generally open until 2 p.m., and
23 there's a snack bar on the fourth floor which is
24 usually open until 4.
25 And hopefully the next announcement will be

1 of no use, but I have to say it.
2 In the event of an emergency, an alarm will
3 sound. There are two types of alarms. One is a long,
4 loud, continuous tone, which means that we will need
5 to evacuate to get outside the building. An
6 intermittent tone followed by a public address
7 announcement means that we're going to stay here and
8 shelter in place.
9 If either of these alarms sound, somebody in
10 a yellow hat or vest will pop up and tell you what to
11 do. It's Fred Wong back there. Ah, we have two
12 people.
13 Please do not plug your laptops, phones, et
14 cetera into the sockets on the wall. Having cords in
15 the walkway is kind of a tripping hazard. And
16 finally, again, make sure your cell phones are turned
17 off or silenced.
18 And now I'll turn this over to my colleague
19 and fellow deputy assistant secretary, Judy Mares.
20 MS. MARES: Well, welcome everyone who's
21 just joined us today, and welcome back to those of you
22 who were with us yesterday.
23 I want to first introduce myself and our
24 panel because you see some familiar faces and you see
25 some new faces. So, as Tim mentioned, I'm Judy Mares.

1 I'm Deputy Assistant Secretary in EBSA, as is Tim.
2 Next to Tim is Joe Piacentini, EBSA's chief economist.
3 Next to Joe is Keith Bergstresser, followed by Chris
4 Cosby, two members of our Office of Policy and
5 Research.
6 As a departure from yesterday, today we will
7 focus on the regulatory impact analysis, and you all
8 who are present know the importance of looking at the
9 costs and benefits of regulation, and I will welcome
10 all the panels that are here today.
11 We can begin.
12 MR. HAUSER: So we're ready when you are.
13 MR. COLLINS: Thank you. I'm Sean Collins,
14 Senior Director for Industry and Financial Analysis at
15 the Investment Company Institute, a leading trade
16 association representing mutual funds and other
17 regulated funds in the U.S. and jurisdictions around
18 the world. ICI appreciates the opportunity to testify
19 on this important rulemaking.
20 The institute agrees with the principle that
21 providers of financial advice should act in their
22 clients' best interest. Consequently, our comments on
23 the Department's proposal focused on the details.
24 As David Blass, ICI's general counsel,
25 indicated yesterday, we have strong concerns about the

1 proposal, which if implemented, would result in the
2 loss of investment advice for many IRA investors,
3 especially those with low to moderate incomes. We're
4 also deeply concerned about the Department's
5 regulatory impact analysis. The impact analysis must
6 justify the proposed changes. Regrettably, it fails
7 to meet this test and indeed is fundamentally flawed.
8 The impact analysis argues that the rule
9 proposal might deliver benefits to IRA investors of
10 more than $44 billion a year over the next 10 years or
11 about $4 billion dollars a year. Against that, the
12 impact analysis estimates that the costs of complying
13 with the rule are about $2.4 to $5.7 billion.
14 The analysis bases this claim and its claim
15 of "a substantial failure of the market for investment
16 advice" on a review of a "wide body of evidence." The
17 central message of this evidence is that brokers
18 provide biased advice, allegedly leading clients to
19 purchase investments that are expensive or to
20 underperform.
21 We've examined the impact analysis and the
22 academic studies it cites. Unfortunately, they simply
23 do not support the Department's claims of huge
24 benefits. In summary, first, neither the impact
25 analysis nor the studies it cites measure the key

1 factor: is an investor's performance different when
2 an advisor is a fiduciary versus when an advisor is
3 not.
4 Second, the studies that the analysis cites
5 do not reflect current market conditions.
6 Third, the impact analysis misapplies the
7 numerical results of a key study, leading to a vast
8 overstatement of potential benefits.
9 Fourth, the analysis fails to consider
10 readily available data that contradict its claims
11 about broker-sold funds.
12 Fifth, the impact analysis fails to consider
13 that some investors, particularly those of modest
14 means, may face increased costs if the proposed rule
15 forces them to migrate to fee-based accounts or to go
16 without financial advice altogether.
17 Correcting for these problems, we find that
18 the impact analysis' claimed benefits of $44 billion
19 over 10 years is totally unfounded. Indeed, even
20 rather basic calculations based on plausible
21 alternative assumptions to those used in the RIA
22 suggest that the rule, if adopted, could cost
23 investors $109 billion in lost returns and added fees
24 over 10 years.
25 Let me explain. First, the impact analysis

1 and the studies it cites do not, indeed cannot,
2 measure the key question, do investors fare better
3 when using brokers versus using fiduciaries, the same,
4 or worse. No data are available that address that
5 question directly. Consequently, the impact analysis
6 simply cannot use those studies to estimate potential
7 benefits or costs of the proposed rule.
8 Second, the impact analysis cites academic
9 studies indicating that broker-sold funds
10 underperform. But those studies do not reflect
11 current market conditions. They use data on broker-
12 sold funds stretching back to the early 1990s and in
13 many cases ending generally in 2004.
14 Since then, however, the market for funds
15 and investment advice has changed fundamentally. In
16 2000, for example, only half of the funds with front-
17 end load share classes also offered a no-load share
18 class. By 2010, nine in 10 did so, effectively
19 eliminating market segmentation. Funds sold by
20 brokers and funds traditionally described as direct-
21 sold now compete head-on.
22 Had the impact analysis used more recent,
23 publicly available data, it would have found that
24 investors in front-end load funds bought shares that
25 outperformed, not underperformed. From 2007 to 2013,

1 on a sales-weighted basis, front-end load shares
2 outperformed their Morningstar category averages by
3 1/4 percent, 25 basis points.
4 Third, the impact analysis misapplies the
5 results of a study by Christoffersen, Evans, and Musto
6 that forms the linchpin of the benefits analysis.
7 Taking that study at face value, we believe that a
8 correct application of the rule -- correct application
9 of that study to recent data would reduce the claim
10 benefits, stretching the analysis significantly in
11 favor of the RIA, to about $200 million per year at
12 most.
13 That's far less than the $4.4 billion per
14 year claimed by the impact analysis and is within the
15 range of the impact analysis' own estimates of the
16 cost of implementing the rule.
17 Fourth, the impact analysis ignored data
18 that contradicted key assertions. Take its claim that
19 brokers do not recommend less expensive funds. In
20 fact, as detailed in our comment letter, investors in
21 front-end load funds, like other investors, gravitate
22 to lower-cost funds. In 2014, for example, for
23 domestic equity funds, the average expense ratio of
24 all funds offered for sale was 1.29 percent. For all
25 such no-load funds, the average expense ratio was 0.97

1 percent. Investors in domestic equity front-end load
2 funds paid less, .93 percent.
3 Finally, the impact analysis suffers from
4 two major errors of omission. First, it fails to
5 assess the impact on investors who shift to a fee-
6 based model due to the rule. As ICI and others have
7 detailed, the best interest contract exemption is
8 unworkable. Effectively, investors who want advice
9 will no longer have the option of even considering
10 brokers. Many may migrate toward fee-based accounts.
11 These investors, especially low- to moderate-income
12 investors with lower balances, may end up paying
13 higher overall fees.
14 Cerulli indicates that accounts with fee-
15 based advisors cost 1.1 percent of assets on a yearly
16 basis, and fees can be considerably higher for
17 balances less than $100,000. Fee-based advisors, like
18 brokers, provide valuable services and deserve to be
19 compensated for those services. But investors with
20 smaller balances may be better served and may pay
21 lower fees under a broker-based model.
22 The impact analysis also fails to measure
23 the costs of investors becoming disenfranchised from
24 the advice market. The analysis assumes that the rule
25 proposal, if adopted, will drive down brokers'

1 commissions significantly but that brokers will
2 continue to provide the same services to retirement
3 investors as before. That is unrealistic. Some
4 brokers' clients will no doubt migrate to fee-based
5 accounts, but others are likely to be shut out of the
6 advice market entirely.
7 ICI data indicate that 75 percent of
8 traditional IRA investors have balances of less than
9 $100,000, but many fee-based advisors require minimum
10 balances greater than that. Thus, investors with
11 smaller accounts could end up with no access to
12 advice.
13 The impact analysis acknowledges that many
14 investors left to their own devices make mistakes,
15 such as saving too little, trading too much, making
16 poor asset allocations, or paying tax penalties on
17 early withdrawals. Advisors, whether fiduciaries or
18 not, can help investors avoid making those kinds of
19 mistakes. If IRA investors with smaller balances,
20 those with $100,000 or less, are unable to obtain
21 advice at a reasonable cost, these mistakes could be
22 quite costly to them.
23 In our comment letter, using the impact
24 analysis' assumptions about asset levels and the rate
25 at which investors migrate from front-end loads to

1 fee-based accounts, we estimate the mistakes by
2 investors lacking advice could cost $62 billion over
3 10 years. If the remaining 25 percent of IRAs whose
4 balances are $100,000 or more incur higher fees in a
5 fee-based arrangement, that could cost an additional
6 $47 billion over 10 years, for a total of
7 $109 billion.
8 As the Department recognizes, this issue is
9 vitally important to American workers and their
10 families. Research by ICI and others shows that the
11 U.S. retirement system is working to help deliver a
12 secure future for Americans. That could easily be
13 impaired by a rule that's unworkable in its details
14 despite the best intentions.
15 We hope the Department takes seriously our
16 comments and recommended changes. As a start, the
17 Department should revisit the regulatory impact
18 analysis, which should help it craft a more workable
19 rule. The ICI stands ready to help in this endeavor.
20 Thank you.
21 MR. HAUSER: Thank you.
22 MR. REUTER: Good morning. Thank you for
23 providing me with this opportunity to testify.
24 My name is Jonathan Reuter. I'm an
25 associate professor of finance at the Boston College

1 Carroll School of Management. I'm also a research
2 associate at the National Bureau of Economic Research
3 and an institute fellow at TIAA-CREF. I am here to
4 testify -- so I'm not here testifying on behalf of
5 these organizations. I'm here to describe my
6 research, which has long focused on the behavior of
7 mutual fund families and their investors.
8 Today's testimony describes two co-authored
9 papers in which I studied the behavior of brokers in
10 broker-sold mutual funds. These papers have been used
11 by the Council of Economic Advisors and the Department
12 of Labor to argue that conflicted advice is both
13 common and costly. This is an accurate description of
14 my findings.
15 The first paper studies the portfolios of
16 broker clients inside the Oregon University system's
17 defined contribution retirement plan between 1999 and
18 2009. We combined administrative data on participant
19 characteristics with portfolio snapshots from three
20 financial services firms, one of which uses brokers to
21 provide investment recommendations in face-to-face
22 meetings. An updated version is coming later this
23 month.
24 The second paper studies the behavior of
25 direct-sold and broker-sold mutual funds, which Sean

1 made reference to. We analyzed fund-level data on
2 investor flows and returns using data on distribution
3 channels that begin in 1992 and end in 2004. The
4 academic version appeared in the August 2014 issue of
5 the *Journal of Finance*, arguably the top academic
6 journal in the field of finance. These are
7 independent research projects. My coauthors and I had
8 no financial stakes in the findings.
9 To summarize, we find that conflicted advice
10 is readily observed in real-world data and in the
11 settings that we study, associated with significantly
12 lower after-fee risk-adjusted returns. I conclude
13 from this research that regulation that reduces the
14 incidence of conflicted advice is likely to increase
15 investor retirement account balances. Reducing the
16 influence of commissions on investment advice may even
17 improve the average quality of broker-sold mutual
18 funds by shifting competition away from broker
19 commissions and toward investor returns.
20 To be clear, my testimony is not about the
21 inherent value of active management versus passive
22 management, although I'll have something new to say
23 about that, and not a universal critique of brokers
24 and broker-sold mutual funds so much as a critique of
25 broker incentives and client outcomes in the current

1 regulatory regime.
2 I've structured the remainder of my
3 testimony around three questions which I will answer
4 in the time remaining.
5 First, what is the evidence that broker
6 clients are receiving conflicted advice? So, we find
7 strong evidence of conflicted advice in two completely
8 different settings. We find that broker clients'
9 portfolios in the Oregon University system are heavily
10 tilted towards those investments that pay the highest
11 annual commissions. This is especially true when
12 comparing options that invest in the same types of
13 stocks or bonds, so, for example, small cap growth
14 funds. This evidence of conflicted advice is
15 inconsistent with brokers recommending the better-
16 than-average funds on their platforms.
17 Furthermore, because the brokers in our
18 sample sell variable annuities, it is not the case
19 that existing evidence of conflicted advice is limited
20 to mutual funds.
21 In terms of performance, we find that broker
22 clients earn significantly lower annual returns, lower
23 risk-adjusted returns, and lower Sharpe ratios than
24 counterfactual portfolios based on target-date funds,
25 so the portfolios we think people would have invested

1 in in a world where a TDF is a default. For example,
2 risk-adjusted returns are more than 2 percent lower
3 per year.
4 The obvious caveat is that we only possess
5 account-level data for a single retirement plan. The
6 lack of academic papers studying the behavior of
7 broker clients and broker-sold mutual funds in the
8 United States reflects the inability of academics to
9 obtain account-level data rather than the lack of
10 interest by academics.
11 However, it is worth noting that my findings
12 are broadly consistent with account-level studies in
13 Canada and Europe. It is also worth noting that I am
14 willing to analyze a "representative sample of
15 investor portfolios through time" if financial
16 services firms would be so kind as to share these data
17 with me and my co-authors.
18 When we turn our attention to the universe
19 of broker-sold mutual funds, we find that broker-sold
20 actively managed funds underperform broker-sold index
21 funds by more than 1 percent per year. To be clear,
22 this is not a comparison of broker-sold funds and
23 direct-sold funds. This is a comparison of investment
24 options within the broker-sold segment of the market,
25 which includes funds sold by insurance agents, for

1 example, but does not include funds sold by registered
2 investment advisors.
3 Despite the significant underperformance, we
4 find that only 2 percent of broker-sold assets are
5 invested in index funds at the end of our sample
6 period. We interpret this underperformance as
7 reflecting the cost of conflicted advice.
8 Importantly, the underperformance of broker-
9 sold actively managed funds is not an inevitable
10 consequence of active management. In the direct-sold
11 segment, we find that actively managed funds are in
12 the same after-fee risk-adjusted returns as index
13 funds. Rather, it is the consequence of weak
14 incentives in the broker-sold segment.
15 We conclude that broker-sold, actively-
16 managed funds are of lower average quality than their
17 direct-sold peers because flows into broker-sold funds
18 respond to raw returns and commissions rather than to
19 risk-adjusted returns. In other words, competition in
20 the broker-sold segment focuses on the wrong
21 characteristics, which has implications for how mutual
22 funds are designed.
23 For example, we show that broker-sold
24 families offer wider ranges of funds than direct-sold
25 families and are significantly more likely to

1 outsource portfolio management, two organizational
2 decisions shown to predict lower fund-level returns.
3 Unless broker-sold families have begun to make
4 fundamentally different decisions about how they
5 design and manage their funds, it is hard to
6 understand how or why the performance of broker-sold
7 funds might have improved. I plan to explore this
8 issue later this year, using distribution channel data
9 acquired from Lipper.
10 Second, why do we find evidence of
11 conflicted advice in real world data? The simple
12 answer is that investors seeking advice on asset
13 allocation and fund selection tend to have less
14 investment experience than investors who are confident
15 in making their own decisions. This difference in
16 experience significantly reduces the likelihood that
17 broker clients can identify when they are receiving
18 conflicted advice. The fact that broker commissions
19 are typically bundled with other mutual fund fees
20 makes the conflict less obvious.
21 Participants who joined the Oregon
22 University system before November 2007 had the choice
23 between four investment providers, only one of which
24 offered access to broker recommendations. Using
25 demographic data on participants joining during this

1 period, we find that demand for brokers is decreasing
2 in income, age, and educational attainment. It is
3 also significantly lower for economists and business
4 school faculty. These correlations suggest that
5 broker clients are less financially literate or have
6 less investment experience than other plan
7 participants. Indeed, when we asked participants
8 survey questions about the factors that led them to
9 choose their investment provider, broker clients
10 respond that they valued receiving face-to-face
11 recommendations on asset allocation fund selection.
12 At the same time, only 23 percent of broker
13 clients agreed or strongly agreed with the statement,
14 I understand how much money my advisor earns on my
15 account. I suspect that the fraction would have been
16 even lower in a more representative sample of
17 investors.
18 On a related note, I was surprised by T.
19 Rowe Price's claim that salesmanship is a cultural
20 norm understood by individuals as well as plan
21 fiduciaries, no matter their level of financial
22 literacy or investment sophistication. How is a
23 typical investor to know that investment advice
24 offered in an IRA account is held to a lower legal
25 standard than advice offered in an ERISA-covered plan,

1 especially when their initial exposure to financial
2 advice is likely to have come within an ERISA-covered
3 plan? To be honest, I did not fully appreciate this
4 distinction until I began doing this research many
5 years ago.
6   Third and finally, is conflicted advice
7 better than no advice? So, the answer depends on how
8 broker clients would behave in the absence of broker
9 recommendations, which is likely to vary across
10 settings. Within a defined contribution retirement
11 plan like the one administered in Oregon, however, the
12 answer is no. We find that participants with a high
13 predicted demand for broker recommendations
14 disproportionately choose to invest through brokers
15 when they're available, which is mechanical, and
16 disproportionately choose to invest through targeted
17 funds when brokers are not available.
18   In other words, when advice is limited to
19 asset allocation and fund selection, we find strong
20 evidence that target-date funds substitute for
21 brokers. This substitution justifies the use of
22 target-date funds as counterfactual portfolios for
23 broker clients, and it ultimately leads us to conclude
24 that conflicted advice is dominated within a DC
25 retirement plan by a sensible default option.

1 We also show that target-date fund
2 portfolios dominate the portfolios of self-directed
3 investors. Given this analysis, it was surprising to
4 see NERA conclude that Chalmers and Reuter does not
5 provide any evidence that consumers that are currently
6 using brokers would do as well as self-directed
7 consumers if they were left to their own devices.
8 That's precisely what we show.
9 In analysis that will appear in the next
10 version of the paper, we also find that the portfolios
11 of non-TDF investors joining after the change in menus
12 compare favorably to those of broker clients.
13 In the context of an IRA rollover, it is
14 unlikely that conflicted advice is better than no
15 advice, especially when the alternative is to leave
16 assets invested in an ERISA-covered plan.
17 Thank you. I look forward to your
18 questions.
19 MS. SCHOAR: Good morning. My name is
20 Antoinette Schoar. I'm a professor in finance at MIT
21 Sloan. I'm also a member of the NBER, the National
22 Bureau of Economic Research. And obviously all the
23 comments reflect my opinion and not those
24 institutions.
25 Thank you for giving me the opportunity to

1 testify before you today. In my testimony, I want to
2 address three distinct questions. First, do conflicts
3 of interest lead to the provision of sub-optimal
4 advice to consumers? Second, how will imposing
5 fiduciary standards affect the provision of services
6 to customers, especially those with small balances?
7 And then third, can market forces and competition
8 alone eliminate conflict of interest given the current
9 regulatory framework?
10 So, in the following, I will lay out my
11 arguments based on my own research and research I have
12 conducted with co-authors.
13 So the first question, do conflicts of
14 interest lead to the provision of sub-optimal advice
15 to customers. The current structure of the market for
16 financial advice exposes consumers to a confusing
17 array of different service providers. As we've heard
18 before, they range from registered investment advisers
19 who adhere to fiduciary standards to broker dealers
20 who are only subject to what is known as suitability
21 standards. A large literature has shown that
22 conflicted advice is bad for consumers since it pits
23 the interests of the broker against that of the
24 customer rather than aligning them.
25 So, when brokers are paid on commission for

1 placing customers into specific investment products,
2 their interest is to maximize these commissions rather
3 than to maximize the performance of the customer's
4 portfolio. These problems are aggravated if customers
5 actually are not aware or if they do not understand
6 the nature of the conflict of interest that their
7 broker faces. But research has also shown that
8 disclosure alone will not fix these problems.
9 So the fiduciary standard proposed by the
10 Department of Labor seeks to level the playing field
11 and ensure that consumers are not faced with financial
12 service providers whose interests are diametrically
13 opposed to theirs. While surely this rule alone does
14 not solve all the problems that might arise in retail
15 financial services, my research suggests that it will
16 actually help to improve the quality of the advice
17 that people receive.
18 My research shows that registered investment
19 advisors who have fiduciary responsibility towards
20 their clients provide better advice than those who are
21 just registered as broker dealers. Advisors in my
22 research were less likely than brokers to reinforce
23 erroneous beliefs about the market that clients might
24 have, and they were also less likely than brokers
25 to -- brokers were less likely than advisors to guide

1 people towards high-fee funds and away from low-cost
2 funds.
3 So let me explain to you the type of
4 research that we did to support this. So, to test the
5 quality of the advice that is provided by different
6 parties in the market, I conducted an audit study
7 together with two co-authors of mine, Sendhil
8 Mullainathan at Harvard and Markus Noeth at the
9 University of Hamburg, and what we did is we looked at
10 the advice that goes into the investment decision. In
11 particular, we wanted to understand:
12 First, do brokers and advisors differ in how
13 they correct well-documented biases or investment
14 mistakes that retail customers make. Second, do they
15 differ in how they direct clients towards low-fee
16 investment alternatives such as index funds rather
17 than focusing them on high-fee options? And third,
18 when providing supposedly individualized advice, do
19 these different parties provide specific customized
20 recommendations based on the need of the client?
21 As you will see, the answers to all three of
22 these questions show that there are big differences
23 between brokers and registered financial advisors.
24 What we did is we sent mystery shoppers to
25 make more than 250 client visits to registered

1 investment advisers and broker-dealers in the greater
2 Boston and Cambridge area. We then also replicated
3 the study for more than 450 visits in the New York
4 City area. These were professionally trained mystery
5 shoppers who visited brokers and financial advisors to
6 seek advice on how to invest their retirement savings.
7 So these were not MIT undergrads. Don't worry about
8 that.
9 We also varied the level of bias or
10 misinformation about financial markets and financial
11 products that the clients had to see whether advisors
12 and brokers correct these misconceptions. For
13 example, in half of the visit, mystery shoppers
14 presented mistaken beliefs about financial markets,
15 such as wanting to chase past returns, which has been
16 shown in a lot of research of producing lower returns,
17 and we also used other well-documented biases that
18 have poor returns.
19 Other mystery shoppers went into the advice
20 situation with what you might call a textbook
21 portfolio, so well-diversified, low-cost index funds.
22 The results we found were very concerning.
23 Number one, the advice shoppers received from brokers
24 failed to correct their biases. Even more worrisome,
25 most brokers seemed to encourage the existing

1 misconception of clients, especially if it made it
2 easier for them to sell more expensive and higher-fee
3 products to them. For example, they encouraged return
4 chasing but pushed hard against investments in low-
5 cost index funds. In comparison, financial advisors,
6 those with a fiduciary duty, were less likely to
7 engage in this activity.
8 Second, we found brokers strongly favored
9 high-fee funds, such as actively managed funds, over
10 lower-cost index funds. The only visits where we
11 found that these experts actually pushed for low-fee
12 funds were in financial advice visits -- I mean with
13 financial advisors, not with brokers.
14 Third, we found no consistent evidence that
15 the advice that was provided took into account the
16 specific characteristics of the clients, such as
17 whether they have children, whether they were
18 homeowners, their wealth level, et cetera.
19 And finally, we found that actually women
20 were treated as if they were -- the women as clients I
21 mean -- as if they were more gullible than men. In a
22 significant amount of visits, women were asked that
23 they would -- should first transfer their funds to the
24 broker before they could receive any factual advice.
25 Let me now come to the second point that I

1 want to make. The question is: How will imposing
2 fiduciary standards affect the provision of services
3 to customers, especially those with smaller balances?
4 So this is a concern that has often been voiced by
5 the financial service industry as a response to this
6 proposed Department of Labor regulation, with the idea
7 that it should lead to an increase in the cost to
8 brokers and therefore reduce the services, especially
9 to lower income customers.
10 But it is actually very important to note
11 that the current system already does not well-serve
12 low-balance customers. We found, for example, in our
13 audit study that individuals who have less than
14 $100,000 in savings found it very difficult to even
15 get a first appointment with any financial advisor or
16 broker. They were routinely turned down.
17 However, even when looking at customers who
18 are currently receiving advice, this argument is not
19 internally consistent because we need to remember that
20 ultimately it's always the customer who pays for the
21 advice, no matter which form the payment takes.
22 Advisors do not work pro bono, and obviously neither
23 should they. So, if a set of customers has the
24 financial means to pay for the conflicted advice, even
25 though these investments, as we have seen in the

1 statement before, have lower returns, they will know
2 that customers would be able to pay for that advice if
3 it came in the form of non-conflicted payments.
4 So then the actual argument must be that the
5 industry fears that the only way people are willing to
6 pay for advice is through conflicted payments, where
7 the full costs of the advice are hidden from the
8 customer. In other words, the industry must be
9 implicitly asking whether customers would be willing
10 to pay for this advice if they realized how much they
11 actually are being charged.
12 But it definitely cannot be in the interest
13 of customers to only be exposed to these conflicted
14 payments. If the fear of providing non-conflicted
15 advice leads to some brokers to drop out of the
16 market, the proposed rule would actually be doing
17 exactly its job by screening out advisors who are not
18 planning to act in the best interests of their
19 clients.
20 So finally, let me come to my last question.
21 Can market forces and competition alone eliminate
22 these conflicts of interest given the current
23 regulatory framework?
24 A growing theoretic literature has shown
25 that in markets where a significant fraction of

1 customers cannot differentiate the quality of the
2 products that they're being sold, competition will
3 lead to a race to the bottom. The market for
4 investment advice is one such market. To
5 differentiate good from bad advice, clients cannot go
6 by their experience or even the experience of their
7 friends since it takes decades to know if the advice
8 that is given to them is good or bad.
9 So actually clients would have to understand
10 financial models and financial theory, which is not
11 something we expect an average customer to have. So
12 many high-quality financial advisors will point out if
13 retail investors are poorly informed, advisors who
14 provide sound financial advice often find it difficult
15 to compete with less sanguine investors.
16 Therefore, an important additional benefit
17 to a policy that reduces conflict of interest between
18 clients and their advisors is that it helps to harness
19 the market's competitive forces to the benefit of the
20 consumers. Firms now would have to compete on
21 dimensions that create value for their clients rather
22 than just trying to extract rents from them.
23 As a result, the proposed regulation is
24 quite light touch and pro market since it leaves all
25 the operational decisions to the private sector and

1 allows them to determine how they want to serve their
2 clients. It also does not prevent innovation in the
3 private sector, but it ensures that the incentives of
4 the financial service providers are aligned with their
5 customers. Thank you.
6 MR. HAUSER: Thank you.
7 Mr. Wilkerson?
8 MR. WILKERSON: Good morning. I'm Carl
9 Wilkerson, Vice President and Chief Counsel of the
10 American Council of Life Insurers. Thank you for the
11 opportunity to share the views of the American Council
12 of Life Insurers and our 300 members, who represent
13 over 90 percent of the industry assets and premiums.
14 ACLI members offer annuities, retirement
15 plans, and life insurance that provide 75 million
16 American families with financial and retirement
17 security. At the outset, I emphasize that life
18 insurers strongly support recommendations and advice
19 in the best interests of retirement savers and clear
20 disclosure of potential conflicts. ACLI is committed
21 to working constructively with the Department to
22 achieve these important goals.
23 The 25 panels over four days will offer a
24 diverse range of opinions on whether the rule is good,
25 bad, or indifferent. There is one thing, however,

1 that all panelists can agree on. Americans face
2 profound retirement security challenges. The most
3 important consideration therefore is whether the
4 regulation will help solve or will impair long-term
5 retirement security.
6 We have four core observations about the
7 regulatory impact analysis or RIA. One, the RIA
8 overstates benefits, understates costs, and disregards
9 harm to small retirement plans.
10 Two, several of the academic studies cited
11 in the RIA are misinterpreted, misapplied, or contain
12 now stale data.
13 Three, in calculating the proposals made,
14 the RIA fully ignores comprehensive state and federal
15 laws that directly protect the retirement savers
16 against the very abuses that the rule seeks to
17 rectify.
18 And four, the initiative mentions annuities
19 172 times, but the RIA contains nothing estimating the
20 impact of the rule on retirement savers using
21 annuities, advisors recommending annuities, or an
22 annuity's role in retirement security.
23 The statement of benefits is flawed. The
24 RIA cites six academic studies and three working
25 papers to quantify the rule's benefit with data that

1 is sometimes 15 to 20 years old, about one type of
2 mutual fund, at one point in time. Fees and charges
3 have fallen significantly since the data measured in
4 the studies. Moreover, this mutual fund data is not
5 germane to advice about annuities. Even the
6 Department admits that none of these papers tried to
7 detect asset underperformance due to conflicted
8 advice.
9 The studies serve as a poor measure of the
10 proposal's benefits. Additionally, the RIA does not
11 consider the benefits for retirement savers of
12 annuities, which can ensure financial security for
13 life, or the benefits of in-person advice.
14 The proposal harms small employers and
15 moderate retirement savers. The RIA fully overlooks
16 the proposal's harm to small businesses and to small
17 to moderate balanced retirement savers. The RIA
18 extols a parallel 2013 initiative in the UK and cites
19 a significant reduction in commissioned advice. It
20 fails to mention, however, an even greater drop in
21 advice overall to retirement savers following that UK
22 regulation.
23 In 2014, UK Morningstar reported that 11
24 million investors had fallen through an advice gap
25 following industry regulation. In response to this

1 severe problem, the UK last week launched a
2 comprehensive review of its regulations and its
3 abandoned retirement savers.
4 It is most telling that the U.S. Small
5 Business Administration, the advocate for small
6 businesses, opposed the initiative for overlooking the
7 impact on small businesses and the loss of advice.
8 Those in the weakest position stand to lose the most
9 from a lack of advice.
10 Robo-advisors are a poor substitute for
11 human advice. The RIA suggests that robo-advisors
12 will fill any gaps that result from the proposal.
13 Robo-advisors are a new and untested method of
14 providing financial advice and are not necessarily
15 more cost-effective than in-person advice. There are
16 no rigorous studies that have examined whether a robo-
17 advisor is a good substitute for a human being,
18 especially in troubled markets, such as the 2008
19 market crash.
20 Moreover, non-commissioned, fee-only advice
21 could likely cost more for many retirement savers
22 because of asset management or wrap fees that are
23 charged year after year after year. In contrast,
24 commissions occur only once, if at all. The RIA
25 failed to consider these factors.

1 In sum, the regulation is built on two false
2 premises: all commissioned advice is conflicted, and
3 all fee-only advice is always unconflicted and serves
4 the retirement saver's best interest.
5 Annuities are absent in the RIA calculus.
6 Although the initiative mentions annuities a total of
7 172 times and acknowledges that 31 percent of IRAs
8 include investments in annuities and that insurance
9 companies will be significantly affected by the
10 proposal, the cost-benefit analysis makes no attempt
11 to examine the impact of the proposed rule on
12 annuities, advisors, insurers, or retirement savers
13 using annuities. That's a blind spot in the RIA.
14 The extrapolation of front-loaded mutual
15 fund data to annuities is simply wrong and a poor
16 foundation for rulemaking. Surrender charges are
17 misrepresented. Concerning surrender charges
18 associated with insurance products like annuities,
19 DOL's public statements assume that all annuities have
20 surrender charges, full surrender charges are applied
21 100 percent of the time, and all surrenders are for
22 the full amount of the annuity.
23 None of these presumptions are correct.
24 Surrender charges are contingent deferred sales
25 charges, meaning that if the customer holds the

1 contract for the surrender period, which is usually
2 seven years, there is no surrender charge. Since the
3 discussion of surrender charges is based on anecdotal
4 information, ACLI commissioned NERA to examine the
5 incidence of surrender charges in a sample of 237,000
6 variable annuity contracts, representing 30 percent of
7 variable annuity reserves.
8 NERA's report was published on August 8.
9 It's available on our public website, and it found
10 that 76 percent of those firms surveyed offer
11 contracts with no surrender fees. The average
12 surrender charge for any surrender, full or partial,
13 is .8 percent or .008 in decimal notation.
14 Of the accounts with surrenders,
15 approximately 23,000 or 70 percent are IRA accounts.
16 For IRA variable annuities only, the average surrender
17 fee paid on any partial or full surrender is even
18 lower, at .6 percent. And lastly, 78.6 of withdrawals
19 in IRA accounts paid zero percent in surrender fees.
20 This type of data needs to be part of the
21 conversation on the proposed regulation and the RIA.
22 The proposal unacceptably excludes the protection of
23 current regulatory standards from its quantification
24 of need. In its justification for the proposal, the
25 Department asserts that current regulatory protections

1 are inadequate to address its concerns about advice to
2 retirement plan participants. We disagree with the
3 wholesale disregard of detailed systems of significant
4 protection for the analysis of regulatory need.
5 For example, significantly enhanced FINRA
6 regulations governing variable annuity suitability,
7 supervision, and non-cash compensation were fully
8 outside the scope of the RIA's assessment of need.
9 Likewise, parallel regulations under state insurance
10 laws were fully omitted.
11 Our submission provides 269 pages
12 highlighting the comprehensive scope of state and
13 federal regulations of annuities. I don't have time
14 to summarize it now, but I think it goes a long way to
15 demonstrate that consumers are adequately protected
16 when you add together state and federal regulation.
17 The legal standards and exposure to
18 litigation. Congress, courts, and the Executive
19 Branch of government have unequivocally mandated
20 balanced and objective cost-benefit analysis in
21 rulemaking. Collectively, these standards ensure that
22 federal agencies strike the right balance and develop
23 more affordable, less intrusive rules to achieve the
24 same ends, giving careful consideration to benefits
25 and costs. That, by the way, is a direct quote from

1 President Obama when he issued Executive Order 13563
2 in 2011.
3 In its June 29 decision in Michigan v. EPA,
4 the Supreme Court underscored again the critical
5 importance of balanced and objective regulatory impact
6 analysis in federal agency rulemaking. The Department
7 failed these standards by overstating benefits,
8 understating costs, and disregarding harm to small
9 retirement plans. Consequently, the initiative is
10 exposed unnecessarily to legal challenges if the rule
11 is adopted as proposed.
12 To recap, Life Insurers support the best
13 interests of retirement savers and advice that's
14 provided to them and the full disclosure of potential
15 conflicts. We pledge to work constructively with the
16 Department to achieve these goals and to help solve
17 America's retirement security challenges. Thank you.
18 MR. HAUSER: Thanks. Joe?
19 MR. PIACENTINI: Okay. Thank you to the
20 panel for those comments. I'd like to start with some
21 questions for Mr. Collins.
22 So, Mr. Collins, your testimony and ICI's
23 comment on the RIA spent some attention to the
24 comparison between averages across all funds or funds
25 in a particular category and load funds, presumably

1 mostly broker-sold funds, and find generally that the
2 broker-sold funds performed better than average, had
3 lower fees than average, which is reassuring to know
4 that investors are mostly doing better than, you know,
5 a random choice, if you would, across all funds that
6 might come out the same as the average.
7 But that leaves open the question of whether
8 the advice could be better, of whether the types of
9 compensation that are paid might affect how much the
10 investments do better than this average.
11 So my question then is, you know, some of
12 the peer-reviewed research that we relied on did try
13 to look directly at the magnitude of conflicts and
14 concluded that payments that potentially pose larger
15 conflicts seemed to be associated with poorer
16 performance. So my question is, did your examination
17 of data try to isolate the potential size of conflicts
18 and look at whether the performance varied with that
19 or the fees?
20 MR. COLLINS: That's a -- I think there's
21 probably about four or five different questions in
22 there. But first of all, let me back up. You said
23 that we had sort of -- in the analysis we had done,
24 that we kind of used a random choice of funds. That's
25 not correct. We compared front-end load from --

1 MR. PIACENTINI: Well, I'm sorry. Let me
2 clarify. I was talking about a comparison to an
3 average, and I was suggesting that if you make a
4 random choice, many times you end up near the average,
5 and that the choices appear to be better than that if
6 they're beating the average.
7 MR. COLLINS: Okay. So could there be cases
8 where a particular fund underperformed? Certainly.
9 You see that in the data. You also see cases where in
10 the data front-load forms outperformed and
11 outperformed by significantly more than the averages
12 suggest. And so that's the key, is that you need to
13 take consideration of both the guys that are
14 underperforming, the guys that are overperforming, and
15 weight by where investors are making their choices, so
16 where are they buying shares. Where are they holding
17 shares?
18 And that's a key difference. And the
19 studies that you're referring to generally don't do
20 that. Generally, they look at a specific fund and say
21 how does that specific fund, which may have very few
22 assets or may have very few sales, compare to the
23 average fund.
24 So just to complete the thought, in the
25 analysis that we did, that's one of the things that we

1 do. We use more updated data, more recent data, which
2 we believe reflects more current market conditions,
3 and asset weight or sales weight as appropriate to the
4 context of the question, and that's how you get the
5 answer that we come up with.
6 MR. PIACENTINI: But I haven't heard any
7 reference to taking account of the potential magnitude
8 of conflicts and how that might have affected results.
9 MR. COLLINS: I'm not quite sure how you
10 would do it. I'm not quite sure that any of those
11 studies do --
12 MR. PIACENTINI: What about the question of
13 whether the magnitude of potential conflicts has any
14 bearing on where the funds are, where flows end up
15 being directed? I heard you say that they are
16 directed disproportionately to less expensive than
17 average funds, but could you see whether the magnitude
18 of the potential conflict to the advisor himself had
19 any bearing on --
20 MR. COLLINS: Again, if there's a range of
21 potential influences of conflicts, and there could
22 be -- there could also be, you know, forces working in
23 the opposite direction. For example, brokers think
24 that they will do best in their business if they best
25 represent the interests of their clients. I mean,

1 certainly our members would say that, that, you know,
2 that's how they run their business, is, you know, do
3 best for your clients, and you'll do best in your
4 business.
5 But put that aside. What the data show is
6 that people are directing, irrespective of how you
7 were to measure conflicts of interest, the data show
8 that people are directing their assets to front-load
9 funds that either outperformed over the period we
10 considered or had below average expense ratios.
11 MR. PIACENTINI: That outperformed an
12 average of all funds.
13 MR. COLLINS: That outperformed an average
14 of funds in that specific Morningstar category. So,
15 for example, if it's a small cap value fund, we
16 compare it, as most of the academic studies you cite,
17 compare it to a small cap value fund.
18 MR. PIACENTINI: Was there a control for the
19 risk within the category? Does the risk vary within
20 the categories? We heard, for example, some research
21 that took account of Sharpe ratios.
22 MR. COLLINS: Yeah. I mean, it certainly
23 can vary within the category.
24 MR. PIACENTINI: So then did your
25 examination take account of whether the Sharpe ratios

1 might be better or worse? You're seeing returns that
2 are compared in one way. Could you see -- was that
3 adjusted on a risk basis the way it was, for example,
4 if I understood in Professor --
5 MR. COLLINS: No. So that could be done.
6 Having said that, I mean, a number of the studies that
7 are cited in the RIA also -- so, for example, CEM does
8 not, I think, adjust for load on a risk-adjusted
9 basis. So to the extent that that's an issue --
10 MR. PIACENTINI: Right.
11 MR. COLLINS: -- it would be an issue
12 broadly.
13 MR. PIACENTINI: See --
14 MR. COLLINS: And in any case, I would say
15 that since you're taking averages --
16 MR. PIACENTINI: Just for -- yes.
17 MR. COLLINS: -- you're taking some guys
18 that have above average loads, some guys that have
19 below average loads. There will be Sharpe ratios in
20 the same way above average and below average. And I
21 don't think it's safe to assume that because you risk
22 adjust the analysis will come out more in your
23 direction. It could come out the opposite way.
24 MR. PIACENTINI: Just for the record, so CEM
25 was your reference to Christoffersen, Evans, and

1 Musto --
2 MR. COLLINS: Correct.
3 MR. PIACENTINI: -- one of the papers that
4 we cite. And also, just to clarify, when I said that
5 some of the research we relied on did try to measure
6 the actual magnitude of conflicts and find out whether
7 that seemed to be tied to results, that was a paper
8 that I was referring to.
9 Let me turn to a couple of other witnesses
10 to follow up a little bit on the same line of inquiry.
11 If I understood correctly, you know, you do see that
12 funds are directed on average toward less-expensive-
13 than-average funds. But going to the question of
14 whether the incentive of the advisor has some bearing
15 on where the funds are directed, I think I heard Ms.
16 Schoar say that in her research it appeared that they
17 did.
18 MS. SCHOAR: Yes.
19 MR. PIACENTINI: And in Mr. Reuter's
20 testimony, I certainly heard that it had some bearing
21 on the results. Did it also have some bearing on
22 where flows were directed, the size of the potential
23 conflict?
24 MR. REUTER: Yes. So the way I had
25 interpreted your question to Sean previously was how

1 does the size of underperformance vary with the level
2 of the conflict, right, or does the extent of
3 underperformance vary with the level of the conflicts.
4 MR. PIACENTINI: Yeah.
5 MR. REUTER: And so there are kind of two
6 ways that we've looked at this, right? One is to look
7 at actual broker-client portfolios and kind of ask the
8 question do the high commission funds end up
9 overweighted in the portfolios of the clients. And
10 the answer is strongly yes. The funds that pay 105
11 basis points a year end up with much higher market
12 share than the funds that pay 55 basis points a year.
13 This is true within asset class.
14 So the small cap value funds that pay the
15 highest commission get the highest flow in that
16 setting, okay? So that's the first piece of evidence.
17 Those are variable annuities, to be clear, there.
18 But there is this kind of broader question
19 about underperformance within the broker-sold segment
20 more generally. And the right way to think about
21 asset weighting there at least in the period that we
22 studied where we find that broker-sold index funds
23 vastly outperform broker-sold active funds is to ask
24 what's the market share of broker-sold index funds.
25 And the answer is 2 percent.

1 So that is a valuated number. It's a
2 striking valuated number honestly. And that's the way
3 we come at the measure of underperformance.
4 I think if you want to compare broker-sold
5 to direct-sold, that raises lots of questions about
6 selection that are potentially problematic, which is
7 why we look within a particular segment to make these
8 comparisons.
9 There is one other point I'd like to make,
10 though, which is that the nature of competition in a
11 segment affects the quality of the products you get in
12 that segment. And the way I interpret our findings,
13 using admittedly older data, is that back when we were
14 looking, the broker-sold segment was not competing on
15 risk-adjusted after-fee returns. It was competing on
16 raw returns, which gave them an incentive to ramp up
17 risk. And it was competing on commissions, as we and
18 other people have found in other settings.
19 And to the extent that you're competing on
20 commissions, you don't have much incentive to create
21 the sort of mutual funds that I would think investors
22 would be better off investing in. And that I think is
23 the fundamental issue here. To the extent that you
24 can change the nature of competition, you can do
25 dramatic -- you can make a dramatic improvement using

1 market forces as opposed to trying to tinker with
2 things around the edges.
3 MS. SCHOAR: Can I add -- I just want to add
4 one comment to what Jon Reuter just said, because if
5 you -- the research that I described, you know, is
6 actually complementary to his because what we found
7 again, right -- we compare brokers to fiduciary
8 advisors. And we find if you look at the advice going
9 into the situation -- not even the long-run
10 performance, right -- that the quality of the advice
11 that is given to our mystery shoppers varies
12 dramatically whether they meet a broker or whether
13 they meet a fiduciary advisor.
14 And we find that actually, you know, in some
15 sense, that's really quite concerning, and it goes
16 very much in the same direction, is that only in 7
17 percent of the visits do brokers -- sorry -- does
18 anyone suggest investment in index funds, right? And
19 we actually find that by a vast margin it's only
20 advisors who even mention these lower-fee options,
21 while, you know, kind of the brokers actually are
22 pushing actively against lower-fee options.
23 MR. PIACENTINI: So just quickly picking up
24 on both of those last comments, so there was a
25 question raised over whether the RIA had any evidence

1 that compared fiduciary with broker advice, and so I
2 think I'm hearing that this is one piece of research
3 that we can take account of that does that.
4 MR. COLLINS: Can I respond to that? So I
5 would be very cautious about conflating the issue of
6 active and passive versus broker-sold and fiduciary --
7 or fee-based sold. So just as an example, let's say
8 you have a broker-sold index fund. It could be a S&P
9 500 fund. And let's say it sold with a front load.
10 Maybe the front load is waived because it's an IRA,
11 and it's an IRA rollover with a big enough balance.
12 And it goes into a broker-sold fund with, say, an
13 expense ratio of 50 basis points, 25 of that is
14 12(b)(1) fee.
15 The correct comparison is to a fee-based
16 advisor who is putting somebody into a low-cost index
17 fund, or it could be an ETF, let's say five basis
18 points, and on top of that adding something like 110
19 basis points to put together the asset allocation.
20 So what's going on here -- and this is
21 very -- you have to be very careful about this -- is
22 that the -- in some sense what's happening is advice
23 is moving from advice within funds, so actively
24 managed funds, advice is bundled with the fund, to
25 advice being provided outside the fund, but investors

1 paying for that directly through an out-of-pocket fee
2 or an account-based fee to the RIA.
3 And so, again, I would be very cautious
4 about conflating those two issues. They're not the
5 same.
6 MS. SCHOAR: Can I --
7 MR. PIACENTINI: Thank you. Just --
8 MS. SCHOAR: Sorry. Can I comment on this?
9 Because there is actually a different -- a second
10 dimension in our research because, you know, Sean
11 brought up the point of advice. However, we find that
12 as -- if you -- you know, we don't just look at
13 whether people go into active versus passive funds but
14 whether the quality of advice that is given to the
15 clients about how to understand the market is
16 different between brokers and advisors.
17 And we find, as I was saying before, that
18 the brokers seem to reinforce bad, erroneous beliefs
19 about how markets function if it's in their own
20 interest, which means if it allows them to sell a
21 higher cost -- and also to just sell -- you know,
22 churn the client's portfolio more.
23 So, you know, forget even, you know, where
24 they allocate them. It is just -- it doesn't seem to
25 jive with our data that, you know, kind of that

1 brokers give the same quality of advice to their
2 customers.
3 MR. PIACENTINI: Thank you.
4 MR. COLLINS: Can I jump in?
5 MR. PIACENTINI: Well, in the interest of
6 time, I do want to get to some other topics as well.
7 MR. COLLINS: Okay. All right.
8 MR. PIACENTINI: Okay. Thank you. And I'll
9 try to leave some time at the end.
10 Just quickly, I heard, Mr. Reuter, you say
11 that the research you were describing, that it
12 pertained at least in part to variable annuities. But
13 I also heard the question raised about whether in the
14 RIA we had taken any account of evidence on insurance
15 products. So that research does tell us something
16 about insurance products?
17 MR. REUTER: So the Oregon University
18 system, the way it was originally designed, there were
19 four providers. Two were variable annuity providers
20 and two were mutual fund families. And the people we
21 study here, who provided brokers, was one of the
22 variable annuity families. And so, when we were
23 looking at broker recommendations, it was within the
24 context of a menu that's constructed entirely of
25 variable annuities. So, in that sense, yes, we found

1 evidence of conflicted advice in the variable annuity
2 space.
3 MR. PIACENTINI: Okay. Thank you.
4 MR. WILKERSON: May I respond to that?
5 MR. PIACENTINI: Sure.
6 MR. WILKERSON: While his research, as he
7 explained, did include variable annuities, the point
8 that I was making in our statement is that the RIA
9 itself doesn't take into account the impact on
10 variable annuities advisors to variable annuities or
11 purchasers of variable annuities. Two different
12 things.
13 MR. PIACENTINI: Okay. Thank you.
14 MR. WILKERSON: Thank you.
15 MR. PIACENTINI: So let me ask a different
16 question then to you, Mr. Wilkerson. You point out
17 that, in your view, the RIA does not take adequate
18 account of other protections that are in place. But
19 the empirical evidence that we present and review in
20 the RIA is research that was carried out in the
21 current and historical market under the rules that
22 were in place then. So what additionally should we do
23 to evaluate how people are faring under all of the
24 current protections?
25 MR. WILKERSON: Well, there's a number of

1 things. I think part of the concern about the absence
2 of a full consideration of the existing laws and
3 regulations, if that's the drift of your question, is
4 that it was in reliance upon FINRA rules that predated
5 the proposal. Things have changed significantly in
6 FINRA, as I mentioned, with regard to incredibly
7 enhanced suitability, supervision, and additional
8 charges for variable annuities. Am I catching the
9 drift of your question correctly?
10 MR. PIACENTINI: Yes. Is there a specific
11 regulatory reform that you have in mind there that
12 might cause a bend point in the data?
13 MR. WILKERSON: Let's take non-cash
14 compensations, something that was very much in the
15 forefront with regard to the Department's public
16 statements. FINRA essentially slammed the door on
17 unfair noncash compensation.
18 MR. PIACENTINI: Okay. I think, though, the
19 research that we rely on mostly deals with forms of
20 cash compensation.
21 MR. WILKERSON: Well, I think it's part of
22 the total equation, but that is -- you know, if you're
23 going to do a regulatory impact analysis, it should
24 look at the broad horizon of all existing laws and
25 regulations that protect consumers.

1 MR. PIACENTINI: ACLI's comment in the
2 portion of the comment that deals with the regulatory
3 impact analysis, it makes the point that an asset
4 under management fee might disadvantage annuities as a
5 potential product to be sold relative to a commission
6 model. So that appears to be -- that appears to
7 suggest that the ACLI recognizes that different kinds
8 of payment arrangements can influence which kinds of
9 products will be promoted to customers. Is that an
10 accurate interpretation?
11 MR. WILKERSON: Yeah. But let me embellish
12 that a little bit. When you're comparing a purchase
13 of a mutual fund or other financial products to the
14 purchase of an annuity, an annuity is a long-term
15 accumulation vehicle that the customer should have
16 purchased with that time horizon of 15, 20, 30 years.
17 It's not something that's appropriate to be churned,
18 as was suggested here. It should be held for the long
19 haul.
20 There's a single commission paid upfront,
21 and as I mentioned, if people hold it for the
22 surrender period, they never pay the commission. They
23 don't pay the surrender charge. But I think the point
24 to which you're raising is for fee-based advisers who
25 use wrap fees, they don't get a wrap fee.

1 They can't construct a wrap fee around a
2 variable annuity. There is no asset management
3 needed, no service needed, so they frequently would be
4 disinclined to recommend an annuity to help preserve
5 the financial security of a retirement saver because
6 it's not in their best interests. It's conflicted.
7 They will overlook a product for which they can't get
8 a wrap fee.
9 MR. PIACENTINI: Okay. Your testimony also
10 raised concerns about small business, that
11 disproportionately is served by the insurance industry
12 in terms of small business-sponsored retirement plans.
13 There is research that was conducted by the
14 Government Accountability Office that we looked at in
15 the RIA that suggested that small businesses are
16 sometimes challenged to obtain fiduciary service in
17 support of their efforts or even to be able to discern
18 whether their service providers are acting in a
19 fiduciary capacity or not. Is that consistent with
20 ACLI's experience, or does ACLI serve -- do ACLI
21 members serve as fiduciaries to small businesses?
22 MR. WILKERSON: There are -- we're unique in
23 that we have different distribution models. Some life
24 insurers use career agents. Some use independent
25 agents. Some use direct distribution. So there are

1 different levels at each of those. Many of our
2 members have salespeople who are registered investment
3 advisors, registered insurance agents, and also
4 registered reps of a broker-dealer.
5 So it's a little difficult to give you a
6 precise answer to the question. But there are many in
7 the life insurance industry that do distribute under a
8 fiduciary duty of registered investment advisers but
9 are also subject to very high standards and
10 suitability and supervision under FINRA regs when
11 they're selling variable annuities.
12 MR. PIACENTINI: Okay. And your testimony
13 also referenced the reforms in the United Kingdom,
14 what they call the retail distribution review, and the
15 potential that that may have caused what some people
16 have called an advice gap, that smaller savers may not
17 be as served as they were before.
18 You know, the RDR is something we've paid
19 close attention to. You mentioned that there's a new
20 review that's being undertaken, and we're very
21 interested in that. There have been a lot of reviews
22 that have been ongoing of that. We've been following
23 them pretty closely.
24 So, you know, I think one of the questions
25 for us is how do we draw lessons from that, and there

1 are similarities and there are differences. For
2 example, in the UK, I think that the abuses that they
3 were dealing with were very large and very pervasive,
4 maybe a different kind than we find evidence of here
5 that might have led you to expect that there would be
6 a different kind of market disruption following
7 reform.
8 We've been told by the regulators there that
9 disclosure as a solution was tried and didn't work.
10 The reforms that they undertook were very different.
11 They banned commissions, and they raised qualification
12 levels. And at least some of the reviews that I've
13 heard suggested that advisers who are closer to
14 retirement were inclined to drop out because of the
15 qualification levels more than a change in
16 compensation.
17 Advisor numbers did fall but rebounded at
18 least some. It also seems that in the UK there have
19 been other reforms that might affect the demand for
20 advice. There are, you know, new sort of default
21 savings programs in place that give people a different
22 way to prepare for retirement.
23 To the extent that some small savers are
24 less taking advice now, some of the reviews have
25 suggested that some of that might be the increased fee

1 transparency, and this came up in other testimony,
2 that people maybe didn't realize before what they were
3 paying for advice. So I wonder, do you have a view in
4 light of that, are there particular ways we should
5 draw or not draw lessons for the U.S.?
6 MR. WILKERSON: Yes. And I concur with your
7 point that it was not a four square identical
8 regulation, but the lessons of less advice to small
9 and moderate savers is unequivocal, and that's
10 troubling for the U.S. markets.
11 Small advisers -- excuse me. Small savers
12 very much are in need of advice. They're not certain
13 to do inquiry. Let's take the 2008 market crash where
14 the account values could be dropping rapidly. A less
15 sophisticated, small or moderate advisor might be
16 inclined to panic and to lock in their losses by
17 selling in a down market. If it was a long-term
18 accumulation vehicle, like a variable annuity, where
19 they're going to hold it for 15 or 20 years, that
20 would have been a very poor thing to do.
21 The benefit of an advisor in that
22 circumstance is they would counsel them against
23 locking in their losses and help point them to the
24 fact that they have many cycles to recover and it
25 would be much better not to liquidate their portfolio

1 in a falling market.

2 MR. PIACENTINI: I've become aware that I've

3 exhausted almost all of our time. I want to turn to

4 other panel members.

5 MS. MARES: Mr. Wilkerson, I have a question

6 for you. You talked about the protections from the

7 current regulatory standards, in particular, state

8 standards. And I understand that the NAIC in 2010

9 suggested some model regulation around suitability in

10 annuity transactions. I assume by your nod you're

11 familiar with that.

12 MR. WILKERSON: I am.

13 MS. MARES: Can you talk about how many

14 states have in fact adopted the model regulation?

15 MR. WILKERSON: I can. And you raise a good

16 question.

17 First off, that model regulation was drawn

18 almost identically from the FINRA suitability and

19 supervision standard for variable annuities. There

20 are 37 states, if memory serves correctly, that have

21 it. It begs the question what about the remaining

22 states, and that's not to suggest that those states

23 don't have equivalent provisions.

24 The benchmarks that we had in our materials

25 when we come up with that total tally is states that

1 have the mirror image of the NAIC model. States are
2 independent, and they will vary and add certain
3 different features, but I can say with conviction that
4 the majority of states have essentially the guts of
5 what are in the NAIC suitability and annuity
6 transactions regulation.
7 MS. MARES: So then I have a followup
8 question because in promoting the model regulation,
9 they said it -- NAIC said it was, and I'll quote, "to
10 better protect consumers from inappropriate and
11 abusive marketing practices." I wondered if you could
12 share with us a vision of what those inappropriate and
13 abusive practices were.
14 MR. WILKERSON: I can't speculate as to what
15 was in their mind, but generally what that regulation
16 was designed to do, like FINRA suitability standards,
17 to make sure that the advisor who is recommending a
18 purchase or sale of a security, which would include a
19 variable annuity, variable life insurance, takes into
20 consideration the full range of consumer needs.
21 So that would be their long-term investment
22 objectives, their short-term objectives, their liquid
23 net worth, their other investments and other tax
24 conditions that they may have, so that if there had
25 been some problems with agents who were recommending

1 products that didn't meet those standards, then that
2 regulation should fully address it.
3 I can give you a little bit of historical
4 background. What that regulation initially began with
5 was a senior protection. It was called the senior
6 protection and annuity transactions regulation. And
7 there were legitimate concerns by the NAIC to make
8 sure that senior citizens were getting a proper match
9 of their needs with the product recommendation.
10 ACLI fully supports the NAIC suitability in
11 annuity transaction regulation in all the states and
12 the aggressive prosecution of anybody that crosses a
13 line on those regulations.
14 MS. MARES: Thank you.
15 MR. HAUSER: So we really are about out of
16 time, but I'm going to ask a question anyway. And
17 this is -- and I'm not an economist. I'm not a
18 finance guy. Feel free to tell me that my question
19 makes no sense. But the obligation is then to tell me
20 why it makes no sense.
21 So, Mr. Collins, this is really for you. As
22 I understand one of your key modes of analysis, you
23 said if I -- you looked at essentially the simple
24 average of some category of funds, and you compared
25 that to the weighted average of the returns in that

1 set of funds, and you said, well, the weighted average
2 is better than the simple average. Is that about what
3 the number was?
4 MR. COLLINS: That's one of the comparisons
5 we do, only one, though.
6 MR. HAUSER: Okay. Well, so let me ask
7 about that. I mean, so if you take -- I mean, how
8 many -- putting -- taking this outside of the broker
9 context, if one were to do that kind of comparison in
10 a context where the people receive no advice
11 whatsoever, do you have any view on whether the
12 unadvised investor is likely to be in the fund that on
13 the asset -- you know, whether the asset-weighted
14 number is going to be better or worse than the simple
15 average?
16 MR. COLLINS: Well, look, I can tell you
17 what the data say. I don't think I can answer your
18 question because the data to your answer your question
19 simply aren't available, and I'll tell you why. So,
20 if you look across all funds, weighted averages based
21 on assets or sales will tend to be lower than simple
22 averages. So what that tells you is that investors,
23 however they're getting there to those funds, are
24 putting their money into funds that cost less than the
25 funds that are being offered for sale.

1 Now what you're asking, I think, is can we
2 see, can we say, can we infer from that that RIAs are
3 -- can we infer from that something about RIAs. Well,
4 the answer is yes, but only indirectly. We know the
5 portion that's going into front-load funds because,
6 you know, they're called A shares. We don't know
7 where RIAs are directing investor dollars because, you
8 know, we don't have availability of that account-level
9 data. But I think it's safe to infer that they also
10 are moving investors to lower-cost funds.
11 MR. HAUSER: But I guess that's the question
12 I'm asking. I mean, I wonder why you say that.
13 I mean, if on average -- it seems to me the
14 question would be, well, how would the investor have
15 done, you know, with or without the advice and with or
16 without conflicted advice. I mean, one could imagine
17 a variety of scenarios, but it's quite possible in
18 every single scenario, you know, the investor's going
19 to do better on -- you know, that on an asset-weighted
20 basis the average is going to be better than the
21 simple average.
22 So unless -- so what does that tell us about
23 the nature of the advice or what it did for the
24 investor? I think --
25 MR. COLLINS: Well, again, the question you

1 were raising in the RIA is how did brokers do for
2 their clients. And the suggestions are that they're
3 putting people into high-fee, low-return funds. And
4 so the easiest way to address that question, to simply
5 ask that question, is let's look and see. Did they
6 put people into high-fee, low-cost funds? And the
7 answer, using data from 2007 to 2013, is no.
8 MR. HAUSER: Well, I mean, just to -- and I
9 probably am beating a dead horse a little bit, but I
10 don't know that that's quite correct either. I mean,
11 the point of our regulatory impact analysis is that
12 these conflicts of interest are resulting in a reduced
13 performance over what people would receive if they
14 weren't faced with that conflict.
15 It seems to me, to attack that analysis,
16 you'd have to do something that goes to the conflict
17 being the relevant variable, and you'd have to do a
18 comparison not between a simple and an asset-weighted
19 average but between how the performance is going to
20 vary based on the conflict, wouldn't you? I mean, I'm
21 not an economist.
22 MR. COLLINS: Well, so if what you're asking
23 is -- the best approach, if it were possible to do,
24 would do a head-to-head comparison between how
25 investors are doing with similar characteristics using

1 RIAs or fiduciary advisors versus how they're doing
2 with a broker. The data as far as we know don't exist
3 -- Jonathan has got something to that effect.
4 MR. HAUSER: And I'm not going to stop --
5 MR. COLLINS: But it's for a single plan,
6 admittedly a single plan in New York -- or single plan
7 in California.
8 MR. REUTER: Oregon.
9 MR. COLLINS: Oregon, sorry. A single plan.
10 But, so that would be the best and proper way, I
11 think, to do that. The data is not available, so you
12 in the RIA worked with what's available.
13 And so I think all we're saying is if you
14 work with what you guys were working with, look at
15 more updated data, and try to evaluate the suggestion
16 that was in the RIA, which is that brokers -- and the
17 language is fairly specific: Brokers are putting
18 people into underperforming funds, higher-cost funds.
19 Look at the data for 2007 to 2014, and that's not
20 true.
21 MR. HAUSER: I'm just not hearing that your
22 data tells -- that your mode of analysis tells us
23 anything about whether the investor was actually made
24 better or worse by virtue of the advice the broker was
25 giving in particular.

1 MR. COLLINS: Well, I'd say if that's true
2 of our analysis, it's true of your analysis as well.
3 MR. HAUSER: Okay. Mr. Reuter?
4 MR. REUTER: So just a couple quick points.
5 So the first thing is that Sean is right that once
6 you're in the direct-sold space, it's hard to know
7 whether someone made their own decision or whether a
8 registered investment advisor put them there. And
9 that is a completely fair point.
10 I think the issue that's coming up here is
11 this one of what would people have done if the
12 broker's compensation were different, which I think is
13 the relevant question. What I'm able to do in Oregon
14 is see what happens when a plan changes in such a way
15 that new participants can't use a broker, but old
16 participants could. And there what we find is that
17 what the new participants do is they invest in a
18 target-date fund, which at least over our sample
19 period is lower-fee and higher kind of risk-adjusted
20 return.
21 So that's an example of taking a broker away
22 and then using -- the people basically self-select
23 into the target-date fund, which was chosen by the
24 plan sponsor, the fiduciary, and at least ex poste
25 have done quite well.

1 Also, we look at the people who don't go in
2 the target date fund but we think would have wanted a
3 broker. And in some new analysis, which is over a
4 very limited time period, which is basically 2008-
5 2009, so this is, you know, kind of a particular
6 period obviously, we also find that the people who are
7 not getting advice are doing better, right?
8 So this question of what would people have
9 done otherwise is hugely complicated. The only way we
10 could answer it was to exploit the fact that a plan,
11 because of the Pension Protection Act, basically
12 dropped the provider that offered advice and see what
13 happens afterwards.
14 I would love to run experiments on people,
15 but that's not something that would be nice for the
16 people being experimented on. And in the absence of
17 that, you know, we can't run randomized controlled
18 experiments the way we can in medicine, right? It's
19 different. And so there are limitations.
20 I'm happy to get additional data from people
21 in the financial services industry. I promise to just
22 look at it and see what it says because, frankly, I
23 care more about what it says than -- you know, I just
24 want to write a good paper that I can publish
25 someplace. That's all I care about.

1 (Laughter.)
2 MR. COLLINS: Could I just follow up on
3 Jon's question for just a second? I know we're
4 running very short on time.
5 MR. HAUSER: No. Actually, it turns out we
6 have 'til 10:45, so --
7 MR. COLLINS: Oh, okay. Just to redirect a
8 bit here, I accept everything Jonathan is saying. But
9 again, the question is the relevance for the issue at
10 hand, which is how would people do under a broker
11 model versus how they would do under an RIA or a fee-
12 based model. Their study addresses the question of
13 how would you do with advice versus no advice.
14 Different question.
15 MR. HAUSER: So may I ask -- and I may be
16 trying to get at the exact question. Are you aware
17 of -- well, anybody on the panel. Can you point me to
18 any literature that's either peer-reviewed or not
19 funded by the industry groups or a financial services
20 company that shows better investment outcomes, you
21 know, associated with conflicted advice models?
22 MR. COLLINS: I don't know of any, but I
23 would stand that statement on its head and say just
24 as -- by the same token, I don't know of any studies
25 that show that brokers are putting people into -- you

1 know, providing worse outcomes. You know, as I said
2 at the outset, our understanding is that brokers, just
3 like fee-based advisors, try to do best by their
4 clients because they think that that's how they'll get
5 the most business.
6 MR. HAUSER: And why is the -- I'm sorry,
7 Mr. Wilkerson. You wanted to add something?
8 MR. WILKERSON: I just wanted to answer your
9 question. I too am not aware of any studies, but I
10 too would flip that on its head and say it begs the
11 question are there any studies evaluating whether or
12 not an advisor who charges fees only, no commissions,
13 but assesses a wrap fee year after year after year,
14 and what kind of drain on performance that inflicts on
15 consumers that have made that choice for advice.
16 MR. PIACENTINI: So a lot of this most
17 recent discussion has focused on, you know, should we
18 be comparing fiduciary, fee-based advice to
19 commissioned advice. Is that really -- and there's
20 been some assertions that that really is what we
21 should be doing. And yet I think, you know, what the
22 proposal attempts to do is make it possible to
23 preserve a commission model but with stronger
24 protections to mitigate conflicts so that they don't
25 have the potential to bias advice.

1 And so I would submit that a lot of what we
2 tried to do in the regulatory impact analysis was
3 focus on the question of conflicts. And is there
4 evidence that conflicts are influencing advice, and if
5 so, to what effect that has on investors? And we
6 looked a variety of evidence, including mystery
7 shopper studies, including actual account-based
8 results, including comparisons of funds similar to
9 what's offered in the ICI letter but that was done,
10 you know, by some other authors in different contexts,
11 with somewhat different findings on somewhat older
12 data.
13 So I guess my question is, you know, why is
14 it that a comparison of fee-based and commissioned is
15 the point when what we're I think trying to do in the
16 proposal is find a way to make sure that a
17 commissioned-based model can thrive but without a risk
18 that it will introduce harmful bias. And so that's
19 what we were trying to study. It's a question of bias
20 in --
21 MR. COLLINS: Is that a question for me
22 or --
23 MR. PIACENTINI: For anybody on the panel.
24 MR. COLLINS: Well, so again, I think the
25 first thing is -- and I'm sure you're probably very

1 tired of hearing, you know, people say this, what I'm
2 going to say.
3 MR. PIACENTINI: Right.
4 MR. COLLINS: But, I mean, we support a
5 best-interest principle. So I don't -- again, that's
6 not the issue. The issue is the devil is in the
7 details. How do you get there? And I think there's a
8 lot of concern not just by us but across the industry
9 in general that in the particular details of this
10 particular proposal there's a risk that a number of
11 investors, especially those with small balances, small
12 to moderate incomes, will be shut out of the advice
13 market.
14 So you're trying to control conflicts.
15 Understand that, get that. But the way in which you
16 do that is critical. And if you get the details wrong
17 and you shut people out of the advice market, the
18 examples that we show and we showed in our comment
19 letter show that that could be very costly for society
20 in general. And so I think that's part of our message
21 in our comment letter, is that I think if you get the
22 details right in the regulatory impact analysis, it
23 will help you better understand how to craft a rule
24 that avoids issues like that.
25 MS. MARES: Mr. Collins, I'd like to follow

1 up with that. You said in your oral testimony that
2 the proposed rule forces a move to fee-based accounts.
3 So, first of all, I'd like to take some exception to
4 that because I don't think our rule forces that. And
5 you also just said that you support acting in the
6 customer's best interest.
7 If staying in a commission-based account, as
8 we've heard testimony many times yesterday, is in the
9 customer's best interest, why would you force people
10 to move to fee-based accounts?
11 MR. COLLINS: So again, I think some people,
12 some -- you know, the view is that under the rule as
13 currently structured, some people will undoubtedly
14 migrate from broker-sold funds to fee-based accounts.
15 Some of the people that migrate will undoubtedly pay
16 higher fees than they would pay.
17 One example of that -- and I think you have
18 this in the comment letter -- is what do you do about
19 people that should have been grandfathered, for
20 example, preexisting accounts. Are they knocked out
21 of their preexisting account where they've already
22 paid an A share commission upfront? And let's say
23 they paid that three years ago. Now they're forced
24 into a fee-based account and they've lost that front-
25 load commission. So that's an example of how they

1 could end up paying higher fees.

2 I think the other example -- and again, I
3 think -- be careful. We qualified our statement. We
4 didn't say, "everybody is going to be forced into fee-
5 based accounts and will payer higher fees." I think
6 the general sense in the industry is that some people
7 will be forced to pay higher fees because they will
8 want advice still, and it will be more expensive under
9 a fee-based model because of the relative balances
10 that they have.

11 Now, for certain people, especially more
12 wealthy people, people with higher balances, a fee-
13 based model is absolutely the right way to go. And I
14 think most brokers would probably, depending on what
15 it is you're looking for, most brokers would probably
16 acknowledge that.

17 So I think it depends a lot on your
18 characteristics. And what we're saying is that the
19 characteristics are very important. And in this case,
20 small balance investors, those of modest means, are
21 probably either going to be forced out of the advice
22 market because brokers, fee-based account advisors,
23 just won't find it profitable enough to deal with
24 those investors.

25 So, as an example of that, yesterday one of

1 the panelists said, look, the average account balance
2 in my firm is: for average account balances below
3 $25,000, we put everybody into a broker-based
4 arrangement. The average account balance in his firm
5 I think was $50,000. So in his firm -- and he's a
6 fee-based advisor -- 20 -- everybody with $25,000 or
7 less is still going into a broker-based account.
8 So what happens to those people after the
9 rule? I don't know. I don't think -- he seemed to
10 think that he would be willing to continue to serve
11 those people. I don't know. But I will tell you that
12 our data, ICI's data, about 50 percent of the IRAs
13 have balances of $25,000 or less. So, to the extent
14 that there are fee-based advisors who are unwilling to
15 deal with small accounts like that, they're being
16 dealt with now because they worked pretty well in the
17 broker-based model. Those accounts may simply lose
18 advice.
19 MS. SCHOAR: Can I -- sorry. Can I just
20 quickly comment on this? I think it's exactly right
21 that, you know, very small accounts -- for very small
22 accounts, the relative cost of providing advice is
23 high, right? And as we said before, so Sean is right,
24 that as we said before, no matter how you structure
25 the advice, right, given that brokers' or advisors'

1 time is valuable relative, right, to the size of the
2 account, it's an expensive proposition.
3 I don't think anyone, you know, kind of
4 disagrees with that. I think what, you know, at least
5 I personally would suggest people to really think
6 about is that the advisors' or the brokers' time has
7 to be paid for under either of these models. And in a
8 way, you know, kind of the difference is how this
9 payment is structured. And I feel the more the client
10 actually understands what they're paying for, the more
11 they can evaluate whether the quality of the advice
12 and the service they're getting is in their interest.
13 And I would even -- I would also agree with
14 Sean that maybe a fee structure that is, you know,
15 kind of a yearly or, you know, quarterly wrap might
16 not be so good for people who have a very small
17 account.
18 But we know -- I mean, you know, I have full
19 confidence in the innovativeness of industry, right?
20 I mean, and we have seen models where actually
21 advisors are paid, say, for the hours that they're
22 spending, not for in a continuous way, right? And so
23 that could actually allow even small account holders
24 to get some advice and indeed pay for the advice that
25 they're getting because, again, like we don't expect

1 an industry to work pro bono. That makes no sense
2 either.
3 MR. PIACENTINI: So just quickly I want to
4 apologize for any confusion I caused earlier. I was
5 so accustomed to the one-hour panels before. But the
6 good news is that means that my fellow panelists also
7 will get a chance to ask you some questions.
8 MR. COSBY: Good morning. Thanks for your
9 testimony. We really appreciate it. I had a question
10 for Mr. Reuter. You had talked about some
11 difficulties you had encountered getting data. You
12 cited -- you said that in your Oregon paper that's the
13 only time that you were able to access account-level
14 data to do your analysis. I was just wondering if you
15 could talk a little bit about what your efforts have
16 been to try to obtain this data and what you've
17 encountered in that quest.
18 MR. REUTER: So getting account-level data
19 on broker clients is tough, and if you ask firms,
20 they'll typically say no. The reason we were able to
21 get the data in this particular case is that this
22 relationship was a relationship within a retirement
23 plan in a state in which I happened to be employed at
24 the time. And so we were able to go to talk to people
25 who were basically running the plan and say, look, we

1 know that you're evaluating how the plan is working
2 for participants, that this is motivated partly by the
3 Pension Protection Act, and we'd like to get some data
4 and see what these data say.
5 And so, in their capacity as the plan
6 sponsor, they were able to get us the data and they
7 were able to facilitate the matching. So we got the
8 data for all the financial services providers. They
9 went to Oregon. There was someone there who basically
10 took the Social Security numbers, came up with a way
11 to anonymize them, match them, give us the data.
12 I don't know how that long that process took
13 them, but it was a process that we very much
14 appreciated. And in the interest of full disclosure,
15 the data we got from the provider that worked with the
16 brokers was actually the most comprehensive data we
17 got from anyone. It was not, however, the case that
18 they would let us know who the brokers were. So the
19 one thing they wouldn't tell us was which broker works
20 with which clients. But in terms of, you know, how
21 contributions were working and snapshots, they were
22 kind of the most comprehensive.
23 I am in the process of doing some work with
24 TIAA-CREF. That's, I suppose, public -- it's on my
25 CV -- although it's not really looking at these sorts

1 of questions. They were trying to understand how menu
2 design affects demand for advice within their system.
3 But that's only something I was able to do based on a
4 relationship I formed with them over many years. It's
5 hard. I mean, it's hard to build trust, and it's hard
6 to get legal to sign off on giving academics data
7 honestly.
8 MR. COSBY: Thank you.
9 Ms. Schoar, I wanted to ask you a question
10 about your mystery shopping experiments that you
11 performed. What kind of implications does that have
12 for clients that are looking for advice when there's a
13 market downturn? Do you think that there could be
14 negative implications based on the incentives that the
15 brokers are getting in terms of the advice that
16 they're providing in those circumstances?
17 MS. SCHOAR: So we conducted our first study
18 actually in 2008, and then the follow-on study was
19 done three years later. So the results that I, you
20 know, reported to you were, you know, actually in a
21 market downturn situation or at least going into a
22 downturn. This was the beginning of 2008.
23 You know, just to be very clear, our mystery
24 study, mystery shopper study shows kind of at the
25 point of a client for the first time accessing either

1 broker-advisor the type of advice that they're
2 getting.
3 What we unfortunately cannot see -- and
4 that, you know, goes back to the difficulty of
5 obtaining data -- is now how would this relationship
6 develop over time, right? And would the client, say,
7 with an advisor versus a broker, perform differently
8 in a downturn, right, or an upturn.
9 The one thing I can say -- and, you know, of
10 course, this is extrapolation from our mystery shopper
11 study, though, as I was saying before, right -- by the
12 way, you know, everybody on the panel has already
13 alluded to the fact how difficult it is to know the
14 counter faction of what would have happened had we
15 randomly assigned somebody. At least in this study we
16 actually did randomly assign customer with different
17 mistakes about the market to different brokers and
18 advisors.
19 So at least at the moment of first visit we
20 have a sense of, you know, how brokers and advisors
21 deal with different type of customers.
22 And so the one thing that we see or what we
23 found is that customers who have what people call
24 return-chasing biases -- which means, you know, kind
25 of that you look at the past performance of an

1 industry or even a stock and, you know, you buy into a
2 stock that performs very well, which is a very well
3 documented bias that retail customers have, and which
4 has been shown in study after study to have very bad,
5 you know, return for customers -- that is something
6 that actually especially the brokers actively
7 supported.
8 And, you know, in a way, it's because in the
9 commission model it makes it easier to kind of sell
10 different stocks to people, especially when
11 performance of a stock or an industry changes.
12 MR. COSBY: Thank you.
13 And my final question is directed to Mr.
14 Wilkerson and Mr. Collins. Mr. Reuter brought up in
15 his testimony the important question of whether
16 conflicted advice is better than no advice. And
17 implicit in your testimony seems to be that access to
18 advice for small savers could be cut off. It seems
19 like their research is indicating that some of these
20 small savers are detrimentally affected by conflicts.
21 So my question to you is, is conflicted advice better
22 than no advice in your opinion?
23 MR. WILKERSON: I think no advice is very
24 detrimental to small and moderate savers. They need
25 advice. And so maybe I wouldn't use the word

1 conflicted, but people that have variable compensation
2 or commissions, left to their own decisions -- for
3 example, in the 2008 market crash, people could have
4 made very poor decisions that were detrimental to
5 their long-term retirement security.
6 MR. COLLINS: I think what I would say is
7 that it sounds like the question is should we force
8 people in low-income, moderate-income brackets, low-
9 balance funds, into a no-advice situation. And I
10 think our view would be better to let them have the
11 choice because they're the ones that know their
12 circumstances best. So the rule as currently
13 structured we think precludes that, and it would be
14 better to let them have a choice.
15 MR. HAUSER: I wonder, though, if there
16 isn't something a little -- I mean, I wonder if that
17 really is a choice issue in a way.
18 I mean, if you go back to a comment
19 Professor Schoar made, I mean, folks are paying for
20 this advice. They're paying for it in the form of the
21 money that's coming out of the investment that they're
22 making. That's not terrifically visible to them.
23 And presumably, if that's enough money to
24 get a broker to render this service, one could just as
25 easily, you know, enter into an arrangement with a

1 customer to say, "here is how much I'm going to
2 charge, it's going to be upfront, and I'll put you in
3 whatever is best for you." That's completely
4 unconflicted. It's completely transparent. You would
5 have no need of a prohibited transaction rule or
6 special conditions or anything.
7 But I gather that the concern is that a
8 customer confronted with that might choose -- I mean,
9 I guess I'm wondering if it isn't fear of choice, that
10 the customer would choose not to take that advice if
11 they were told, look, there really isn't a no-fee
12 option. I mean, one way or another you're going to
13 pay a fee. Are you willing to pay this fee for
14 advice? I mean, first off, what do you think of that
15 characterization? And second, how should I think
16 about that problem?
17 MR. COLLINS: First off, I don't think that
18 characterization is correct. If you're in an A share,
19 a broker puts you into an A share, you know upfront
20 what you're paying. They tell you. They show you the
21 fee schedule. The fee schedule of the front-load fee
22 has to be disclosed in the prospectus. So that's just
23 an improper characterization.
24 Now there is -- you know, with an A share,
25 normally you'd have a 25 basis point 12(b)(1) fee.

1 But you could also have the same kind of a fee on a
2 no-load fund. You could have one on a retirement -- I
3 think it's probably an R1 share or maybe -- oh, I'm
4 sorry, R6 or R5 share, where there's a 25 basis-point
5 12(b)(1) fee.
6 So I think that's not a correct comparison.
7 Again, I think the issue that you're asking about is
8 are people better off with advice or not. Should
9 people pay for advice or not? And personally I think
10 the best answer to that question is it's best to leave
11 that decision to the individual in conjunction perhaps
12 with an advisor because they're the people that know
13 best their circumstances in their entirety. And if
14 you force people into certain situations, that may not
15 be the best outcome for them.
16 Personally, if somebody told me I couldn't
17 use a broker and I wanted to use a broker, that
18 would -- you know, that would constrain my choices,
19 and I wouldn't necessarily appreciate that.
20 MR. HAUSER: Yes, Mr. Wilkerson.
21 MR. WILKERSON: Let me just answer your
22 question. I'll follow on Sean's comment. We support
23 full disclosure of all fees and charges. We worked
24 with the SEC and FINRA to come up with a very clear
25 point of sale document that was user-friendly, plain

1 English, streamlined disclosure so people could make
2 those choices and comparisons.
3 I also wanted to differentiate your
4 question. You said is there one of the problems that
5 there isn't a choice for no commission. And it
6 differentiates, say, the purchase of a load mutual
7 fund. So you buy 100 shares, and on your confirmation
8 statement, it says you bought 100 shares, and here is
9 what the commission was that you paid.
10 If you contrast that with an annuity sale,
11 no commission comes out of the customer's pocket
12 immediately. The life company fronts the commission
13 to the sales agent at the outset. There is a
14 surrender charge that if the customer leaves his long-
15 term accumulation vehicle before the seven-year
16 period, they will be assessed a downgraded surrender
17 fee to recoup what the life company invested in
18 funding the commission to the sales agent.
19 But if the customer bought it for the right
20 reason, holds it for the long haul, they never pay a
21 commission. So the option that you pose, is there a
22 fear of no commission, that's a very viable option in
23 the sale of insurance products.
24 MR. HAUSER: So I think we've come to an
25 end. I mean, I would just like to reiterate, you

1 know, a point that was made in the discussion between
2 you and Mr. Piacentini, which is that our goal is in
3 fact to preserve both of these models, I mean, not to
4 force people, you know, in or out of a particular
5 model.
6 And, of course, there isn't a mandate
7 anywhere in the rule that people choose one option or
8 the other, that, in fact, what we're trying to
9 structure here is an arrangement that permits a
10 commission-based model but does it in a way that tamps
11 down the effect of conflicts of interest.
12 What I'm hoping is as we continue these
13 discussions we'll figure out the best way to achieve
14 that goal.
15 MR. COLLINS: I think that's what we're
16 hoping as well, and we stand ready to help. And I
17 think that, you know, again, our suggestion is go back
18 and revisit the RIA, and hopefully that will help you
19 in that process.
20 MR. HAUSER: All right. Thank you very
21 much.
22 ALL: Thank you.
23 MR. HAUSER: The next panel.
24 (Pause.)
25 MR. HAUSER: Okay. We'll get started again

1 in just a moment.
2 (Pause.)
3 MR. HAUSER: Okay. Mr. Bird, whenever
4 you're settled.
5 (Pause.)
6 MR. BIRD: Good morning. I'm Ron Bird. I
7 am the senior regulatory economist at the U.S. Chamber
8 of Commerce.
9 I'm glad to be back here in the Labor
10 Department, amongst familiar faces, old friends. I
11 used to work here in the Office of the Assistant
12 Secretary for Policy, and where I had the pleasure to
13 review and draft many a regulatory proposal from all
14 of the agencies. And I used to be also for many years
15 a federal contract economist who did regulatory impact
16 analysis support work for a number of the agencies in
17 this Department and the Energy Department and EPA and
18 so forth.
19 I'm here on behalf of the U.S. Chamber of
20 Commerce and our members. And my approach here is not
21 to address the pros and cons of some of the issues,
22 for example, that the previous panel addressed very
23 competently. I'm here to look at the regulatory
24 analysis process and the regulatory decision-making
25 process as a process.

1 My question is not did you come to the right
2 answer or the wrong answer. Did you come to the
3 answer that you've gotten by the right process? And
4 could your answer therefore have been made more
5 credible, more reliable, and certain if you had
6 addressed the process in certain other ways?
7 And I've developed these kind of structures
8 from my own perspective, but this involves input from
9 member companies at the Chamber, all of whom are
10 committed to the basic principle that regulatory
11 decisions on any subject should be based on sound,
12 scientific, and statistical and economic evidence.
13 And here I'm addressing the adequacy of the regulatory
14 economic analysis that's presented as the basis for
15 the specific proposal that is here and the proposed
16 PTEs in your notice of proposed rulemaking.
17 Now, Executive Order 12866 and Executive
18 Order for President Obama's more recent executive
19 order, 1213563, form a basis, a referential basis, for
20 a lot of what I will say here.
21 But I'm not just speaking to the specifics
22 of the executive orders. These executive orders
23 reflect also a sort of codification of what I think is
24 good common sense, what has evolved over many years
25 among economists, among public policy analysts, as an

1 appropriate way to approach the important duties of
2 making regulatory decisions.
3 In particular, EO 12866, which provides the
4 framework that all executive agencies are supposed to
5 follow, was I think conceived in the 1970s and the
6 1980s in part as a bulwark against the charge of
7 arbitrary and capricious rulemaking. And this
8 framework provided by Executive Order 12866 and
9 further strengthened by President Obama's 13563
10 executive order, was designed to ensure that
11 rulemaking decisions were made on the basis of
12 demonstrated evidence, and that the reasoning
13 underlying a decision was well-documented, and in fact
14 could be replicated by an objective observer.
15 Rather than add -- and I've been around the
16 rulemaking business for a long time, and I know that
17 there are time pressures and there are budget
18 pressures and all of these things. And I have heard
19 -- I have heard some of you, and years ago, complain
20 about the burden of having to go through all of this
21 detail required by the executive orders.
22 MR. HAUSER: None of us, surely.
23 MR. BIRD: Oh, it wasn't you, Tim. I swear
24 it wasn't you. And it wasn't Joe. And so maybe it
25 wasn't anybody up here. But it was somebody. I've

1 heard this in this building. Okay. I will absolve
2 you two of any of that. Thank you. I think you
3 understand this.
4 But what I want to say is that in fact
5 rather than adding a burden to regulators, to your
6 job, I think the requirements really are liberating
7 for you because they should be seen as a means of
8 protecting the agency from charges of arbitrary and
9 capricious action, and also of protecting yourselves.
10 Most of you, you know, are career civil servants.
11 You're dedicated to serving the public interest.
12 I remember the first time I walked into this
13 building and took a government job. I had to raise my
14 right hand and swear to uphold the Constitution of the
15 United States. And that's a solemn oath, and
16 actually, especially for the career civil servants as
17 well as those who are here only for a time. The
18 executive orders protect your professional integrity,
19 to do the job the right way, which I know is what
20 everybody really wants to do.
21 And I think if an agency diligently follows
22 the requirements and the intent of the executive
23 orders by making regulatory decisions based on
24 rigorous regulatory impact analysis, the risk of cost
25 of litigation, the risk of attendant delay, and

1 actually getting the job done that needs to be done
2 for the public interest, those risks are reduced if
3 you do the job right.
4 Now, our examination of the regulatory
5 impact analysis has found a number of significant -- I
6 think significant flaws, and I think flaws that you
7 can correct. And frankly, I hope that before you
8 proceed to a final rulemaking, even if -- you know,
9 whether you're proposing a -- in the final, you go
10 with this proposed approach or some other, or
11 whatever. I hope that you will prepare an amended
12 regulatory impact analysis that addresses some of
13 these flaws. Particularly the flaw that I'm going to
14 mention in a minute about failure to fully examine the
15 cost and benefits of alternatives, and present --
16 Before you public a final rule, I would hope
17 that you would publish for public comment the revised
18 regulatory impact analysis. Which should be a
19 document offering alternatives that is the basis for
20 the administrator to make a final decision. And put
21 that out for public comment so that it can be further
22 refined and improved upon.
23 Some of the failures -- I think that you've
24 failed to present an adequately detailed baseline
25 description of need for the regulation and of the

1 entities and transactions and outcomes associated with
2 the rulemaking baseline.
3 I think you really need to go do more field
4 research to describe really what is going on. How
5 many people fit in what box? What boxes give what
6 results? Really describe the context of the field
7 you're operating on because that's important, and then
8 framing properly your questions about the need for the
9 regulation.
10 Another failure is to adequately compare
11 fully benefits and costs of multiple alternatives.
12 And you list some alternatives, sort of as an
13 afterthought at the end of your RIA. The alternatives
14 ought to come up front, and every alternative ought to
15 be fully subjected to cost/benefit analysis. You've
16 done an interesting and fulsome job of looking at some
17 of the elements and so forth of the cost and benefits
18 of your favorite proposal, but what are the costs and
19 benefits of the others?
20 And you've got my comment letter that lists
21 all of these, but I'll just -- I think an important
22 failure is the failure to adequately address the risks
23 of a big change in the environment, in the marketplace
24 that this regulation intends to make. And I think
25 that especially President Obama's executive order

1 gives you a good basis for taking a little different
2 approach there.
3 I mean, you go assess a problem -- and I'm -
4 - this is my last minute -- and you see: here is how
5 things are, and here is how things ideally ought to be
6 over here. And, you know, if we just did A, B, and C,
7 we could just move the world in one fell swoop from
8 its existing flawed and troublesome circumstance to
9 perfection, okay, or at least something a whole lot
10 better.
11 The problem is when you're dealing with
12 something really big like the financial markets -- and
13 first, the financial markets -- you really have to be
14 careful about unintended consequences. And, you know,
15 you are the agent of Leviathan. That's what Hobbes
16 400 years ago called the government. And there is a
17 reason -- that's an appropriate term.
18 A Leviathan is a huge beast, you know. And
19 it can be a force for great good, but its very
20 hugeness brings forth a risk, a risk of while
21 Leviathan can see the danger over the hill, if
22 Leviathan is not careful in running over the hill,
23 Leviathan is going to trample over five or six
24 villages on the way. And you don't want to do that.
25 That's why small steps, incremental steps,

1 in many regulatory contexts -- and I don't know what
2 those steps might be in this one, but in general,
3 small steps, incremental steps are very useful because
4 those marginal, incremental steps actually mimic what
5 the market itself does as it responds to things that
6 it can respond to.
7 And it gives you a protection against those
8 unintended consequences because if you don't -- if you
9 take small steps and then do what President Obama has
10 said you should do, build into your regulatory process
11 a procedure to evaluate after the fact, retrospective
12 analysis, to evaluate what you've done, and then say,
13 okay, is this having an effect. Do we need to go
14 further? Do we need to back off? Do we need to
15 adjust?
16 You can achieve getting from here to the
17 ideal over a period of time it may take years. It
18 could take a decade or even two. But, hey, this
19 country has been around for over 200 years, and we
20 plan to be around for a lot longer, toward a more
21 perfect government, a more perfect society. We move
22 incrementally.
23 So if you adopted more incremental
24 approaches rather than a fell swoop, that would be --
25 would be perhaps a prudent approach that would --

1 okay. I'll conclude here because my time is up, and
2 there are a lot of other things I would be happy to
3 talk about. I wish we had more time. And I hope
4 somebody is going to ask me the question that is there
5 -- have I ever met a regulation impact analysis that I
6 liked.
7 MR. HAUSER: Well, was it this one?
8 (Laughter.)
9 MR. BIRD: Well, okay. So that --
10 (Simultaneous comments.)
11 MR. HAUSER: I mean, at the risk of -- and
12 let me just -- let me just say, we will -- this is a
13 -- this panel has a little more time than most. So I
14 hope I didn't lose my credibility with any speakers to
15 come. We really do want people to stick to the ten
16 minutes. But I was a little intimidated that I'd be
17 seen as an overbearing Leviathan if I tried to stop
18 you.
19 (Laughter.)
20 MR. BIRD: You're the agent of Leviathan.
21 (Simultaneous comments.)
22 MR. BIRD: The metaphor of Leviathan is not
23 a pejorative thing. In fact, Hobbes was promoting the
24 idea of the government as an overweening power to
25 restrain things. But the important -- the thing you

1 get out of -- go back and reread the book, *Leviathan*.
2 The important thing is that that power has to be used
3 with discretion. And sometimes that power is more
4 effective when it's held as a contingency than when
5 it's actually exercised.
6 MS. MARES: Okay. At this point, I'm going
7 to exercise my power. Mr. Cummings.
8 MR. HAUSER: Thank you. A much more
9 effective agent.
10 (Laughter.)
11 MR. CUMMINGS: Already we're off to a more
12 unique tone than I had anticipated. Well, I want to
13 thank the panel for allowing me to speak today. I
14 also want to thank you personally for the time and the
15 effort that you have exerted and will continue to
16 exert in crafting this rule, which is clearly intended
17 to protect American consumers as they prepare for
18 retirement.
19 My name is Benjamin Cummings. I'm an
20 assistant professor of financial planning at St.
21 Joseph's University in Philadelphia, where I also
22 serve as the academic liaison for our CFP board-
23 registered financial planning program. I've also
24 obtained my certified financial planner certification.
25 So although I will echo the thoughts of

1 others who have spoken and written about this issue,
2 the thoughts I express are my own. In a large part, I
3 agree with the proposed rule, although I do see some
4 areas for improvement.
5 I come today out of concern for consumers of
6 individualized advice regarding retirement assets. I
7 also come out of concern especially for seniors, who
8 are especially vulnerable to expensive and complex
9 financial products that can be difficult to reverse.
10 Lastly, I'm also concerned for the taxpayers
11 who forego tax revenues in an effort to encourage
12 individuals to save for retirement through tax-
13 sheltered retirement accounts like 401K plans and
14 IRAs. The intent of these accounts and their
15 favorable tax treatment is to enhance the retirement
16 savings and preparedness of Americans. However,
17 excessive rent extraction can create a significant
18 drain on accumulated assets.
19 At the same time, the financial products
20 available to consumers within these retirement
21 accounts can be complex, and many individuals benefit
22 from the assistance of a financial professional.
23 Yet it's well established that the advice
24 they receive may not be in their best interest, and
25 evidence is widely cited that investors are confused

1 about the duties of care to which financial
2 professionals are held. As these points have been
3 widely discussed, I would like to focus my comments on
4 areas that in my opinion may benefit from additional
5 attention.
6 First, I want to briefly reiterate what
7 others have said and written regarding what I argue is
8 an unfounded claim that the rule will limit access to
9 financial advice for middle-income households. In
10 their comment letter for this proposed rule, the
11 Financial Planning Coalition cites considerable
12 evidence to the contrary.
13 To highlight just one of their examples: in
14 a study of advisors who are personally familiar with
15 operating under a suitability standard and a fiduciary
16 standard, 80 percent report either an increase or at
17 minimum no change in the range of services when
18 operating under a fiduciary standard. This suggests
19 that providers who are willing to operate under a
20 fiduciary standard could -- oh, sorry.
21 To suggest that providers who are willing to
22 operate under a fiduciary standard could not easily
23 fill any potential gap left by advisors who are
24 unwilling to rise to the occasion seems rather naive.
25 Second, I would like to emphasize the

1 importance of incentivizing financial services firms
2 to better align policies, training, and supervisory
3 practices with the interests of their clients. Much
4 emphasis has been given on the need to align the
5 incentives of advisors with the interests of their
6 clients, but less attention has been given to the
7 culture of the firms which employ advisors.
8 Currently, many firms recognize the conflict
9 of interest that exists for their advisors, yet they
10 do little more than disclose those conflicts. For
11 example, in their comment letter related to this rule,
12 the Financial Planning Coalition cites part of a form
13 ADV of a large financial services firm. The form
14 states the firm's advisors have a conflict of interest
15 based on an incentive to recommend investment products
16 based on the compensation received rather than the
17 interests of the client.
18 The Financial Planning Coalition also
19 references the code of conduct of a large insurance
20 firm, which, quote, "states that rather than acting in
21 the client's best interest, advisors must act in the
22 best interests of the firm," end quote. The proposed
23 rule is certainly an attempt to align the incentives,
24 not only of advisors and their clients, but also of
25 firms and the clients of their advisors.

1 To aid firms in the desired direction, I
2 draw from legislation passed by the Washington state
3 legislature in which they define the standard of care
4 for medical professionals as, quote, "that degree of
5 skill, care, and learning possessed at that time by
6 other persons in the same profession," end quote. I
7 emphasize the learning aspect, which is imperative
8 when providing expert advice on complex subjects like
9 medicine.
10 Similarly, I believe that one way financial
11 firms can be incentivized to better align their
12 interests with those of their clients is to provide
13 guidance about the training and educational attainment
14 required of their advisors, especially when they
15 provide advice regarding complex financial products.
16 Too often advisors provide advice about and promote
17 the sale of products that they do not fully understand
18 themselves.
19 If advisors do not fully understand the
20 products they sell, financially unsophisticated
21 clients certainly cannot be expected to make fully
22 informed decisions about such financial products.
23 Most importantly, I question how such an uninformed
24 advisor can act in the best interests of their client.
25 Third, I am concerned about the continued

1 allowance for financial services firms to require
2 mandatory pre-dispute arbitration clauses. In an
3 article in 2010, Arthur Laby, who testified before
4 this panel yesterday, commented, quote, "Unlike court
5 litigation, arbitration generally does not yield a
6 well-reasoned written decision," end quote.
7 According to recent data from FINRA, breach
8 of fiduciary duty is consistently the leading
9 controversy involved in arbitration cases, yet little
10 is divulged about the legitimacy of the claims or the
11 resolutions of the cases.
12 This lack of transparency makes it difficult
13 to identify whether investors achieve some sort of
14 financial restitution as a result of these claims of a
15 breach of fiduciary duty. Allowing firms to require
16 arbitration cases involving breach of fiduciary duty
17 as it relates to registered representatives of a
18 broker-dealer has led to what Laby argues is, quote,
19 "an underdeveloped jurisprudence," end quote.
20 Another concern about mandatory arbitration
21 is that depending on the regulatory regime of the
22 advisor, investors in retirement plans may have access
23 to only one of two rather dissimilar routes to seeking
24 redress for allegations against an advisor, yet few
25 consumers realize the distinction.

1 This spring, the Consumer Financial
2 Protection Bureau did a study on the impact of
3 arbitration cases, and found that, quote, "More than
4 75 percent of consumers surveyed did not know whether
5 they were subject to an arbitration clause in their
6 agreements with their financial service providers, and
7 fewer than 7 percent of those covered by arbitration
8 clauses realized that the clauses restricted their
9 ability to sue in court," end quote.
10 The CFPB study also finds, quote, "no
11 evidence of arbitration clauses leading to lower
12 prices for consumers," end quote. With little
13 evidence of its benefit to investors, I question the
14 value of continuing to allow financial services firms
15 to use mandatory pre-dispute arbitration clauses.
16 To conclude, the main concerns I hope to
17 address today are, number one, claims that the
18 proposed rule will limit access for middle income
19 households to receive individualized advice are
20 unfounded. To the contrary, considerable evidence
21 suggests that services either remain the same or
22 increase under a fiduciary standard.
23 Number two, only educated and well-informed
24 advisors are capable of providing quality advice in
25 the best interests of their clients. Firms need

1 regulatory incentives to properly train and educate
2 their advisors.
3 Number three, allowing firms to continue the
4 use of mandatory pre-dispute arbitration clauses
5 limits the benefits of the proposed rule.
6 Thank you for my comments, and thank you for
7 your time.
8 MR. HAUSER: Thank you.
9 MR. WEBB: Okay. My name is Anthony Webb.
10 I'm a senior research economist at the Center for
11 Retirement Research at Boston College, and the
12 comments are my views rather than those of the Center
13 or Boston College.
14 So thank you for inviting me. It's my
15 pleasure to be here. Since the Employee Retirement
16 Income Security Act was passed in 1974, the retirement
17 savings landscape has been transformed. Nowadays,
18 most private sector workers, if they have a retirement
19 plan, are covered by a 401K, where the participant is
20 responsible for investment allocation and draw-down
21 decisions. Importantly, most DC assets are actually
22 not even in 401K plans. They are in IRAs when
23 investors are not currently accorded ERISA protection.
24 We face a retirement saving crisis.
25 Research by the Center for Retirement Research shows

1 that more than half of working-age households will not
2 be able to maintain their standard of living in
3 retirement. Now, many factors have contributed to the
4 crisis, but high fees and subpar investment returns
5 have played a significant role.
6 Even seemingly small differences in
7 investment returns accumulate to large amounts over
8 time. Some simple math shows that the 1 percentage
9 point annual reduction in investment returns will
10 decrease retirement assets by about one-fifth of
11 retirement.
12 A recent report by the Council of Economic
13 Advisors estimated that conflicted advice decreased
14 investment returns by about 1 percentage point. And
15 there is about 1.7 trillion of assets that were
16 subject to conflicted advice, which gave a loss of
17 about 17 billion a year. To put this number in
18 context, it's between one-quarter and one-third of the
19 tax expenditure on 401Ks and IRAs.
20 I believe that the Council of Economic
21 Advisors' number is in the right ballpark, but
22 possibly a little low for three reasons.
23 So number one, it excludes 401K plans. And
24 many plans are great, but some have high fees and poor
25 investment options.

1 Number two, about 600 billion of the 1.7
2 trillion is invested in variable annuities, where fees
3 can often be much higher than the one percentage
4 point.
5 And number three, it excluded advised assets
6 other than load mutual funds and annuities. And
7 research has shown that investors in brokerage
8 accounts also suffer from conflicted advice.
9 On the other hand, although as the fees have
10 been trending down over the last ten years -- and on
11 balance I think that the one point -- the 17 billion
12 is probably a lower bound estimate. So we have a big
13 problem that needs to be addressed. And we obviously
14 want to address it in the cheapest and least intrusive
15 way.
16 Now, one approach might be to mandate
17 greater disclosure. I have nothing against greater
18 disclosure, but I don't see it working on its own.
19 There have been many academic studies that show low
20 levels of household financial literacy, and it's
21 simply asking too much to expect households to read
22 disclosures, understand them, sort of figure out what
23 action to take, and then implement a decision.
24 So since disclosure won't work, we need
25 regulation. Now, let me say a few words about the

1 structure of the proposed regulation. Now, number
2 one, it replaces the existing five-part test for
3 determining fiduciary status by a new four-part test.
4 The regulations apply this test not only to 401Ks,
5 but also to IRAs and IRA rollovers.
6 Number two, it creates six carveouts. So if
7 you fall in one of the carveouts, you're not deemed to
8 be a fiduciary. And then finally, the regulation
9 creates exemptions, the most important of which is the
10 best interest contract exemption. The BIC exemption
11 allows fiduciaries to receive commissions subject to
12 conditions designed to safeguard investors.
13 Now, I strongly support the new four-part
14 test. The old five-part test was a broken reed, and
15 advisors could easily escape fiduciary status by
16 claiming that there was no mutual understanding that
17 the advice should form the primary basis of the
18 investor's decision.
19 I also strongly support the decision to
20 apply the proposed regulation to both IRAs and
21 rollovers and to IRAs. The bulk of money these days
22 in IRAs is 401K rollovers. So these accounts are
23 really an integral part of the retirement system. On
24 job change, the household's option is often to leave
25 its money in a 401K rather than to roll it over into

1 an IRA. But the problem is advisors have an incentive
2 to recommend a rollover.
3 Under the regulation, advisors would only be
4 able to recommend a rollover when the rollover is in
5 the household's best interest, not when it is merely
6 suitable.
7 Now, while carveouts mostly cover situations
8 in which fiduciary status would not be appropriate, I
9 have the concerns about the carveout for platform
10 providers. Research has shown that mutual fund
11 families acting as trustees for 401K plans favor their
12 own affiliated funds, especially their poorly-
13 performing funds, to the detriment of plan
14 participants. So I would favor eliminating the
15 carveout.
16 As an alternative, the U.S. could either
17 follow UK practice and prohibit platform providers
18 from getting fees, or alternatively create an
19 exemption similar to that applied to broker-dealers.
20 And yet another alternative would be to restrict the
21 carveout to platforms servicing large plans. And the
22 carveout should definitely not be extended to
23 platforms servicing IRAs, where the protections are
24 weaker.
25 I'll now move on to the part of the

1 regulation that has led to the loudest protests from
2 the financial services industry, the BIC exemption.
3 Now, can I start by stating in contrast to
4 what has happened in other countries, this is very
5 much light-touch regulation. The argument could have
6 been made that we should have followed the example of
7 others and eliminated sales commissions altogether.
8 But officials at the DOL had made a judgment call that
9 they could secure their objective through less
10 intrusive regulation, and I support that decision.
11 Now, some parts of the industry argue that
12 the BIC exemption is unworkable and will lead to
13 advisors abandoning large sections of the population
14 and pushing others into more expensive fee-based
15 advice. Now, if you're willing to make really extreme
16 assumptions about the number of people who might lose
17 access to advice and the value of that advice, it is
18 easy to show that the cost of the regulation exceeds
19 the benefits. All you need is an Excel spreadsheet.
20 But these assumptions are simply not
21 credible. We're being asked to believe that returns
22 of the BIC exemption are so burdensome and so onerous
23 that the industry will choose to walk away from 1.7
24 trillion of assets, and perhaps 17 billion of revenue,
25 rather than make an attempt to comply with them.

1 Now, what the industry characterizes as
2 insuperable obstacles are to my mind just minor in
3 course. I'll give you one example. The exemption
4 asks the advisor to disclose the fees on an investment
5 over a holding period. And the industry argues that
6 making such an estimate is impossible because the cost
7 depends on the return and holding period, both of
8 which are unknown, and different companies might be
9 making different assumptions, and any assumptions
10 might conflict with the FINRA guidelines.
11 Now, all of these concerns are valid, but
12 none of these problems are insuperable. One might as
13 an example have a stipulation that companies should
14 use reasonable assumptions. In this, as in other
15 areas, the BIC exemption would benefit from tweaking,
16 but I think that the overall structure is correct.
17 So to summarize, I view the proposed
18 regulation as a carefully crafted attempt to address a
19 serious problem. I think that the DOL has struck a
20 nice balance between doing enough to be reasonably
21 certain of improving conduct, and not doing so much
22 that it limits a consumer's choice as to how they
23 receive advice. And I thank you for your time.
24 MR. HAUSER: Thank you.
25 MR. PIACENTINI: Okay. Thank you to the

1 panel. And I think I will ask questions in reverse
2 order at this time. So to start with Mr. Webb, one of
3 the points made in your written statement, it warns
4 that when households don't understand fees, fees will
5 be inefficiently high. Can you elaborate on that a
6 little bit? What does inefficiently mean in this
7 context, and why is that the case?
8 MR. WEBB: Yeah. So if households were
9 aware of the level of fees --
10 MR. PIACENTINI: Into the microphone.
11 MR. WEBB: Sorry, yes.
12 MR. PIACENTINI: Thank you.
13 MR. WEBB: If households were aware of the
14 level of fees, they would carefully trade off the
15 level of fees versus the level of service and possibly
16 the level of investment performance. Now, if
17 households are unaware of the level of fees, then
18 investment companies have an incentive to increase the
19 level of fees and use the extra fees on advertising to
20 generate new business.
21 The equilibrium will be where the marginal
22 revenue from the extra fee is zero.
23 MR. PIACENTINI: And do you believe that
24 that is the case in the market for investment advice,
25 investment products, today?

1 MR. WEBB: My suspicion is that we have a
2 segmented market, that we have -- we have some people
3 who are aware of the level of fees and go for low-cost
4 funds, and we have other people who aren't aware of
5 fees and go for the highly advertised, heavily
6 marketed, high-cost funds. And only that can explain
7 the coexistence of high-cost and low-cost funds in the
8 market. I don't think it's a function of differences
9 in distribution costs.
10 MR. PIACENTINI: Okay. Let me shift topics
11 a little bit. One more question for you, Mr. Webb.
12 So your testimony says that arguably maybe we should
13 have considered even a more aggressive reform,
14 something closer to what was done in the UK, although
15 you agree with the decision that was made to propose
16 something that you've characterized as a lighter
17 touch.
18 So we've heard some testimony that what has
19 happened in the RDR in the UK maybe resembles Mr.
20 Bird's Leviathan, and that it has had some unintended
21 consequences. But in your view, a more aggressive
22 reform like that in the UK, and in the UK experience
23 so far, has that been on balance positive or negative
24 for consumers?
25 MR. WEBB: Right. So despite the accent,

1 I'm not that familiar with what has been going on in
2 the UK.
3 MR. PIACENTINI: You did mention that in
4 your testimony.
5 MR. WEBB: The UK has faced different and
6 more serious problems.
7 MR. PIACENTINI: Sure.
8 MR. WEBB: My understanding is that it has
9 not led to a mass exodus of advisors. Obviously, it
10 is very early days, and we have to see how things play
11 out. But I have looked at data on the number of
12 advisors. I have looked at the profits of direct
13 sales investment companies. And they seem to have
14 coped relatively well with the reform.
15 MR. PIACENTINI: Okay. Thank you. A couple
16 of questions for Mr. Cummings. So if I understood
17 your testimony correctly, it's your view that under
18 the type of reforms that we have proposed, that
19 impartial and independent advice could be available to
20 middle class investors, that it need be too expensive.
21 Do I understand that?
22 MR. CUMMINGS: Yeah, by all means. I don't
23 think there is anything in the proposal that should
24 suggest that it's going to limit access to advice. I
25 think there is ample evidence of firms that already

1 provide advice under a fiduciary model to these
2 households, and if advisors or unwilling or don't want
3 to step up to that challenge, there are plenty of
4 others that already do provide advice and a fiduciary
5 model that will fill that gap.
6 MR. PIACENTINI: So part of the conversation
7 that we've heard about this topic suggests that some
8 of these market entrants that can provide inexpensive
9 advice are limited to just algorithm-driven robo-
10 advice, and that there is not human contact, and that
11 that might not be adequate or sufficient or even
12 something that some consumers would want to take
13 advantage of.
14 Do you think that affordable advice will be
15 so limited, or can those technologies support models
16 that are broader than just pure robo advice? What is
17 your view on that?
18 MR. CUMMINGS: Well, I think a few things.
19 As it relates to robo-advice, one is that as a teacher
20 of financial planning education, I have a great
21 concern about the future employability of my students.
22 And I have looked to the firms that I believe we're
23 referencing, that they are one of the highest -- one
24 of the largest employers of undergraduate graduates of
25 financial planning education.

1 And so I look to those firms as the future
2 -- the future of our industry in a large sense because
3 they now have designed a model for entry-level
4 positions in financial planning. So really, it seems
5 to me that some of these firms have provided a great
6 innovation in the industry to allow us to shift our
7 onboarding process of new advisors.
8 I mean, we're well aware in the industry
9 that there is a demographic concern of predominantly
10 older advisors providing advice, and that new advisors
11 aren't coming onboard under old business models. And
12 so introducing new business models is actually helping
13 re-energize the industry for younger advisors.
14 So I think on one side, a lot of these
15 advisors actually are providing new job opportunities
16 for students who want to work in financial planning
17 and provide advice. Also, these students are more
18 akin to providing advice digitally or virtually, and
19 so they are okay with having virtual meetings and web
20 conferences.
21 So even though they may not be sitting one-
22 on-one with an advisor, a lot of these robo-advisors
23 aren't just algorithms, but they are actually
24 supporting that with personalized advice, either on
25 the phone or some sort of a web conference.

1 As an aside from the robo-advisors, there
2 are other models out there that are also providing
3 advice through financial planning networks. I think
4 one that easily comes to mind is the XY planning
5 network that is designed specifically to target
6 clients from generation X and generation Y. And these
7 advisors that are part of this network agree to and
8 sign a fiduciary oath, and provide -- they are also
9 included, or include within their practice, some sort
10 of compensation model that is amenable to low and
11 middle income households.
12 So the business model certainly exists, and
13 I think that they can certainly scale to meet any sort
14 of changing demand, and that they are ready and
15 willing to provide fiduciary-level advice.
16 MR. PIACENTINI: Okay. And we've heard in
17 your testimony and in preceding panels that consumers
18 sometimes can't tell whether the advice that they're
19 receiving is potentially conflicted or not, and so
20 forth. You talked about the culture of conflicts or
21 customer interest in some of the firms.
22 So my question is, given that there is this
23 new entry and innovation going on in the market that
24 you've described, is there under the current rules a
25 risk that it could be -- it could become conflicted

1 because of the way that competition has evolved in the
2 past? Is the new model potentially vulnerable to
3 that?
4 MR. CUMMINGS: You know, some comments in
5 response, and I'm not sure if this is getting directly
6 at your question, so feel free --
7 MR. PIACENTINI: Sure.
8 MR. CUMMINGS: -- to clarify if this doesn't
9 address it. One of the concerns that I've had as
10 we've discussed and gone through this process, or
11 heard a lot of these testimonies, is quite honestly
12 any compensation model involves conflicts. And so our
13 objective isn't to remove conflict. It's to minimize
14 conflicts and recognize them when they do exist.
15 I think although I tend to favor a
16 registered investment advisory business model, I think
17 that often they lay claim to the high ethic road of
18 operating under a business model that has no
19 conflicts. And I disagree with that approach, that
20 whenever you're hiring an agent to act on your behalf,
21 that there is inherent in that relationship the
22 possibility for conflicts.
23 So I think what we're intending on this --
24 and I think this is also stresses the importance of
25 the fiduciary standard because what we're saying is

1 regardless of compensation model -- because we can
2 recognize that all compensation models are going to
3 have at least some element of a conflict of interest -
4 - that we need to, because of that inherent conflict
5 of interest in hiring an agent, we need to have a
6 fiduciary model.
7 I don't know if that completely addressed
8 your question, so feel free to clarify.
9 MR. PIACENTINI: That's close enough.
10 MR. WEBB: Okay.
11 MR. PIACENTINI: The last question for you.
12 Your testimony addresses the issue of complexity in
13 products and how that can create challenges for advice
14 and for consumer decision-making. So I guess my
15 question is, if there are potential conflicts in the
16 market, does complexity interact with the degree of
17 risk that might be posed by conflicts, and are there
18 particular products or modes of distribution of
19 products that might raise or lower concerns about the
20 challenges of complexity?
21 MR. CUMMINGS: You know, I think part of the
22 concern that I have regarding the complexity is that
23 often complex products are marketed towards
24 financially unsophisticated consumers. And so rather
25 than these products being purchased or being sought

1 out by a consumer, they're often being pressured and
2 sold by an advisor, so that the impetus of the
3 potential transaction comes from the advisor rather
4 than the consumer.
5 So the consumer is seeking some sort of
6 advice, doesn't know the landscape, and is instead
7 presented with a potentially complex product that they
8 may not fully understand, but because of some element
9 of trust with the advisor, is going to rely or accept
10 the idea that this product is in the best interests of
11 the client.
12 MR. PIACENTINI: And what is causing the
13 advisor to do that?
14 MR. CUMMINGS: I think largely it's their
15 compensation. But even outside of that it's -- yeah,
16 I guess I would say largely compensation is what is
17 driving that. But I think inherent in that could also
18 be some element of the culture that you were talking
19 about as well, that there is -- the concern that I
20 have regarding the culture is as I have sensed in some
21 firms, and not all firms, that there is an element of
22 a desire to provide advice without necessarily seeking
23 out proper education about the products that they're
24 pursuing.
25 MR. PIACENTINI: Okay.

1 MR. CUMMINGS: So part of it could be that
2 because of the compensation model, that then becomes
3 the advisor's driving force without any sort of proper
4 education about the products themselves. And so
5 absent more information on the advisor's side, they're
6 going to pursue what is in their best interest on a
7 compensation basis since they lack or arguably lack
8 the information about the products to make a more
9 informed decision themselves.
10 MR. PIACENTINI: Thank you.
11 A question for Mr. Bird. So I very much
12 appreciate the experience that you bring to the table
13 with, you know, a long experience with regulations and
14 with doing economic impact assessments of regulations.
15 One of the challenges I think that we face, and maybe
16 particularly with respect to financial regulations, is
17 thinking about all of the potential indirect effects.
18 And I think, yeah, that there has been a lot
19 discussed already today about potential unintended
20 negative indirect effects.
21 But I wonder if sometimes there are also
22 unforeseen positive indirect effects of regulations.
23 One of the things that we have trouble
24 predicting is how technology, market entry, and those
25 sorts of things will proceed under a reformed

1 regulatory environment. And I'm thinking -- you
2 mentioned you have experience in environmental
3 regulation, how -- and, you know, you probably know
4 more about this than I do.
5 But, you know, there has been at least some
6 record of environmental regulations where the costs
7 have ended up being lower than had been anticipated by
8 the industry, sometimes I think even than had been
9 anticipated by some of the regulators, that, you know,
10 cap and trade allowances for emissions have ended up
11 falling in price faster than some might have expected
12 because the market was able to adjust in ways that
13 hadn't been foreseen.
14 So I guess my question is, you know, should
15 we be taking account of that in thinking about how
16 advice might be accessible or priced under a
17 regulatory regime that might impose some different
18 constraints around things like incentives.
19 MR. BIRD: I think what you're asking me is,
20 first of all, are there both beneficial as well as
21 costly indirect effects --
22 MR. PIACENTINI: Yes.
23 MR. BIRD: -- and especially you're
24 referring to the technology-driving aspect of some
25 aspirational regulations, particularly out of EPA.

1 And then you're -- but you're also asking how --
2 whether and perhaps how you should take into account
3 those.
4 There -- while it's very true, certainly,
5 that there are unintended consequences in both ways,
6 and you're doing the right thing in thinking about
7 what those might be, I would encourage you in a better
8 revision of your RIA to actually lay those out, what
9 the negative ones and the positive ones might be, and
10 think about it in a systematic way to -- and I know
11 you can't put firm probabilities on it, and this will
12 happen, that will happen.
13 MR. PIACENTINI: Right.
14 MR. BIRD: But if this happens, how would it
15 affect results? If this happens, how would it affect
16 results? Can we postulate relative likelihoods? Can
17 we draw from other examples like you did from the EPA
18 example there? Mentioning that, and if I were reading
19 your RIA critically, as I did, I would mark that, if
20 you had that in there, as a plus.
21 MR. PIACENTINI: Maybe under a heading of
22 uncertainty, to use a term that --
23 MR. BIRD: Yeah, absolutely. And I think --
24 MR. PIACENTINI: -- in the executive order,
25 for example, that you referenced.

1 MR. BIRD: -- one of the real lacks, lacking
2 areas, in your -- the present draft RIA is that you
3 haven't addressed the risks and uncertainties, I
4 think, thoroughly enough.
5 MR. PIACENTINI: So you found a chapter that
6 we dedicated to uncertainty to be not sufficiently --
7 MR. BIRD: It could be better.
8 MR. PIACENTINI: Okay.
9 MR. BIRD: It could be better.
10 MR. PIACENTINI: Thank you.
11 MR. BIRD: It could be better, and I'll be
12 happy to -- and I think I have addressed that somewhat
13 in my comments that you have in writing. But we could
14 -- I could further expand on those if you'd like.
15 MR. PIACENTINI: But it is appropriate that
16 in there we tried to consider both negative and
17 positive --
18 MR. BIRD: Oh, yeah.
19 MR. PIACENTINI: -- potential and
20 foreseeable --
21 MR. BIRD: Absolutely, absolutely,
22 absolutely.
23 MR. PIACENTINI: Thank you.
24 MR. BIRD: And just to take that one step
25 further, though, the -- you can't just rely on good

1 things happening, no more than you can predict with
2 certainty that the bad things will happen.
3 And one way to improve that risk analysis is
4 to back it up with some -- with more research. With
5 more research where you could, for example, go out and
6 conduct an experiment or conduct a survey that begins
7 to provide you with information about what sort of
8 responses actually are likely to certain stimuli. And
9 also, by looking at other -- other rulemakings and
10 other research in other contexts and what that light
11 can spread on that.
12 So those are some ways that could be
13 improved and elaborated, I think, more.
14 MR. PIACENTINI: Thank you.
15 Okay. Other panel members?
16 MR. BERGSTRESSER: Yes. A question for
17 Professor Cummings. You mentioned that you would like
18 to see us or perhaps a regulator incentivize firms to
19 provide training to advisors. And I was just
20 wondering if you could elaborate on specifically how
21 -- I know you probably don't know all of the levers we
22 have, but some -- a little bit more specific on how
23 you would do that.
24 MR. CUMMINGS: You know, largely that was I
25 guess just a plug for the current proposal. I think

1 that by designing regulation that will encourage
2 advisors to act in the best interests of their client,
3 it naturally incentives firms to provide the training
4 that is necessary so that advisors can fulfill that
5 duty.
6 So it was more a roundabout way or a
7 different perspective of a similar article -- or
8 argument. Just to suggest that it's not just the
9 relationship between advisors and the clients that we
10 need to consider, but also the firms. And so this
11 proposal really does help align not just advisors with
12 clients, or the interests of advisors with clients.
13 But it also helps align firms. Because they
14 naturally have an incentive to, rather than word in
15 their code of conduct that their advisors have an
16 incentive to the best interests of the firm, they now
17 have to change their code of conduct and their culture
18 so that their advisors have the incentives to act in
19 the best interests of their clients.
20 So I think in large part this proposal does
21 accomplish that. And then I would leave it largely up
22 to the innovation of the firms to determine how best
23 to implement that. And I just hope that they do take
24 this as an opportunity to better educate and train
25 their advisors.

1 MR. BERGSTRESSER: Thank you.
2 And a question for Mr. Bird. You mentioned
3 doing more research, and one of those possibilities to
4 do more research to explore possible unintended
5 consequences.
6 MR. BIRD: Uh-huh.
7 MR. BERGSTRESSER: One of those
8 possibilities was a survey. And I was wondering if
9 you could elaborate on that, especially who the
10 respondents of the survey might be, and how reliable
11 you think -- or just sort of your vision for what the
12 questions might be and what -- you know, a lot of
13 times with surveys, you have sort of self-reported
14 thoughts about what somebody might do in the future,
15 and what kind of structure you would require for that
16 to sort of be a reliable tool to use in the
17 rulemaking.
18 MR. BIRD: Do we have the rest of the day?
19 (Laughter.)
20 MR. BIRD: Yeah, okay. I understand your
21 question. You're asking about -- you start from the
22 unintended consequences colloquy that Joe and I were
23 having a moment ago. But you're really asking a
24 broader question, I think, about surveys, about the
25 feasibility of surveys, who should be surveyed in this

1 context in particular, ideas for that, and questions
2 to be asked. And I was not joking when I said do you
3 have the rest of the day because there are just --
4 that's a really open question.
5 But let me, in an attempt to be brief, just
6 say a few things about the question of surveys. And I
7 want to also make clear that when I say doing surveys,
8 I'm not just talking about going out and asking people
9 their opinions of things. I'm also talking about
10 going out and asking for factual information about
11 what people do, how they do it, how often they do it,
12 things like -- there are BLS and the Census every
13 month conduct the current population survey.
14 We can put our heads together and design an
15 entire monthly -- an entire supplement for one month
16 of the CPS that would really provide some information
17 here, I think. But it's not just about doing surveys.
18 You can also do experiments. Now, one of the things
19 I brought up in my comments was I have a whole section
20 there where I'm really criticizing you about your cost
21 estimations, where you've made assumptions about how
22 many seconds or minutes or hours this, that, or the
23 other job will take.
24 And I've said, hey, you know, who -- where
25 did this come from? You know, and you don't really

1 have where that came from. And there are all sorts of
2 ways you can do better than just apparently pulling it
3 out of the air or out of your own, frankly, limited --
4 your limited, my limited personal experience.
5 I'll give you an example, 60 hours for the
6 average firm to develop its best-interest contract, 60
7 hours of lawyer time to draw up the template for the
8 best-interest contract exemption. I don't know where
9 you got that. I would like to know. But I could
10 suggest, even without going -- and one thing you can
11 do is go ask lawyers, hey, here is a kind of contract.
12 I want you to fill these, and how many hours would
13 you bill me to do it. Okay. That's sort of a survey
14 approach.
15 Another approach you could take that might
16 be even more feasible and cost effective within your
17 capabilities is to go to your Department of Labor
18 general counsel's office. You know, upstairs. And
19 recruit three or four teams of three lawyers each, and
20 say: "Okay, here is our plan for the best-interest
21 contract, okay, and I want each of you, your teams, to
22 go take whatever amount of time you need, and draw up
23 a draft best-interest contract."
24 And each of your team results be submitted
25 to another panel of lawyers from your general

1 counsel's office and, you know, from your office, to
2 evaluate how good they are, how much they fit what you
3 want, and in the process, though, of the teams drawing
4 up the contracts, they each keep up with their hours.
5 And so you wind up with an experiment, and
6 an experiment that says, well, if you do it this many
7 hours, you get a C grade contract. If you do it with
8 this many hours, you maybe a B grade -- you know,
9 there are some differences. So you would actually
10 have empirical data to deal with. You know, 60 hours
11 out of where? I don't know. I think maybe that's
12 high, maybe that's low. I have no idea.
13 MR. PIACENTINI: So, Mr. Bird, Keith's
14 question reminds me of a question I meant to ask you
15 and forgot, which has to do with one of the surveys
16 that we did rely on, which is a survey not that we
17 conducted, but I think was right on point, that was
18 conducted by the Government Accountability Office.
19 And I mentioned it, I think, in questions
20 with the preceding panel. But GAO a few years back
21 looked at employers' ability to understand and
22 discharge their fiduciary duties under ERISA. So are
23 they, you know, acting appropriately, understanding
24 their obligations in running their employee benefit
25 plans.

1 And they found that employers, particularly
2 small employers, were very hard-pressed to understand
3 and discharge those duties, and that they were
4 particularly hard-pressed to find service providers
5 that they can concretely know were in fact assuming
6 and discharging those responsibilities to help them
7 out. Or sometimes even to be able to discern whether
8 the service providers were, in fact, assuming that
9 status with respect to the plan or not and -- you
10 know, if not, then what that would imply for their own
11 potential liability.
12 Is that the kind of survey that you have in
13 mind that would help us understand needs, and is the
14 potential cost of small employers' difficulty in
15 dealing with that something that we should build into
16 our understanding of the baseline of the current
17 regulatory system?
18 MR. BIRD: Okay. If I understand correctly,
19 you're asking me a couple of questions. Or are you
20 asking me to assess the survey that GAO did several
21 years ago in the reports you referenced?
22 MR. PIACENTINI: Whether that approach, if,
23 you know, surveying employers, asking about --
24 MR. BIRD: The employers, yeah.
25 MR. PIACENTINI: -- their ability to deal

1 with, you know, the relevant regulatory regime --
2 MR. BIRD: And you're also asking me to --
3 the latter part of your question, you're asking me
4 to --
5 MR. PIACENTINI: Should those be the types
6 of costs that we understand as part of the existing
7 baseline --
8 MR. BIRD: Okay.
9 MR. PIACENTINI: -- that currently it costs
10 small employers something to --
11 MR. BIRD: Well, first of all, I have not
12 examined in detail the survey instrument that GAO
13 relied on. So I cannot speak to it in particular
14 detail. I will say, however, that in general, yes,
15 going out and asking questions of the people in the
16 field that are affected by something --
17 MR. PIACENTINI: Okay.
18 MR. BIRD: -- is a great starting point. It
19 may not be the end point, but asking those kind of
20 questions, if you then look at the responses --
21 MR. PIACENTINI: Right.
22 MR. BIRD: -- and actually think about them,
23 then other questions come to mind. That's the great
24 thing about doing research. It's a full-employment
25 program because every piece of research raises

1 questions that lead to more research.
2 MR. PIACENTINI: I understand.
3 MR. BIRD: And, of course, I know obviously
4 you have to at some point make some decision and take
5 some action.
6 MR. PIACENTINI: So let me pick up
7 briefly --
8 MR. BIRD: But -- but if you read carefully
9 what President Obama has directed you to do, he's
10 directing you not to stop the process right there.
11 Once you've made a preliminary, a first step at a
12 regulation or something, keep asking questions. Keep
13 doing research. Go back and evaluate the results of
14 what you've done so that you can say, oh, we went in
15 the wrong direction, we went in the right direction,
16 and things are fine, or we went in the right direction
17 and we didn't go far enough.
18 So it's an iterative process. Knowledge is
19 an iterative process, and you're in the knowledge
20 business.
21 MR. PIACENTINI: Okay. So let me pick up on
22 -- your other suggestion was experiments. And in
23 fact, just in the last panel, we heard of an
24 experimental approach to discern what might be, you
25 know, the benefits or costs for consumers of dealing

1 with advisors in the current regulatory regime. Is
2 that another example --
3 MR. BIRD: And you're talking about
4 Professor Schoar's --
5 MR. PIACENTINI: Yes, I am.
6 MR. BIRD: -- paper. And I have actually
7 read her original paper that was based just on the
8 Boston data.
9 MR. PIACENTINI: Yes.
10 MR. BIRD: And I picked up on the fact that
11 when she was talking, she mentioned New York, too.
12 And I though, I don't remember New York in what I
13 read. And afterwards, I spoke to her a moment. And
14 in fact, there is another paper about to come out
15 where she has expanded on this and has the New York
16 data also. And I'm looking forward to seeing that.
17 MR. PIACENTINI: Okay.
18 MR. BIRD: And, yes, that is the kind of
19 thing. No, you shouldn't just pick up one example of
20 a study and say, oh, we have the answer, this is it.
21 No. That study, her study, is a step in the right
22 direction. But it leaves a lot of unanswered
23 questions. And in fact, one of the questions that's
24 unanswered that occurred to me I proposed to her,
25 standing right there. And she agreed that it was --

1 well, I won't speak for her.

2 But anyway, I posed a question, did you

3 control -- did you control in your comparison between

4 different kinds of advisors and differently-

5 compensated advisors -- "Did you control for the

6 individual advisors within your sample for the

7 variations in their education, in their experience, in

8 their training, and other factors?"

9 And she said she didn't. And she explained

10 -- and now I understand why she didn't. She explained

11 because this was a human subjects experiment. There

12 were certain protocols, and she couldn't go either

13 before or after and ask the people about this followup

14 information.

15 But as she and I were talking, between us it

16 came up -- but there is another way to have done that

17 in that same experimental design that would have the

18 -- have the mystery shopper ask some questions in the

19 course of their programmed interview with the person,

20 with the advisor, some questions about their

21 experience and education and so forth, and that then

22 becomes documented in the record. And then if you --

23 so if you -- yeah, her report, her study, is a good

24 step in the right direction.

25 It's not the definitive result. And in

1 fact, going back and redoing her study or expanding it
2 would provide even more information that would be much
3 better because there is a potential for what we
4 economists call an identification/specification
5 problem in her regression analysis.
6 And that is the -- because she didn't ask
7 that question about the variation in education and
8 training and so forth among the different advisors
9 that were in the sample, then the value of the
10 coefficient on whether you're potentially conflicted
11 or not conflicted variable --
12 MR. PIACENTINI: Okay.
13 MR. BIRD: -- in there may be overstated.
14 And it could be if you had the additional
15 information --
16 MR. PIACENTINI: We're beginning to do a
17 very, very deep dive now on one of the many studies
18 cited in the RIA.
19 MR. BIRD: Yeah.
20 MR. PIACENTINI: So I very much appreciate
21 that input, and I would very much welcome you to
22 submit in whatever detail you want for the record on
23 that. But I do want to make sure we have time for any
24 other panel or this panel comments that might want to
25 follow up.

1 MR. BERGSTRESSER: I just wanted to quickly
2 go back to the surveys that we discussed, and just for
3 the record mention -- because you mentioned
4 potentially using a household survey to get more
5 factual information. So I just wanted to --
6 MR. BIRD: You are going to be on about a
7 five-year waiting list to get a supplement in on that.
8 MR. BERGSTRESSER: Right. And so we did
9 utilize quite a bit of information from the survey of
10 consumer finances.
11 MR. BIRD: Uh-huh.
12 MR. BERGSTRESSER: And I'm sure you're very
13 aware because you did carefully read through our RIA.
14 But I wanted to get that out for the record. And if
15 you had additional thoughts about the --
16 MR. BIRD: Oh, absolutely. I'm not saying
17 you didn't do any survey, or you didn't rely on any
18 surveys. And I think the consumer finance survey is a
19 very useful tool, and you used it, and I think
20 generally appropriately. But there are some questions
21 that just aren't answered by the available standard
22 survey sources that are out there, like the CPS and
23 the consumer finance survey, and the census, and all
24 sorts of other things.
25 Frequently for regulatory purposes, you need

1 very specific, very context-oriented information. And
2 I have to tell you that, you know, I've heard the
3 defense and the complaint. But we can't go out and do
4 those surveys. We don't have the budget. Well,
5 that's a question. Set that aside. And anyway, we
6 have to go through this whole clearance process under
7 the Paperwork Reduction Act to get a clearance from
8 OMB to do a survey, and that just, you know, is a lot
9 of red tape and rigamarole and, well, it's
10 regulations, is what it is.
11 But actually, that doesn't cut it with me.
12 I have experience right there. In 1991, I was doing
13 support work for OSHA on a regulation that was
14 addressing a very imminent public health problem.
15 Okay. This wasn't about just people -- you know, this
16 wasn't about whether or not people are getting 100
17 basis points difference on their rate of return on
18 investments. This was about whether people were
19 living or dying.
20 Okay. And so to get around the OMB
21 clearance problem, we went out and collected what data
22 we could because the regulations at OMB allow an
23 agency to go ask nine questions to a given group of --
24 MR. PIACENTINI: Nine parties.
25 MR. BIRD: Not nine people, asking nine

1 different respondents a set of questions without any
2 clearance. And so in fact what we did on that, we
3 went out -- this was a regulation that affected
4 certain procedures in different industries. Well,
5 I'll tell you. It was the blood-borne pathogens
6 regulation in 19 --
7 MR. PIACENTINI: Needle sticks.
8 MR. BIRD: Yeah, in the late eighties, early
9 nineties. And so it affected doctors' offices,
10 nursing homes, hospitals, funeral homes, police
11 Departments, fire rescue Departments, all sorts of
12 people.
13 So we went out to nine -- selected nine in
14 each category and asked slightly different questions
15 to each nine tailored to their context. So we wound
16 up actually getting 45 or 50 respondents sort of under
17 OMB's radar, and to answer our -- there are ways if
18 you want to --
19 MR. PIACENTINI: I understand.
20 MR. BIRD: If you want to really dig, there
21 are ways. And then we got to analyzing those results.
22 But it turns out -- you know, the results of
23 that initial survey of, you know, how many gloves do
24 you use a day, how many this, what are your -- do you
25 practice this procedure or that, you know, things like

1 that. It didn't give a definitive answer because the
2 answers were kind of all over the place. And so it
3 was decided, you know, we really got to go into the
4 field with a full-field representative sample of all
5 of the doctors' offices, all of the fire and rescue
6 Departments, all the prisons, all the mortuaries, all
7 the hospitals, and so forth in the United States.
8 And so we set about to design a survey and
9 to do the work with the OMB to get the clearance for
10 the survey, and we designed the survey and got it
11 cleared in four months. We took that survey into the
12 field with -- I think it was 5- or 6,000 respondents,
13 and hired a company to call people up and talk to
14 them, and got their responses.
15 And I remember this clearly because after my
16 children opened their Christmas presents on Christmas
17 day 1991 -- and I left my home and went to the office
18 and spent the rest of Christmas day running -- running
19 SPSS progress, compiling the data results for that so
20 that we can get it in. Within a year, we went from
21 start to finish, and we had something that you can
22 rely on.
23 MR. HAUSER: So we're going to need to wrap
24 up this panel. But thank you all very much. And
25 we'll compare notes, you and I, about holiday

1 sacrifice for regulatory projects.
2 (Laughter.)
3 MR. HAUSER: Thank you all very much.
4 MALE VOICE: Thank you.
5 MALE VOICE: Thank you.
6 (Pause.)
7 MR. HAUSER: And now if we could have the
8 next panel, please, Mr. Baily and Mr. Covington. And
9 we just --
10 (Pause.)
11 MR. HAUSER: So I have an announcement.
12 This is kind of akin to, you know, your lights are on
13 and, you know, if you have driver's license such and
14 such. This is somebody left their key at our front
15 table. So if you're missing a key, it's out there.
16 I think this last panel, we just have two
17 sets of witnesses, so do not -- we don't feel obliged
18 to go, you know, to 1:15, but we will if you'd like.
19 MR. BAILY: I stand between you and lunch,
20 right?
21 MR. HAUSER: Hey, well, ERISA is food enough
22 for me, but others --
23 (Laughter.)
24 MR. HAUSER: Mr. Baily, whenever you're
25 ready.

1 MR. BAILY: Okay. I'm ready. Thank you for
2 the opportunity. I'm impressed that you're doing four
3 days of hearings on this. This is pretty grueling for
4 you, and I appreciate the opportunity to talk.
5 The statement that I submitted to you was, I
6 think, going to be a little bit more general than many
7 of the comments that you've gotten that's talking
8 about retirement issues more broadly. I'm not going
9 to try, either here or in that statement, to do a
10 point-by-point discussion of the DOL proposal. I hope
11 the general comments are helpful to you. If not, we
12 can finish quickly.
13 Okay. First statement, I think we have to
14 recognize that the bottom third or bottom 25 percent
15 of the income distribution is going to rely on Social
16 Security for their retirement saving, you know, work
17 with families, maybe what they accumulate in their
18 house, continue to work beyond retirement years.
19 Those folks are not going to save a whole lot. And so
20 it would be nice if they would, but I think the fact
21 is they're not doing so.
22 So we're really talking about the middle and
23 upper middle income levels. The rich get advisors.
24 I'm not sure we need to worry too much about whether
25 those advisors are conflicted or not. If they're

1 rich, they'll be fine in retirement.
2 So it's the lower middle and the upper
3 middle we are most concerned about, making sure that
4 they save enough and get the right kind of advice.
5 And I want to say that based on what I've seen of
6 studies, what I know of friends and anecdotes, a lot
7 of people make bad mistakes about the investments they
8 make.
9 There is a *Wall Street Journal* survey of
10 Nobel Prize-winning economists and what they did with
11 the money, and it was sort of like, oh, my goodness,
12 why did they do that.
13 Okay. So the most important mistakes that
14 people make are, number one, not saving enough;
15 second, withdrawing savings prior to retirement -- and
16 I realize under some circumstances, that may be
17 necessary, but it's basically a bad idea -- taking
18 Social Security benefits too early, which many of my
19 friends have done; not managing tax liabilities
20 effectively; and failing to adequately manage risk in
21 investment choices.
22 And this last item, which I think is often
23 neglected, includes those who are too risk-adverse and
24 choose low return investments, as well as those that
25 are overestimate their own ability to pick stocks and

1 time market movements. These points are discussed in
2 the paper I submitted to DOL in July.
3 I think they do indicate that retirement
4 savers can benefit from good advice, even those with
5 Nobel Prizes perhaps, but certainly for the rest of us
6 and even those with good educations often don't make
7 good decisions.
8 Turning to the market for investment advice,
9 this is one where there is asymmetric information,
10 which is a red flag for an economic market. It's
11 going to be difficult to get optimum outcomes there,
12 certainly not the only such market in the economy.
13 I've had occasion to study the way doctors make
14 decisions.
15 We also know the way lawyers, economists,
16 all kinds of people make decisions. And they are
17 affected by the economic incentives that they face.
18 So I think there is -- it would be very surprising to
19 me if advisors were not impacted by the different fees
20 that they receive.
21 I'm familiar with the CA study. I know the
22 authors of the CA study. I don't know if that amount
23 is right, 100 basis points, but it may be in the right
24 ballpark that that happens.
25 At the same time, I think if you have

1 advice, people who can really encourage increased
2 saving, and help save or select the products and good
3 returns, create adequate diversification, they I think
4 really will make their clients better off. That could
5 be true even if those fees are paid to the advisors.
6 So it's really a question, as I think you've said
7 earlier, of the cost and benefits of this.
8 Okay. The implications of these general
9 comments for the DOL's proposal.
10 First of all, on disclosure -- and I'm a
11 supporter of the idea that we should have much better
12 disclosure. A simple standard form given to all
13 households receiving investment advice that lists the
14 fees that they receive and tries to annunciate the
15 extent to which those fees are affected by the
16 decisions that actually -- excuse me, the
17 recommendations that are made by the advisor. So if
18 the advisor recommends this portfolio rather than
19 portfolio, there should be a statement of how that
20 would affect the advisor's fees.
21 Second, on small savers, I think there is a
22 concern that complying with the rules as you have put
23 them out currently may limit the number of people who
24 have access to advice. I think there is some evidence
25 from the UK that that happened. I know they're in the

1 process of rethinking their proposal there.
2 So I think the DOL, you should be thinking
3 quite hard about how you can simplify and maybe alter
4 your proposal in such a way that you allow business
5 models that can serve small savers to continue to
6 exist, recognizing that there may be some fees, there
7 may be some loss of return, but the saver is made
8 better off anyway if they can get good advice.
9 Obviously, professional standards are important there.
10 The DOL has been arguing that online
11 solutions is a good way to go. And I think obviously
12 over time we're all going to move more to online
13 solutions. So I'm not against that. I do think at
14 this point, though, it's a stretch to say, okay, small
15 savers should use online solutions. I'm sure there
16 are good ones there. There are probably bad ones
17 there.
18 But I also think there is a certain amount
19 of face-to-face or personal interaction that may be
20 needed to guide people to make the right decisions.
21 They don't pull money out. They don't get panicky
22 when the market goes down, and so on.
23 One of the recommendations is that savers
24 use myIRA. That I looked at and did some calculations
25 on. It's a pretty low return option. It's not one

1 that I would personally use or recommend to anybody
2 that I knew. Maybe towards the end of one's life one
3 doesn't want to take any risk. That's a good option.
4 But I think for saving for retirement, if you're 20,
5 30, 40, you would want to take more risk or more
6 diversified portfolio.
7 I think there is some clarifications about
8 education versus advice, and I talk about that in the
9 paper that I submitted. Can advisors give advice
10 without necessarily triggering fiduciary
11 responsibility? And I think again, think about the
12 line between education and advice, and how to
13 discourage advisors from sharing information in a way
14 that leads to future conflicts of interest. So try to
15 standardize maybe some of the information that's
16 provided.
17 And then finally, I mention the implications
18 for risk management. I sort of talked about that
19 already. I think young savers certainly, if you look
20 at the return to equity over the last 200 years, it
21 has been substantially higher than the return to risk-
22 free bonds.
23 We don't know what is going to happen over
24 the next 50 years or 200 years, but certainly it
25 suggests that you would like to have some equities in

1 your retirement portfolio. Maybe for young people, it
2 would be predominantly equities, and then as you reach
3 retirement, you would move more into bonds. Or, well,
4 there is still often a long period from first year of
5 retirement to death.

6 So I think again, getting some good advice
7 -- a target fund often can be a good way to go, which
8 automatically adjusts the portfolio.

9 So finally, I appreciate the DOL's efforts
10 to increase consumer protection in this area. I think
11 in its current form, the proposal might have some
12 undesirable or problematic outcomes, drive advisors
13 away from certain clients. But I think with some
14 thoughtful revisions, I think this rule can be a net
15 benefit. Thank you for listening to me.

16 MR. HAUSER: Mr. Covington.

17 MR. COVINGTON: Great. Good afternoon. My
18 name is Lee Covington. I'm senior vice president and
19 general counsel of the Insured Retirement Institute.
20 I'm joined here by my colleague, Frank O'Connor, who
21 is vice president in charge of our research
22 department. He also spent over ten years at
23 Morningstar as an annuity product and market expert
24 there.

25 IRI is the only national trade association

1 that represents the entire supply chain of the insured
2 retirement income industry. Our members include major
3 life insurers, banks, broker-dealers, and asset
4 management firms, and are represented by over 150,000
5 financial professionals serving 22-1/2 million
6 American households in communities across the country.
7 I appreciate the opportunity to share our
8 perspectives about the impact of the proposal on
9 Americans who use and need guaranteed lifetime income
10 products. And I want to take this opportunity to
11 share particular thanks to the Department, to you, Tim
12 and Judy and your entire time, for meeting with us and
13 our members after the rule was released and prior to
14 this hearing. We found those discussions to be very
15 productive and constructive, so thank you for taking
16 time to do that.
17 The administration, including the DOL, as
18 you know, has done more than any administration before
19 it to increase Americans' access to guaranteed
20 lifetime income. And we know the Department shares
21 our goal of ensuring that this rule does not undermine
22 those efforts. To that end, we provided a detailed
23 comment letter requesting changes to the proposal to
24 adopt a best-interest standard for financial advisors
25 without making it harder or impossible for people to

1 use annuities to plan for a financially secure
2 retirement.
3 Today, I will briefly discuss the benefits
4 that annuities provide, and then I will share some key
5 findings from our study Deloitte and Touche conducted
6 for us on the likely operational and market impacts of
7 the proposal in these highly valued and needed
8 products. In particular, I will explain why we
9 believe the BIC exemption is unworkable for variable
10 annuities, and why PTE 84-24 is the only viable way to
11 continue to make VAs available to the majority of
12 Americans.
13 So the benefits of annuities. As we all
14 know, Americans today are living longer than ever
15 before, with a married couple of 65 years of age
16 having an over 35 percent change of one of the spouses
17 living to be age 95 or older. Access to defined
18 benefit plans we all know have plummeted, and
19 healthcare costs continue to rise.
20 As a result, over 30 million baby boomers
21 and half of Gen Xers are at risk of outliving their
22 savings. Outside Social Security and private
23 pensions, annuities are the only products that can
24 provide guaranteed lifetime income to help retirees
25 ensure they will not outlive their savings.

1 Based on the principle of risk-pulling,
2 annuities enable individuals to shift the uncertainty
3 about how long they will live to an insurance company,
4 who then spreads that risk among all of the annuity
5 owners, all of its annuity owners. In addition,
6 annuities offer a guaranteed feature no other
7 financial product provides, such as insurance
8 guarantees to protect investment values during market
9 downturns, and principal protection in the form of
10 fixed investment options.
11 So here is a real-world example of how these
12 features help consumers during retirement, even in the
13 face of adverse market conditions. A client of one of
14 our member companies retired with about $500,000 in
15 savings, but substantially depleted her assets by
16 2005. Her advisor recommended putting $150,000 into
17 a variable annuity, with a lifetime income guarantee.
18 Her account value dropped by about 20 percent in
19 2008, but her guaranteed monthly payments were not
20 affected because they were guaranteed based on the
21 initial investment, regardless of market performance.
22 As a result, she did not have to make the
23 difficult decision so many others had to make in 2008
24 to either reduce her withdrawals and with that her
25 standard of living, or to maintain her withdrawal

1 amount and run the risk of running out of money.
2 You know, unfortunately, only 1 percent of
3 the more than 50 million Americans participating in
4 employer retirement plans have access to annuities.
5 And I know the Department is working on that, meaning
6 that the only way most retirement savers can obtain
7 guaranteed lifetime is through purchasing annuities in
8 IRA rollovers.
9 Given the benefits of annuity ownership, the
10 four documents ruled the Department should fully
11 evaluate the impact of any rule on the access to
12 guaranteed lifetime income products. These benefits
13 show why the administration's work is to increase
14 access to annuities is so important, and why 13 Senate
15 Democrats sent letters to Secretary Perez last week
16 urging the Department to assure the rule does not
17 negatively impact Americans' access to retirement
18 income products.
19 Unfortunately, the rule proposal as
20 currently written would make it even harder for most
21 Americans to obtain guaranteed lifetime income, but we
22 of course know that that is not the Department's
23 intent.
24 So in this regard, I'm going to focus on the
25 proposed -- proposal to remove variable annuities from

1 PTE 84-24 and instead permit VA sales only through the
2 best interest contract exemption.
3 We believe, based on our internal analysis,
4 feedback from our members, and our Deloitte study, as
5 well as the testimony of several witnesses yesterday,
6 that the BIC is just not feasible for variable
7 annuities, and that the Department should restore VAs
8 to the scope of PTE 84-24.
9 It's important to emphasize at this point
10 that 84-24 already requires financial professionals to
11 charge only reasonable compensation, and the proposal
12 would layer a best-interest standard on top of the
13 existing conditions, which we fully support, as you
14 know.
15 Now, turning back to the BIC, even if the
16 Department adopts our requested changes, including
17 refining the definition of best interest and
18 reasonable compensation, insurers would still have
19 undertake extremely extensive, costly, and time
20 consuming changes to people, processes, and
21 technology, just to determine the applicability of the
22 BIC to particular transactions, not to mention the
23 systems and process changes needed to comply with the
24 complex requirements of the BIC.
25 According to the Deloitte report, these

1 changes would involve massive information technology
2 redesigns and buildouts that would likely take several
3 years to complete. The report also indicates that the
4 necessary systems and process changes to implement the
5 BIC may be economically impractical for some smaller
6 insurers, leading some to exit the retirement
7 business, and thereby reducing consumer choice and
8 access.
9 Moreover, the Deloitte report found that the
10 BIC does not provide sufficient clarity as to the
11 requirements and responsibilities of insurers, making
12 it difficult to fully assess the costs and challenges
13 associated with operationalizing the proposal. Due to
14 this uncertainty, our members are still working to
15 evaluate the exact changes that would be needed, and
16 the cost of those necessary changes.
17 It is instructive, though, to consider the
18 findings of the study conducted by Deloitte for SIFMA,
19 which found that it would cost large and medium
20 broker-dealer firms approximately $5 billion dollars
21 just to put in place the systems necessary to comply
22 with the proposals, and a billion dollars in the
23 aggregate on an annual basis ongoing.
24 Removing VAs from PTE 84-24 would have a
25 significant adverse impact on consumer access to these

1 products. Despite this reality, the Department's
2 regulatory impact analysis did not consider all the
3 challenges of BIC compliance for -- of BIC compliance
4 for insurers. These requirements will ultimately
5 decrease consumer choice regarding lifetime income.
6 We believe the impact of removing VAs from
7 PTE 84-24 far outweigh the potential benefits this
8 change might have. In fact, given that PTE 84-24
9 would include a best interest standard and a
10 reasonable compensation requirement, along with
11 existing SEC and FINRA disclosure requirements that
12 achieve the transparency goals that the Department
13 has, it's unclear exactly what consumer benefit is
14 achieved through this proposed change.
15 Fortunately, there is a simple solution, as
16 I already indicated, if the Department should restore
17 VAs to 84-24. This exemption has been in place for
18 both variable and fixed annuities for over 30 years,
19 in recognition of the fact that all annuities are
20 insurance products that provide guaranteed lifetime
21 income, and by all accounts has effectively protected
22 consumers throughout the past three decades, while at
23 the same time facilitating the sales of all types of
24 annuities.
25 With the addition of a workable best

1 interest standard, we believe it can continue to be a
2 viable path for consumers to access these valuable
3 products while achieving the Department's goal of
4 enhancing consumer protection.
5 So thank you for the opportunity to provide
6 input to help the Department understand how the
7 proposal would inadvertently create new barriers to
8 Americans' access to the only products available in
9 the market that can provide a source of guaranteed
10 lifetime income.
11 Happy to answer questions, and again thank
12 you for the opportunity to be here.
13 MR. PIACENTINI: Okay. Thank you to the
14 panel. I'd like to start with a couple of questions
15 for Mr. Baily. So if I understand your testimony and
16 your comments submitted correctly, you have two
17 concerns. Well, maybe more than two, but let me just
18 mention two. One is that compensation arrangements
19 and economic incentives can influence an advisor's
20 behavior.
21 MR. BAILY: Uh-huh.
22 MR. PIACENTINI: And perhaps do. Another,
23 though, is that too heavy-handed a regulatory approach
24 could compromise access to advice for maybe smaller --
25 I guess you would say lower and middle savers.

1 MR. BAILY: Right.
2 MR. PIACENTINI: So I guess my question is
3 can you comment a little bit on how you would
4 reconcile those two? Is it your view that we would
5 have to tolerate some degree of conflict in order to
6 give access to these lower and middle savers, or
7 should we be seeking, and is there a way, and is our
8 proposal coming close, to mitigating those conflicts,
9 and at the same time preserving access to affordable
10 advice services.
11 MR. BAILY: It's a very good question. I
12 think it's really important that people get good
13 advice. So if it's necessary to face a certain amount
14 of conflict of interest in order to do that, I would
15 do it.
16 MR. PIACENTINI: But is it good advice then,
17 you're selling good advice?
18 MR. BAILY: Provided that's good advice. So
19 there clearly has to be the right fiduciary standard.
20 I also mentioned disclosure, and if the disclosure --
21 I know there is some skepticism about whether
22 disclosure works or not. But I think if you could try
23 to simplify the disclosure, and so that it really
24 says, okay, if you -- if you buy this product, there
25 is going to be a 5 percent load fee, so that every

1 $100 you give me, only 95 goes into the saving
2 account.
3 So I think, you know, my concern is actually
4 that would discourage a lot of people from seeking
5 advice. But, you know, I think they should know that
6 that's the case. And I have maybe more confidence
7 than you guys have in whether that disclosure can help
8 because I don't think you're dealing, as I said, with
9 typically the poorest people in our society.
10 I would -- it would be nice if we could
11 completely eliminate conflicts of interest. And I
12 think there are certainly ways of minimizing it so
13 that if you can -- you know, there are people who are
14 giving advice who are really not conflicted. And
15 actually, if you have a load fee, you pay that
16 upfront, and then after that, the advisor suggests
17 which funds you go into. He or she doesn't
18 necessarily have a conflict there about which fund to
19 go into.
20 So I think there is scope for your
21 regulation to really minimize the amount of conflict
22 that's being faced. And I apologize if I'm not more
23 specific about exactly how you would do that, but I
24 think by a process of a) disclosure, and b), you know,
25 favoring certain kinds of -- trying to avoid those

1 decisions made by advisors that would be the most
2 compromised.
3 MR. PIACENTINI: Okay.
4 MR. BAILY: But I would be willing to settle
5 if you could get good advice for even a little
6 conflict. I sort of feel that's life, and you get
7 that in any field.
8 MR. PIACENTINI: Understood. And I
9 understand your preference for simple disclosure, and
10 the example you gave there was a simple way of
11 describing a one-time, single expense, and
12 compensation to the advisor.
13 But I think that, you know, we're dealing
14 with an environment where often the compensation
15 itself and the expenses themselves are not that
16 simple. There may be a load, but often, unlike the
17 scenario you described, it doesn't -- it isn't
18 determined before you select which fund, right?
19 Different funds will carry different loads.
20 MR. BAILY: Yes.
21 MR. PIACENTINI: And different funds will
22 pay different shares of that load to the advisor. So
23 that it's going to depend. And then there may be
24 other pieces to it. There may be 12B-1 fees. There
25 may be revenue sharing that -- the economic analysis

1 goes into a lot of the different -- so I guess my
2 question is, in the presence of some complexity, is it
3 your view that maybe some sort of a generalized
4 disclosure -- I mean, the kind of disclosures you see
5 now in practice say things like, my fees may vary
6 depending on your decision.
7 You know, we do receive compensation in
8 these various forms from these various products. But
9 they don't tend to get down to the details. Is that
10 effective?
11 MR. BAILY: I would -- no. I would like to
12 see a disclosure that gets down to the details. So I
13 would like to actually have the person receiving the
14 advice --
15 MR. PIACENTINI: But then could that be
16 simple?
17 MR. BAILY: Okay. You can only go so far.
18 So there is a trade-off, all right?
19 MR. PIACENTINI: Sure.
20 MR. BAILY: You're going to make it as
21 simple as you can --
22 MR. PIACENTINI: Right.
23 MR. BAILY: -- consistent with trying to
24 minimize the amount of conflicting incentives facing
25 the advisor. So that's a choice that you have to

1 make. What is the trade-off there?

2 MR. PIACENTINI: Understood. And then I
3 have one other question for you. I don't think you
4 mentioned this in your oral comment, but if I read
5 correctly, it was in your written comment, that it may
6 be that there is such a challenge to make affordable
7 advice available to at least some of the smaller
8 savers that you might want to look for some -- and
9 this is outside the scope of our project right at
10 hand, right? But you may want to look for some way to
11 subsidize it.

12 I think you even mentioned some sort of tax
13 incentive --

14 MR. BAILY: Right.

15 MR. PIACENTINI: -- for the advisor. And so
16 it occurred to me when I read that that in fact there
17 already in some sense a tax subsidy for the advisor
18 because, after all, we're talking here about advice in
19 the context of tax-favored retirement vehicles. Fees
20 are often coming directly out of the retirement
21 savings itself, which carries a tax advantage.

22 So in some sense, the advisors are already
23 receiving the benefit of a tax preference. Do you
24 agree with that? And if so, does that have any
25 bearing on the standard of conduct to which advisors

1 should be held?

2 MR. BAILY: That's a good point, and not one

3 that I recognized in my written comments. And I

4 appreciate your pointing that out. I do think,

5 though, that this is just an enormous challenge that

6 we face. I mean, there is a little bit of a rosy glow

7 in the rearview mirror about how many people actually

8 have defined benefit plans in the old days. It was

9 actually a restricted group. Not everyone had them.

10 But the truth is that, you know, most of

11 those are going away now. And so we've got Social

12 Security, but it's a pretty minimal program. So I

13 think there is this urgent need that we have that

14 people have to save for retirement. And they've got

15 to decide to make that saving, and they've got to

16 invest in a sensible way in order to supplement what

17 they're going to have at retirement.

18 So I'm really sort of looking for anything

19 that will allow the market to provide advice on a

20 broad basis. To the extent that you feel that the tax

21 incentives have already been built into the system,

22 then I think that's great. But it is something that I

23 think should be monitored. And also, we can get the

24 evidence from other countries, not just the UK, of how

25 they have proceeded, and what that has done.

1 I know in many countries in continental
2 Europe, for example, people just put money in savings
3 accounts, and that's okay. But it doesn't get you
4 very far to a retirement fund.
5 I did a study some years ago, was part of a
6 study, that tried to answer the question, Americans
7 save so little compared with, say, Germans or other
8 people, but we're much richer than they are. Now,
9 that's on average. Obviously, that's weighted towards
10 the very rich. But it's still the case that most
11 continental Europeans earn negative real rates of
12 return on their retirement savings.
13 So I think we do need to try to face this
14 challenge and get that advice. And, you know, one
15 could maybe do it on a government program, but I don't
16 know that that's feasible. So we've got to find a way
17 to take advantage of good investment advice and incent
18 (sic) it in the right ways.
19 So that's just sort of my spiel, but --
20 MR. PIACENTINI: Okay. So maybe that's a
21 good segue then to talk about lifetime income products
22 a little bit. You know, I do understand the
23 challenges that have been described by Mr. Baily. And
24 I understand how lifetime income products are, you
25 know, intended to address some of these very difficult

1 problems. But they are difficult problems, and so I
2 think that the approaches themselves carry their own
3 challenges.
4 So from the Deloitte report that you
5 referenced, and which is very helpful -- thank you.
6 One of the things I picked up in the report, it said
7 that one of the reasons why this is challenging for
8 the industry is that compensation and fee data is
9 sometimes fragmented or not captured, and therefore
10 would be costly to collect and integrate. I'm
11 paraphrasing a little bit, but I think that's a
12 reasonable summary of one of the major points in the
13 report.
14 I guess my question is, if that information
15 is fragmented, does that create -- and how does the
16 institution then monitor how all of the different fee
17 and compensation arrangements are influencing what is
18 happening down the distribution channel?
19 And, you know, you said you're in favor of a
20 best interest standard.
21 MR. COVINGTON: Uh-huh.
22 MR. PIACENTINI: But if we don't have data,
23 if the firms themselves don't have the data, how could
24 you see whether these different financial arrangements
25 are in fact in effect being consistent with the best

1 interest conduct by the sales channel?
2 MR. COVINGTON: Uh-huh.
3 Well, I think that what we have to look at
4 first, is the current regulatory scheme and the
5 requirements on insurers that are offering these
6 products that require multiple levels of review to
7 ensure that these products are suitable, both from a
8 state perspective, from a FINRA perspective. You
9 know, these products -- when these transactions occur,
10 I think they may be the only product that has this
11 level of review by both the financial advisor, then by
12 a registered principal.
13 And then there is also red flag reporting
14 that's required, both by FINRA and by state insurance
15 eligibility requirements that require a company to
16 have a system of supervision in place to assure --
17 have reasonable assurance of compliance with the law.
18 Frank, do you have anything to add to that
19 from the Deloitte report?
20 MR. O'CONNOR: Yes. I think just speaking
21 about collecting and cataloging and analyzing the
22 costs and the commissions and things like that. You
23 know, a lot of what was pointed to by the working
24 group that contributed to that report were things like
25 revenue sharing that occur that are not necessarily

1 today split out, and are very difficult to account for
2 at an individual level. That and then the nature of
3 some products is to have those costs actually embedded
4 in the product as opposed to being explicit.
5 So it creates a very challenging system and
6 data collection problems for the companies to deal
7 with.
8 MR. PIACENTINI: So if those costs are not
9 separately captured, how you can monitor what effect
10 or relationship it might have or not with what is
11 going on in a sales channel?
12 MR. O'CONNOR: Well, I think the answer to
13 that is really tied to looking at products in the
14 aggregate. You know, the -- if you think about what
15 the Deloitte report is designed to do and what we
16 asked them to do, was to really put together a working
17 group, have them tell us, or tell us through the
18 report, where they think the challenges are going to
19 be in terms of creating the disclosures that are going
20 to be required.
21 So in that, what we have is a report that
22 details those challenges, but if you're kind of
23 talking then about how do they know, you know, what is
24 going on today, I think that would be really an
25 aggregate, you know, type of thing. So for this

1 product type, you know, these are the costs, and this
2 is what happens, and these are how they sold, how they
3 are sold.
4 MR. COVINGTON: Yeah. I would also add, in
5 terms of the red flag reporting and the system of
6 supervision that's in place at all firms today, that
7 they undertake to look and see if there is a
8 concentration of one product being sold over another.
9 They even get down to the advisor level to see if a
10 particular advisor is selling one product or another.
11 So that's one way that they're monitoring those
12 incentives today and ensuring that suitable
13 recommendations are being made under today's
14 regulatory requirements.
15 MR. PIACENTINI: So it's a monitoring of
16 what is being sold against the suitability standard.
17 But that's not exactly the same as monitoring of --
18 MR. COVINGTON: Well, it's a monitoring of
19 concentration of sales by product. And so I think one
20 of the things if you -- if a supervisor in a firm saw
21 some concentration, they'd be -- they would then
22 follow up and ask questions as to why are you selling
23 this product. Now, many times what they find is there
24 is a particular feature that they use for particular
25 situations that a particular company is providing.

1 But that is something that's an ongoing basis that the
2 compliance systems do detect.
3 MR. PIACENTINI: So let me ask one -- I
4 think it's a related question, but it actually appears
5 as a separate point in the Deloitte report. There is
6 a point made a few pages later that some product fees
7 are difficult to quantify or communicate to customers.
8 And, you know, Mr. Baily made the point earlier that,
9 you know, disclosure perhaps could be helpful if it's
10 simple.
11 So I guess my question is, if Deloitte is
12 documenting that some fees are difficult to quantify
13 or communicate, do you have a view about whether those
14 things can be effectively disclosed to consumers for
15 their use in decision-making? And how is that done?
16 MR. COVINGTON: Well, I think one of the
17 things that the report, the Deloitte report, is
18 talking about fees that are embedded in the product
19 structure. And so those are difficult, and there is
20 questions as to whether those can be disclosed. But
21 if it's embedded in the product in a spread type
22 product, there are challenges around that.
23 Frank, do you have anything to add to that?
24 MR. O'CONNOR: No. You stated --
25 MR. COVINGTON: Yeah.

1 MR. O'CONNOR: Exactly right.
2 MR. COVINGTON: Yeah. So when they talk
3 about that, that's not -- I mean, that's a small -- if
4 you were to look at it in terms of variable annuities
5 versus fixed annuities, you'd see that more on the
6 fixed annuity side.
7 MR. PIACENTINI: So consumers then
8 frequently are sort of challenged with the -- that
9 they need to make a good decision, but they need to
10 make it without complete, detailed understanding,
11 without, you know, available information even on
12 exactly what the fees are and what is attached to
13 which product feature and so forth, because as you
14 said, they're sort of in this spread, and so you can't
15 really --
16 MR. COVINGTON: Well, those are -- I mean,
17 that would be inherent just like in a banking product
18 and any type of fixed product. They can look at the
19 marketplace and see what is available in the
20 marketplace. And financial advisors routinely will
21 see, okay, what fixed rate can I achieve for -- you
22 know, for my client.
23 And so they're really looking at that end
24 result of what is the rate of return that can be
25 garnered through this product, just like a bank CD

1 which you can look at in the open market.
2 MR. PIACENTINI: So would it be fair to say
3 then that the consumer really is relying on the
4 advisor, the sales agent, to help them make a good
5 decision around fees maybe that they can't directly
6 evaluate themselves?
7 MR. COVINGTON: Well, I don't know that I
8 would agree with that, with that characterization.
9 What they'd rely on the advisor to do even their own
10 research is to identify for those types of products
11 what range is available in the marketplace from the
12 return standpoint.
13 MR. PIACENTINI: Okay. Thank you.
14 MR. HAUSER: I had intended to bring the
15 Deloitte report with me, but did not. So let me just
16 go from memory. But my recollection is that -- I
17 mean, Deloitte's role here was really to kind of
18 aggregate and collect the input they got from members
19 of your organization, essentially. And they have a
20 fairly, you know, substantial disclaimer about, you
21 know, that they're just passing along what you got.
22 Nevertheless, your report is very helpful in
23 the sense that it identifies these various processes.
24 But what would be very helpful to us, I think, as we
25 move forward with this project is: to the extent you

1 can actually, you know, provide a little more
2 granularity about what the costs are of the various
3 components of the project and, you know, to the extent
4 there are different views from different firms. If
5 you could give us that.
6 You know, anything you can give us in the
7 way of underlying data and a little more specificity
8 about which feature is costing what would be
9 enormously helpful.
10 MR. COVINGTON: Yeah. We'd be happy to do
11 that. And let me emphasize that, you know, Deloitte
12 did what we asked them to do. You know, their role
13 was to meet with our member companies to start the
14 process of surfacing the details around the
15 operational impacts that our member companies have
16 identified.
17 And, you know, as we started this project,
18 we thought there was no better source for this
19 information than the operational professionals who are
20 charged with developing, billing out, and managing the
21 processes to operationalize the proposal. But, of
22 course, we would be happy to provide, you know, any
23 detailed information around questions that would be
24 helpful to you.
25 MR. HAUSER: So as I understand you, you

1 know, 84-24 as amended would incorporate these kind of
2 fiduciary norms, the best interest standard and the
3 like. And I think if I understand you, you think
4 that's workable. Is that right, for your industry?
5 MR. COVINGTON: Well, I mean, obviously it's
6 a great starting point. I mean, we have comments
7 related to the definition of fiduciary. But in terms
8 of the exemption, we believe that insurers and broker-
9 dealers should be able to operate both under 84-24 and
10 the BIC. So our comment letter does detail requested
11 changes both to 84-24 and to the BIC to address those
12 -- to address both the best interest standard and the
13 reasonable compensation requirement.
14 MR. HAUSER: And as you think about it, what
15 are the big -- you know, the key differences between
16 -- or maybe the key cost drivers as between the BIC
17 exemption and 84-24 that are causing you concern about
18 the feasibility or workability of the BIC exemption?
19 MR. COVINGTON: Yeah, well, there is two
20 parts, right? I mean, there are the regulatory
21 requirements, and as these are blended together in the
22 operational impacts. And so each part of the proposal
23 would impact the operationalizing the proposal.
24 So there are -- obviously, there are parts
25 of it that are related to the fiduciary definition and

1 identifying when somebody becomes a fiduciary. And
2 then there are parts -- obviously the contract
3 requirements, who has to be a part of the contract,
4 when does -- you know, all the issues that we talked
5 about over the last day around the contract, the
6 disclosure requirements, and the challenges related to
7 that.
8 So those are around the -- you know, those
9 are the key requirements from an operational
10 standpoint. From a regulatory standpoint, obviously
11 we talked about the best interest standard without
12 regard to language that is currently in there, and the
13 reasonable compensation requirement that is tied to
14 the value of the services that are provided, but don't
15 take into account the fees that are associated with
16 the guarantees that are provided by variable
17 annuities.
18 And those are -- there are other -- you
19 know, on page 35 through 51, but I would say that
20 those are the major provisions, and in addition, what
21 we see as problems in the current proposal around
22 proprietary products.
23 Again, we know that it was not the
24 Department's intention to forbid or to prohibit
25 commissions on these products. We know that the

1 Department wants to be able to -- wants companies to
2 be able to provide proprietary products, just under
3 the current BIC. It just -- we just -- all the
4 experts who have looked at it have indicated that it
5 doesn't work for commissioned-based products as it's
6 currently drafted.
7 MR. HAUSER: And why is that?
8 MR. COVINGTON: Because of the -- because of
9 the provisions that --
10 MR. HAUSER: One in particular.
11 MR. COVINGTON: Well, one of the provisions,
12 it talks about the level of services that are
13 provided, and all the examples that we see go to fee-
14 leveling. And I know that's not the intent, but
15 that's what the examples say, and there is not enough
16 clarity in the reasonable compensation requirements to
17 give people assurances that commission-based would be
18 permitted.
19 MR. HAUSER: I see. So, you know, maybe
20 echoing a bit a question I asked yesterday of SIFMA,
21 but:
22 Suppose that we resolved your operational
23 concerns about the disclosure issues, data retention,
24 and the like under the BIC, that instead of using the
25 "without regard to" language, we just used the, you

1 know, 404(a) language about exclusive purpose, that we
2 made it completely clear that you can sell proprietary
3 products. And we gave you guidance on what those
4 circumstances would be. You know, that the advice
5 would be prudent, the fees in the aggregate would be
6 reasonable in relationship to the services and the
7 product, you know, being sold, that there is nothing
8 materially misleading in the communications to the
9 customer. That you give full and upfront disclosure
10 about fees and conflicts, and that you don't
11 incentivize your sales force to act in a way that runs
12 contrary to those precepts.
13 And that you put all that in the contract,
14 and that's it, that's the proposal, and that's your
15 only obligation. Essentially execute a -- you can get
16 these commissions, you can get the standard
17 arrangements, but you're going to make a contractual
18 commitment to your customer to adhere to these
19 fiduciary norms.
20 Would that present, you know, significant
21 workability issues? Is that something that would be
22 feasible? And if not, why not?
23 MR. COVINGTON: Well, that's a lot to
24 assume. I certainly think that those concepts -- and
25 concepts are a very good step forward. And we'd be

1 very open to, you know, seeing language around that
2 and determining whether those are workable.
3 One thing I don't know that you mentioned --
4 you may have, Tim, but I may have missed it. And
5 again, maybe you did. But I want to emphasize that
6 the reasonable comp requirement we believe should
7 mirror the reasonable compensation provisions in 84-24
8 to take into account the fees that are associated with
9 the guarantees that are provided by the product.
10 MR. HAUSER: Right. And we -- and nobody
11 should think that we're -- you know, that we don't
12 think you should be able to, you know, price those
13 guarantees and take those into account in making a
14 recommendation.
15 MR. COVINGTON: Yeah. And I'd also note
16 again, conceptually that would be a very big step
17 forward. We'd be very interested in having further
18 discussions with you about how -- what that would look
19 like. There are also comments in our comment letter
20 related to the definition of fiduciary that we believe
21 take into account, you know, more typical marketing
22 service and sales activities, and we detailed those
23 comments. We won't go into detail about those today,
24 though.
25 MS. MARES: So, Lee, I have a question for

1 you. And we were talking about the ability of
2 consumers to understand what they're paying for, what
3 they're buying, in a product like a CD. The terms and
4 conditions of a CD are pretty simple, so you could
5 call up a bunch of banks and say: what are you going
6 to pay me for a three-month, a six-month, and a nine-
7 month.
8 When you look at an annuity, that is a
9 contract where the terms and conditions of the
10 contract may vary. Is there a mechanism in the
11 marketplace today where a consumer can in fact shop,
12 comparison shop, fixed annuity, for example, like they
13 can a CD?
14 MR. COVINGTON: I'm going to refer to Frank
15 on this. I think I know the answer to it, but Frank
16 is probably more authoritative on this.
17 MR. O'CONNOR: Yeah, there are certainly
18 sources for that information, and some of those are
19 web-based, where you can put in an amount that you
20 want to invest and see a series of different fixed
21 annuities and what their current rates are. So there
22 is a fair amount of transparency around that.
23 MS. MARES: And those fixed annuities would
24 have a standard set of terms and conditions?
25 MR. O'CONNOR: Not necessarily a standard

1 set of terms or conditions because the crediting
2 periods may vary, you know, for the guarantee. I
3 shouldn't say the crediting period.
4 The guaranteed rate, you know, may be five
5 years in one product and seven years in another
6 product, or three in another. But when that
7 information is presented, those pieces of information
8 come a long way to that. And then there are even
9 calculations that are done that do something that, for
10 lack of a better phrase, would be called yield-to-
11 surrender.
12 So you know, what is that product going to
13 credit over the period of time that you might have a
14 surrender charge, or over the period of time it was
15 guaranteed, and that levelizes that across products.
16 So those things -- those types of things are
17 out there for comparison.
18 MS. MARES: Thank you.
19 MR. HAUSER: And then two questions, one
20 following up on Judy's, but I'll take that second
21 anyway.
22 The first question is yesterday I asked
23 somebody, maybe Professor Finke -- you know, we had
24 proposed -- we hadn't proposed actually. We had asked
25 whether there was -- would be some value in coming up

1 with some version of a streamlined safe harbor for
2 some, you know, set of products that are fairly
3 simple, that are low-cost. We can't imagine the
4 conflicts of interest are what's driving the
5 recommendation for these products. And nevertheless,
6 they're good investments for people.
7 We had huge operational issues of figuring
8 out how to make that work. But it occurred to me in
9 talking, you know, about these insurance products,
10 would there be some sort of, you know, streamlined
11 safe harbor that one could construct for some
12 particular, you know, lifetime income product that
13 would make sense?
14 You know, if you're offering this particular
15 lifetime income product, if it adheres to these
16 features, you just have an exemption. You don't need
17 to worry about the Department of Labor. You don't
18 need to go through all that -- you know, a lot of the
19 conditions that are available otherwise.
20 Is that something you have thoughts on?
21 Whether that can be made --
22 MR. COVINGTON: That's a question we have
23 not considered. I'd be happy to go back and talk to
24 our members about that. But we haven't had
25 discussions about that.

1 MR. HAUSER: Yeah. It's not necessarily
2 part of this project.
3 MR. COVINGTON: Yeah.
4 MR. HAUSER: But it just strikes me, if we
5 want to encourage savings, and if we want to encourage
6 in particular people to annuitize when they seem to
7 have behavioral, you know, impediments to doing that,
8 that's something worth thinking about. And I'd
9 certainly welcome your advice, if you have some
10 proposals along those lines.
11 MR. COVINGTON: Sure.
12 MR. HAUSER: And then maybe following up on
13 Judy's questions, so would there be some way to
14 construct a meaningful disclosure for the customer
15 benchmarking based on the kind of data sources that,
16 you know, Mr. O'Connor was just describing to Judy, or
17 is that just not doable?
18 MR. O'CONNOR: When you say benchmarking,
19 just to clarify that, so you would think of that as,
20 you know, an aggregation of those -- that type of
21 information --
22 MR. HAUSER: So I'm recommending -- right.
23 I'm recommending this particular product. Here is how
24 it lines on various, you know, salient -- various
25 important attributes compared to, you know, this data

1 source.

2 MR. O'CONNOR: Yeah. It's an interesting
3 suggestion. I think that is probably something I
4 would also want to, you know, understand from our
5 membership how they're, you know, using some of these
6 resources today, to the extent to which they're, you
7 know, folding those into their processes, and see what
8 the feasibility of that would look like. But it's
9 certainly an interesting suggestion.

10 MR. HAUSER: Thank you.

11 MR. COSBY: Excuse me. I had a question for
12 Mr. Baily.

13 You had mentioned the UK experience, and
14 that the UK was reconsidering what they had done. And
15 I was wondering if you had seen there was a Towers
16 Watson report that basically indicated that there is
17 sufficient capacity in the marketplace for investors
18 to be serviced.

19 And Europe Economics also did a report in
20 2014 which showed that, on net, new clients -- there
21 is net increase in new clients that are coming to
22 advisors for the advice. And also the transparency
23 that is contained in the legislation that requires
24 advisors to notify investors about how much they're
25 actually paying for the advice is actually having good

1 results in terms of the marketplaces developing better
2 products, and fees are actually going down.
3 So I just wanted to know what your thoughts
4 were to that. And also, you said that they were
5 reconsidering their proposal, so I was wondering what
6 you were referring to when you said that.
7 MR. BAILY: I worked my way through the very
8 lengthy report on the UK and read a number of
9 critiques of it, was left feeling that I didn't fully
10 understand one way or the other.
11 I thought there were some -- clearly some
12 benefits that had been achieved by the standards by
13 doing the kinds of things that you're describing. I
14 think there was some evidence that there had been a
15 drop in the number of people receiving advice, and
16 that's one of the things I was referring to. So
17 again, I think there were some pluses and minuses.
18 In terms of reconsidering, this is just a
19 news item that I read, that the UK is taking another
20 look. I believe it's the Treasury, but -- and I
21 should have checked before coming in here this
22 morning, but I believe -- this afternoon rather. But
23 I believe that it's sort of taking another look at
24 these proposals and seeing if they need to modify
25 them.

1 But overall, I'm a big fan of learning from
2 what other countries do. And I actually wrote a book
3 some years ago looking at different retirement plans.
4 And it's really interesting to see how they vary, how
5 individuals respond to those variations. And I had
6 mentioned -- by the way, I have avoided talking about
7 annuities because I don't want to give you conflicted
8 advice. I am the director of an insurance company
9 that sells annuities, but -- so you can discount what
10 I'm about to say on that basis.
11 But I would say a) that our annuity products
12 are regulated quite heavily already, in our case by
13 Connecticut and New York. And annuities generally are
14 considered to be a pretty low margin product. So, I
15 mean, maybe there is more efficiencies that can be
16 gained there. But this is a little bit like airlines.
17 People complain about airline fares, but over
18 multiple years, airlines generally have been a money-
19 losing operation. So I don't know that we're going to
20 expect to get much lower fares and still have airlines
21 in business.
22 So I think my perception of the annuity
23 market is that it's one with pretty thin margins. So
24 maybe we can get better annuities. Maybe we can get
25 better disclosure of annuities. But the notion that

1 somehow those aren't going to be -- there is going to
2 get much lower fees would have to deal with the fact
3 that these are low-margin items already.
4 MR. HAUSER: So do you have any thoughts on
5 the idea of coming up with some kind of, you know,
6 special safe harbor for, you know, particularly
7 unconcern-worthy -- I couldn't think of the word --
8 you know, annuity?
9 MR. BAILY: I think that's a proposal that's
10 really well worth looking into, that gives the
11 suppliers a safe harbor. I do think different clients
12 will want different kinds of products, so, you know,
13 we maybe created safe harbors on the mortgage side,
14 and there are pluses and minuses to that. But I think
15 it's probably helpful to have qualified mortgages and
16 so on. So I think that's something that I would
17 support you looking at. I don't know if it's part of
18 your charge.
19 MR. HAUSER: And then everyone can go
20 because this is about a different project. But since
21 you're here, what --
22 MR. BAILY: What are you going to do to
23 interest rates?
24 (Laughter.)
25 MR. HAUSER: No, no. Do you have any

1 thoughts on other ways -- I mean, we get a -- well,
2 the advice we tend to get in connection with this
3 project is the best -- is you should promote savings
4 by permitting lots of conflicted advice. But moving
5 out of that space, do you have any suggestions on
6 other ways we could do a better job of promoting
7 retirement savings or other initiatives we should be
8 thinking about? Big question, and it's okay if you
9 don't --
10 MR. BAILY: It has proven very hard to think
11 of ways to increase savings. I served in the White
12 House under Bill Clinton, and I know Bob Rubin was
13 very frustrated with us economists because we kept
14 telling him this and this proposal probably won't do
15 much to increase savings. So it is a really hard
16 problem to get that, certainly. You know, education I
17 think plays a role, having people understand what they
18 will really need to achieve the goal of having a
19 sufficient cushion.
20 I mean, this may be a little bit off in
21 space, but George Bush proposed privatizing Social
22 Security. In other words, he wanted people to invest
23 in private equities and bonds and hold portfolios.
24 And that fell apart partly because I think it's a bad
25 idea. I don't think we should privatize Social

1 Security, and partly because -- actually, when he went
2 to the investment community, he said, we want you to
3 manage this stuff for 30 basis points, and they all
4 said, no, we can't do that.
5 So but I do think that there might be
6 something that would be a sort of add-on to Social
7 Security, so that those who wanted to, and maybe with
8 an opt-in/opt-out provision, that you would
9 automatically get enrolled in a supplement to Social
10 Security, which would be invested in maybe a bunch of
11 default options on investment.
12 I don't think that's going to happen any
13 time soon, but you're asking me for suggestions, and
14 that was one that I have made in the past.
15 MR. COVINGTON: And, Tim, you won't be
16 surprised that I'll take this opportunity, since you
17 asked the question, we think that the Department
18 should move forward with its rule to require employee
19 benefit -- retirement benefits plans to provide a
20 lifetime income disclosure. And our research shows
21 that --
22 MR. BAILY: Absolutely.
23 MR. COVINGTON: -- investors will -- first
24 of all, 90 percent want that information, 90 percent
25 find it would be helpful, and over 75 percent would

1 increase their savings by 4 percentage points, 4 to 6
2 percentage points, more. So we would encourage the
3 Department to move forward with its rulemaking on
4 that.
5 MR. O'CONNOR: Okay. So I hate to go from
6 the big picture back to the narrow, but this did --
7 some of this conversation brought to mind one piece
8 that I think that I'd like to try to just clarify for
9 the record.
10 And I honestly don't remember whether it was
11 this panel or maybe the ACLI witness from the
12 preceding panel who pointed that, you know, we have
13 surrender charges. But after the surrender period,
14 they said, you know, "the consumer buying doesn't
15 really pay any commission out of pocket, right?" And
16 then after the surrender period, I think there was a
17 representation made, well, then there is -- if you get
18 that far, then there is no commission that you have to
19 pay.
20 And this in some sense was inspired by the
21 reference that annuities are a low-margin business. I
22 mean, part of what is making them a low-margin
23 business is that they have to pay some amount of
24 commission, which may or may not be the efficient
25 level, but that's a part of what is making them a low-

1 margin business, is paying that.
2 But anyway, my narrow question is just I
3 think it's the case that if I hold an annuity past the
4 surrender period, that it may be there is still some
5 margin there that's being thrown off that is helping
6 to defray the commission expenses. That is to say,
7 commissions aren't paid entirely from surrender
8 charges of people who surrender early, are they? I
9 mean, some of it comes from other places.
10 I mean, whether a particular consumer ends
11 up out of pocket for the commission that was paid to
12 their agent sort of depends on a lot of things, right?
13 They may end up -- as in your example, you know,
14 maybe the insurance company lost money on them, right,
15 because they protected them through a downturn.
16 But it's not just a question of the
17 surrender charge, is it? I mean, there are --
18 commissions come out of all sorts of pieces of the
19 annuity, I think.
20 MR. O'CONNOR: Yeah. I mean, that's
21 fundamentally true. You know, a variable annuity has
22 a mortality and expense charge, and a portion of that,
23 a significant portion of that, is actually offsetting
24 the cost to the insurance company --
25 MR. PIACENTINI: And that's an ongoing

1 charge.

2 MR. O'CONNOR: It is an ongoing charge. And

3 that has several purposes. It's called a mortality

4 and expense charge because it covers mortality risk,

5 and it also covers some of the insurance company's

6 expenses, not just commissions, but also

7 administrative work and support, ongoing support

8 provided through call centers or what have you, so --

9 MR. PIACENTINI: Okay. Thank you.

10 MR. HAUSER: Thank you very much.

11 MR. BAILY: Thank you for having us.

12 MR. HAUSER: Thank you.

13 MR. BAILY: We appreciate it.

14 MR. HAUSER: Okay. We're back at when,

15 2:15? 2:15.

16 (Whereupon, at 1:01 p.m., the public meeting

17 in the above-entitled matter was recessed, to

18 reconvene at 2:15 p.m. this same day, Tuesday,

19 August 11, 2015.)

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1 A F T E R N O O N   S E S S I O N

2 (2:15 p.m.)

3 MR. HAUSER: So maybe if I could just repeat
4 a couple of things I said earlier. Most important, if
5 you all could just speak into the microphone, that
6 will make life easier for the people who have to
7 transcribe today's events.

8 We're shooting for ten minutes. If you
9 could stick to that, that would be greatly
10 appreciated. And other than that, if you ready, so
11 are we.

12 Mr. Derbyshire?

13 MR. DERBYSHIRE: Thank you for the
14 opportunity to testify today.

15 My name is Ralph Derbyshire. I'm a senior
16 vice president in the legal department at Fidelity
17 Investments. Fidelity is one of the nation's leading
18 providers of financial services to retirement plans
19 and IRAs, and has a deep and longstanding commitment
20 to working with the Department in areas involving
21 investment education and advice. And personally, just
22 last year, I completed a three-year term in the ERISA
23 Advisory Council, which, as of course you know,
24 assists the Department in its rulemaking efforts.

25 Let me begin by saying that Fidelity fully

1 supports a best interest standard for investment
2 advice. Our concern, however, is that the rule as
3 proposed is unworkable and would prevent firms like
4 Fidelity from providing the assistance that our
5 customers ask for and need in preparing for
6 retirement.
7 In our written comment letter, we've
8 detailed the many reasons why the proposal is
9 unworkable. But given the Department's commitment to
10 move forward on the proposal, I'd like to use my time
11 today to outline a solution that we believe offers a
12 simple, straightforward, and viable alternative. And
13 the solution is directed at two fundamental problems
14 with the rule.
15 The first fundamental problem arises out of
16 the rule's attempt to mitigate all conflicts of
17 interest in the provision of investment advice,
18 including the perfectly normal and acceptable conflict
19 of interest that exists in every commercial
20 relationship between a buyer and a seller. Buyers and
21 sellers are by definition on opposite sides of a
22 transaction, and like every seller, a financial
23 services provider has an inherent conflict with
24 respect to the terms and conditions of its own
25 engagement.

1 This is true even for fee-based advisors,
2 who have an incentive to maximize their fees and who
3 will only receive their fee if they can convince the
4 investor to hire them.
5 So the central problem with the definition
6 of investment advice as proposed is that it fails to
7 take into account this basic concept, and it's so
8 broad that it makes an advisor a fiduciary with
9 respect to the establishment of its own services and
10 compensation. In other words, the definition of
11 fiduciary treats selling as advising. This is both
12 unprecedented as a matter of fiduciary law, and not
13 commercially viable.
14 Secretary Perez has often said that
15 financial advisors should be held to the same best
16 interest standard as doctors, and we fully support
17 that concept. But while the doctor's recommendation
18 of surgery must be made in the patient's best
19 interest, no doctor is required to send the patient to
20 the surgeon down the street simply because the surgeon
21 down the street has more experience or charges less
22 for the same operation. Nor do we require a doctor to
23 lower his or her own fees simply because it would be
24 in the patient's best interest to do so.
25 So we recommend a conceptually simple and

1 straightforward fix. The rule should separate the
2 terms of engagement of the advisor, that is, the
3 components of the relationship established through the
4 sales process, from the investment recommendation that
5 is made within the terms of that fiduciary
6 relationship. This could be accomplished through a
7 simple, plain English disclosure that would be
8 meaningful to investors and have three key features.
9 First, it would have a statement describing
10 the scope of an advisor's services, including the
11 transactions on which it is advising, whether the
12 advice is point-in-time or ongoing, and the range of
13 investment options the advisor will consider in making
14 investment recommendations.
15 Second, it would disclose the compensation
16 payable to the advisor for the types of investment
17 options the advisor might recommend, as well as any
18 other material conflicts of interest.
19 Third, where needed, it could include a link
20 to a website where an investor may obtain more
21 detailed information about the cost of and
22 compensation to related to any recommended
23 investments. Once that relationship is established,
24 all of the advisor's recommendations within that
25 engagement framework then must be in the best interest

1 of the advisor.

2 Under this alternative, all advisors would
3 have to be clear about the scope of their advisory
4 services, compensation, and potential conflicts as a
5 condition of excluding other products and services
6 from the scope of their best interest obligation.
7 This will ensure that every investor understands when
8 the service provider is acting as a seller, and when
9 it is acting as an advisor. With that understanding,
10 an investor can agree to engage the advisor, who will
11 then be required to make investment recommendations
12 that are in the investor's best interest.

13 Now, I know the Department has expressed
14 concern that investors can't distinguish between
15 selling and advising. We disagree. We believe that
16 investors are capable of making that determination
17 where they have clear information about the capacity
18 in which the financial services provider is acting,
19 just as they do in every other commercial transaction
20 they encounter in life.

21 Investors have a reasonable expectation of
22 receiving impartial advice when they are being
23 advised, but they should have no such expectation when
24 they are being sold to.

25 Some commenters, including supporters of the

1 rule, have asked the Department to allow fee-based
2 advisors to engage in selling their own products and
3 services free from fiduciary constraints. And this is
4 actually consistent with our alternative approach.
5 But while these comments would limit the approach to
6 fee-based advisors, there is no logical or principle
7 basis for doing so.
8 Whether an advisor's compensation is
9 transaction-based or fee-based, the advisor must be
10 free to determine the terms of its engagement and,
11 accompanied by appropriate disclosure, persuade the
12 investor that it should enter into an advice
13 relationship under those terms and conditions. That
14 activity is simply not fiduciary in nature.
15 Moreover, if the Department adopts a rule
16 that allows fee-based advisors to establish the terms
17 and conditions and their engagement, but does not
18 apply similar concepts to transaction-based advisors,
19 it would clearly be favoring one business model over
20 another, which will ultimately deny investors choice
21 in how they pay for financial services.
22 I'd like to now turn to the second
23 fundamental problem with the rule that's proposed,
24 which is the prohibited transaction relief. Where an
25 advisor's compensation varies based on the products

1 and services recommended within the engagement
2 framework I've described, a prohibited transaction
3 exemption is still needed.
4 Unfortunately, the exemption structure in
5 the proposal is so burdened with unnecessary
6 restrictions and conditions that it is anything but
7 principles-based and largely unworkable. The problem
8 is easily solved by implementing what the Department
9 said it was aiming to do: create a broad, principles-
10 based approach that provides an exemption for
11 regulated financial institutions that agree to act in
12 the investor's best interest.
13 In fact, the Department, within this very
14 same rule proposal, does follow a true principles-
15 based approach in the form of standards of impartial
16 conduct that are proposed as amendments to several
17 existing exemptions. Those standards should form the
18 basis for the broad principles-based exemption the
19 Department has promised, that is, a commitment to act
20 in the customer's best interest, payment of no more
21 than reasonable compensation, and full disclosure of
22 material conflicts. No other limitations or
23 conditions are needed.
24 Adopting a best interest exemption that
25 mirrors these standards of impartial conduct would

1 eliminate the most burdensome aspects of the BIC
2 exemption with the written contract requirement and
3 the disclosure rules.
4 The proposal to create legal enforceability
5 through a written contract with signatures in the BIC
6 exemption is simply not workable. For example, it
7 would require contracts between thousands of
8 individual representatives and millions of customers
9 and potential customers, including plan participants
10 who do not today have a contractual relationship at
11 all with the plan's service provider.
12 Instead of a written contract, the exemption
13 should allow for the creation of a legally binding
14 commitment established on the basis of the unilateral
15 contract with the customer. And that commitment could
16 in fact be made in connection with disclosure,
17 establishing the terms and conditions of the
18 engagement, as I just described.
19 We also suggest replacing the confusing and
20 extremely burdensome three-part disclosure regime in
21 the proposal with a simplified disclosure consisting
22 of the same terms and conditions of engagement, a
23 general description of the compensation and material
24 conflicts with the advisor, along with a link where
25 appropriate to an investor-focused website including

1 detailed information on all the products and services
2 recommended by the advisor.
3 We believe that the expansive and indeed
4 overwhelming disclosure regime proposed by the
5 Department will obscure the information that's most
6 important to investors, that is, the scope and nature
7 of the advice they're receiving, and how their advisor
8 is being compensated. And this avalanche of
9 information, which will not be useful to investors,
10 would require enormous costs to produce and
11 disseminate.
12 We need to make this rule workable so that
13 we can continue to provide investment assistance to
14 millions of working Americans. And a simple example
15 of a transaction we handle perhaps hundreds of times a
16 day at Fidelity might help illustrate the problem.
17 A newly hired employee, one of our plan
18 sponsored clients -- let's call her Jane -- calls a
19 representative in one of our call centers. Jane tells
20 our representative she'd like to enroll in her
21 company's 401K plan. We ask her how much would you
22 like to contribute. Jane says 6 percent of pay, and
23 we say great. You're going to maximize your company
24 match.
25 We then ask Jane how she'd like her

1 contributions invested, and perhaps begin to describe
2 in general terms the funds in her plan's fund lineup.
3 But before we even get through describing those
4 funds, Jane says, I have no idea what funds to choose,
5 and don't really want to manage my own investments.
6 Today, we would tell Jane she should
7 consider the plan's target-date fund, which would
8 likely be one of Fidelity's Freedom funds. And if
9 Jane agrees that's appropriate for her, she'd complete
10 her enrollment.
11 Under this rule proposal, before we could
12 even mention that Jane consider a Fidelity fund, we'd
13 have to stop the conversation, send her a detailed
14 written contract for signature, and prepare and
15 deliver a point of sale disclosure document for that
16 recommendation.
17 From our experience, we know that if we put
18 those types of barriers in place, many people will
19 simply drop out of the enrollment process and never
20 start contributing to the plan. Unless significant
21 changes are made, this rule as proposed will
22 inevitably reduce retirement savings for millions of
23 low and middle income working families.
24 So I will end where I began. Fidelity
25 supports a best interest standard for investment

1 advice. But we urge the Department to adopt our
2 simpler best interest alternative so that we can
3 continue to meet the needs of America's retirement
4 investors. Thank you.
5 MR. HAUSER: Thank you.
6 Ms. Garrett?
7 MS. GARRETT: I'm very pleased to be here.
8 Thank you for the opportunity. First of all, I'd like
9 to acknowledge the wonderful work that has been done
10 with the Department of Labor and getting this far with
11 the proposal and listening to the feedback and working
12 through this process.
13 I'm also part of the Committee for the
14 Fiduciary Standard, and individuals representing that
15 organization have spoken and will be speaking and
16 testifying over these days. But I wanted to share
17 some of my own thoughts.
18 I'm Sheryl Garrett. I represent the Garrett
19 Planning Network. And I'll go into that possibly a
20 little bit more in detail. But I'm speaking on behalf
21 of my own experiences and my own viewpoints.
22 The current rules that we're dealing with,
23 as everyone knows, were written 40 some years ago, and
24 they have not kept pace with the changing ways that
25 Americans invest and save currently. 401K plans

1 didn't exist back then. IRAs were barely in
2 existence. The transfer of responsibility has shifted
3 to the individual, and therefore making objective
4 advice even more important than ever.
5 Unless the DOL rule is updated and broadened
6 as proposed, many workers and retirees will continue
7 to be vulnerable to conflicted advice from brokers who
8 are not legally obligated to put their clients' best
9 interest first.
10 In a survey conducted by the Financial
11 Planning Coalition, the Consumer Federation of
12 America, and the National Association of State
13 Securities Administrators, they show that 97 percent
14 of investors polled indicated that they believed that
15 anyone rendering advice would put it in their best
16 interest.
17 That's what the individuals expect, but it's
18 not the law of the land. But the American public does
19 not know that. Why should they be responsible for
20 figuring out the different schemes that we have in our
21 regulatory environment. It shouldn't be up to the
22 consumers of financial advice.
23 Americans are paying a heavy price for this.
24 Not everyone, but as was mentioned earlier today,
25 those most affected by the heavier prices are those

1 with more modest means, the folks that I have
2 primarily spent my career working with and focusing
3 on, paying a heavy price to the tune of tens of
4 thousands of dollars, if not hundreds of thousands of
5 dollars. And I'm speaking of low to middle to upper
6 middle income individuals in lost retirement income.
7 And this is based on the current status quo, which
8 permits trusted advisors to profit at their client's
9 expense.
10 One point I'd like to mention is that these
11 individuals often don't even know what they're paying,
12 or that they are paying.
13 Cerulli Associates did a study not too long
14 ago, two or three years, four years ago, and
15 approximately 25 percent or a quarter of the
16 respondents didn't believe they were paying anything.
17 These are individuals who are all working with a
18 financial advisor or broker. They didn't believe they
19 were paying anything for that advice. And as we all
20 know, financial advisors and brokers, registered
21 representatives, need to be compensated for their
22 professional services.
23 Another 25 percent, approximately, of this
24 cohort didn't know how much they paid. So they don't
25 know the value of what they're paying for. They don't

1 know how to compare that against other service
2 offerings or anything like that. So with that kind of
3 opaqueness in the system, I'm looking forward to
4 having painful transparency.
5 I've seen the type of issues over and over
6 in the last 28 years that I've been in this business.
7 In the first 18 years, I worked as a personal
8 financial planner, as a registered representative,
9 eventually as an hourly-based -- hourly only, fee only
10 financial advisor.
11 One point that has been discussed many
12 times, and I've seen it in writing and on various
13 conference calls, the discussion of fee-based or fee-
14 only services or fee services -- and that's
15 automatically equated with assets under management.
16 And I would like to clarify for the record that that
17 is one form of fee compensation. And I also agree
18 with those who have shared that every compensation
19 structure does have conflicts.
20 But I want to broaden the concept that fee
21 compensation is not just assets under management.
22 That would be an ongoing payment mechanism or a
23 payment scheme. There could be a one-time payment in
24 fees, and it could be an ongoing, monthly type of
25 thing. It could be periodic or an as-needed type of

1 service, which is how I worked with my clients most of
2 the latter years.
3 Throughout my career, I spent most of my
4 time working with middle income clients and their
5 families. In the last 15 years, I've headed up a
6 network, a nationwide network, of financial advisors
7 who are doing just the same with no minimums. So
8 fiduciary advisors accessible to all people,
9 objective, competent advice as fiduciaries.
10 Over the last ten years, I've spent time
11 working as a litigation consultant and an expert
12 witness, and I'd love to share any of those detailed
13 stories. I'll just briefly mention those -- a little
14 bit of that in this introduction because that's where
15 I got truly passionate and -- passionate is an
16 understatement -- blood boiling, very enthusiastic to
17 I've got to become involved.
18 So I witnessed a number of different cases
19 in this litigation work, where dozens of individuals
20 were inappropriately advised. And I use the word
21 advised -- the advisors in question in this series I'm
22 talking about were registered representatives.
23 But they were advised, provided advice,
24 direction, recommendations, whatever you want to call
25 it, but told what to do. The individuals came to the

1 professional and said, what should I do. They were
2 offered an early retirement buyout from their
3 employer, a company-sponsored defined benefit pension
4 plan and 401K. A few of them had ESOP plans.
5 And lo and behold, this whole series of
6 cases, which there were a few dozen people involved
7 over the years that I've worked with, all of them were
8 middle income individuals, for the most part making
9 wages of $25- to $45,000 a year, by their late 40s to
10 early 50s had amassed a fairly substantial sum in
11 their retirement nest egg.
12 But then they were offered an early
13 retirement out package from their employer, which was
14 Pac Bell Telephone Company in this specific example
15 that I'm giving, which sweetened the offer to allow
16 them to take an early retirement out at that young
17 age. Just because they were eligible to retire did
18 not make them able to afford to retire, kind of like
19 you might be eligible to qualify for a mortgage, but
20 that doesn't mean you can afford to pay it. Same
21 thing with being eligible to retire.
22 So many of these individuals are now in
23 their early 60s, and they're dead broke, very
24 financially devastated. Some said, you know, this
25 advisor ruined my life. I tried to reframe that, your

1 financial life. But it's really heartbreaking about
2 what has happened to too many people. And, of course,
3 this is a rare situation. But these individuals
4 entrusted their entire retirement nest egg to advisors
5 who did not put their best interests first.
6 One of the reasons this came to my
7 attention, these series of cases, is the concept of
8 financial advisors often do not get paid unless they
9 get the hands on the money. So without a retirement
10 occurring, or a rollover occurring, no money left the
11 retirement plan, the ERISA-qualified plan, unless
12 these people chose to retire. So they were provided
13 with advice encouraging them to take the distribution.
14 And then the money was reinvested, and
15 needed to provide their standard of living for every
16 month. It was put in variable annuities, either
17 exclusively or almost entirely, and with a 7 percent
18 surrender penalty with every single monthly
19 withdrawal, for a 2.4 percent minimum mortality and
20 expense fee that we heard on the earlier panel. It
21 was an average.
22 The advisor also calculated the withdrawal
23 rate that these retirees could take, and the lowest
24 withdrawal rate, excluding fees, was just over 8
25 percent, done as a 72T, substantially equal

1 distribution, periodic payment distribution.
2 So I've worked with middle income clients
3 most of my career, and I've only known of a couple of
4 people out of maybe 1,000 clients that could afford to
5 retire, that had enough money to retire. But lo and
6 behold, for some reason, these advisors' clients could
7 all afford to retire in their early 40s and late 50s.
8 Most advisors do have their clients' best
9 interests in mind. However, they're not legally
10 obligated to put their clients' best interests first.
11 And I feel that if we're going to hold ourselves out
12 as advisors, rendering advice, telling people what to
13 do with their money, and where that -- to make those
14 investments, where is the money coming from?
15 I've got a stack of details of stories,
16 horror stories, from financial advisors over the last
17 few months that I've collected. I've heard a number
18 of these over the years. As I've shared just nuggets
19 of these cases, and they're just appalled. Regardless
20 of the distribution channel or the service model they
21 work in, these individuals, the financial advisors,
22 are appalled at these kind of actions.
23 So there are plenty of fiduciary advisors
24 out there, or advisors who are willing -- ready,
25 willing, and able to take on that fiduciary mantle and

1 serve their client's best interest. That's what
2 they're currently doing, and they're willing and able
3 to follow the regulation to do so continually.
4 So I applaud the DOL for continuing this
5 work, and thank you for allowing me to share my
6 thoughts.
7 MR. HAUSER: Thank you.
8 Mr. Nelson?
9 MR. NELSON: Thank you, Deputy Assistant
10 Secretary Hauser and the other members of the panel
11 for this opportunity to discuss the Department's
12 proposed regulation redefining fiduciary investment
13 advice for ERISA plans and IRAs.
14 Voya Financial, along with thousands of
15 advisors and TPAs, serves the needs of over 13 million
16 individual and institutional clients, including
17 approximately 46,000 retirement plan sponsors and 5
18 million plan participants. We take this
19 responsibility very seriously, and we and our partners
20 are committed to acting in the best interests of all
21 of our clients, with a clear, unified mission to make
22 a secure financial future possible one person, one
23 family, one institution at a time.
24 We share the Department's goal of improving
25 the quality and availability of financial advice to

1 workers, retirees, and their families. We are focused
2 on helping Americans plan, invest, and protect their
3 savings so they can retire with financial security.
4 That's why I'm here today. Despite the
5 Department's admirable intentions, I'm concerned that
6 the proposal fails to achieve our shared goal because
7 of its unintended consequences, which will actually
8 reduce access to advice due to fewer advisors and
9 providers willing to take on the liability and make it
10 more costly for plan sponsors and individuals to
11 receive the education and advice they need.
12 This will ultimately jeopardize the
13 availability of advice and education, and will
14 accelerate leakage from retirement plans.
15 Given our limited time today, I'd like to
16 focus on three key areas in which we think the rule
17 needs to be revised to better serve working Americans.
18 First, let's discuss the best interest contract
19 exemption, or the BIC exemption. If it is finalized,
20 it must be substantially revised to actually serve the
21 best interests of participants and IRA owners. In our
22 comment letter, we recommended solving some of the BIC
23 exemption problems with what we call the customer's
24 bill of rights.
25 The BIC exemption process is just not

1 practical. It needs to be simplified and streamlined.
2 As proposed, an advisor would need a signed agreement
3 addressing a significant number of disclosures and
4 representations, obligations even before discussing
5 the recipient's circumstances. Participants will be
6 confused, frustrated, and annoyed when asked to sign
7 an agreement to have a preliminary conversation with
8 an advisor they may not even hire.
9 I'm sure you will agree; it is not
10 productive regulation to create an environment that
11 may encourage participants to turn away from essential
12 advice at a crucial time because of an unprecedented
13 and cumbersome consumer transaction process. The BIC
14 exemption effectively outsources enforcement of the
15 prohibited transaction rules to the plaintiff's bar,
16 including new potential class action -- class actions
17 under state laws.
18 We question whether the Department even has
19 the authority to create these alternative remedies to
20 ERISA's exclusive remedies. However, the new and
21 untested legal liabilities resulting from the contract
22 are one of many reasons it is unlikely to be used by
23 advisors in its current form.
24 If a participant does not sign the BIC
25 agreement, we firmly believe that the extensive new

1 point of sale quarterly and website disclosures will
2 be sufficiently voluminous that many participants will
3 find little or no value in them, despite the
4 significant cost to advisors and providers, which they
5 are going to incur that will ultimately be passed on
6 to the consumer.
7 That's why we recommended replacing these
8 with a simple, one-page customer's bill of rights.
9 The bill of rights provides a participant or an IRA
10 owner with an easy to understand information needed to
11 make an informed decision.
12 Under this approach, the participant could
13 acknowledge receipt of a clear document setting out
14 key disclosures, compensation terms, and any potential
15 conflicts before any money is invested or fees are
16 paid. We attached a sample of the customer's bill of
17 rights to our comment letter, and I have a copy for
18 you here today.
19 As you can see, it clearly states out
20 whether the advisor receives any differential
21 compensation, whether the advisor offers proprietary
22 products, and lists the basic compensation received by
23 the advisor and its affiliates for each investment.
24 The customer's bill of rights also informs customers
25 that they have the right to ask for additional

1 compensation, and advises them to comparison shop with
2 different advisors.
3 The whole point is to give participants and
4 IRA owners useful and actionable information that
5 ensures their understanding. We also want to
6 encourage participants and IRA owners to compare
7 available services and investment options, which can
8 be more easily done through this simpler, less data-
9 intensive approach.
10 The BIC exemption disclosures are not a
11 cost-efficient means of providing useful information,
12 and the expense will ultimately be borne by
13 participants and IRA owners. The customer bill of
14 rights by contrast is a very efficient, consumer-
15 friendly way of providing this information.
16 Another advantage of the customer bill of
17 rights concept is that it identifies whether
18 proprietary products are being made available and
19 under what terms. This is an effective means of
20 upfront disclosure, allowing the Department to modify
21 the BIC exemption, to clarify that advisory grade
22 proprietary products does not violate any impartiality
23 standards.
24 This change is essential because the
25 proposed language that investment advice must be

1 provided, I quote, "without regard to the financial or
2 other interest of the advisor, financial institution,
3 or any affiliate, related entity, or other party," end
4 quote. That's just too open-ended and prone to
5 confusion. It invites after-the-fact second guessing
6 and creates unwarranted litigation risk for offering
7 proprietary products.
8 Secondly, we think the large plan exclusion
9 is just too limited, an arbitrary threshold; and its
10 impractical application based on participant head
11 count bears no obvious relationship to financial
12 sophistication. The proposal denies small plans,
13 participants and IRA owners the same investor choices
14 that large plans have when deciding to purchase a
15 product rather than to receive advice.
16 The Department wrote that, I quote, "The
17 overall purpose of this seller's carveout is to avoid
18 imposing ERISA fiduciary obligations on sales pitches
19 that are part of an arm's length transaction where
20 neither side assumes the counterparty to the plan is
21 acting as an impartial trusted advisor," end quote.
22 We agree. But this logic also applies to
23 all plans, regardless of size, and to IRAs. Like
24 larger plans, smaller plans and IRAs benefit from
25 more, not less, information. Restricting a seller's

1 carveout will lead to less information being provided
2 to them. The large plan disclosures would serve
3 equally well to protect small plans and IRA owners
4 from misunderstanding the true nature of a sales
5 discussion.
6 We also believe that our customer's bill of
7 rights could serve in this role, making it clear that
8 sales information is not fiduciary advice. It does
9 not require financial sophistication to distinguish
10 between sales activity and advice activity, where the
11 activity status and compensation are fully disclosed.
12 The Department should adopt a general sales exclusion
13 for all plans and IRAs, as it did in 2010, while
14 adding clear disclosure.
15 Finally, I'd like to address the proposal's
16 restriction on educational activities. There is no
17 denying that workers face financial decisions that
18 many do not feel well equipped to make, and they must
19 have access to advice and education to help them do
20 so. Reducing that access, as the proposal does, has
21 an even bigger cost to participants and IRA owners
22 than the conflicts the rule is intended to address.
23 The Department's own 2011 estimate showed
24 the lack -- that lack of access to advice cost
25 participants more than $100 billion every year in

1 preventable investment errors. Interpretative
2 Bulletin 96-1 provides a proven and effective pathway
3 for participants to receive and act on educational
4 information.
5 I emphasize acting on education because the
6 industry's long experience with in-person education
7 meetings and online investment and education tools for
8 IRA account holders shows that the biggest challenge
9 is getting people to act on what they have learned.
10 The Department should retain its key elements even as
11 they expand its scope.
12 Another concern in the proposal would
13 prevent many advisors and providers from encouraging
14 participants to not cash out balances when they change
15 jobs, and instead roll their plan, their prior plan,
16 and IRA balances into the new employer's plan. The
17 broad scope of the proposal would transform this
18 education into fiduciary advice regarding a rollover
19 or a distribution. This likely would result in a
20 greater retirement plan leakage and loss of retirement
21 savings. Any final rule should exclude encouraging
22 consolidation from fiduciary advice so we can continue
23 to better serve participants with actionable
24 educational information.
25 In conclusion, participants and IRA owners

1 need access to quality advice and investment services
2 to achieve their retirement goals. The way to get
3 there is to make the advice more widely available.
4 The proposal does not do this, and its unintended
5 consequences limit choices, reduce educational
6 opportunities, and pose significant costs on
7 participants.
8 We want to work with the Department so that
9 any final rule works for participants, and we think
10 these ideas can contribute.
11 Thank you again for the opportunity to
12 testify, and I look forward to answering any of your
13 questions.
14 MR. HAUSER: Thank you. Mr. Nelson, maybe
15 just starting with the customer's bill of rights that
16 you proposed.
17 MR. NELSON: Sure.
18 MR. HAUSER: I mean, as I read this, I'm --
19 I guess I'm not seeing the rights part, to be honest
20 with you. I mean, so is there a commitment to give --
21 make a recommendation that's prudent as part of the
22 bill of rights, and would Voya agree to make prudent
23 recommendations as -- I mean, is that something that
24 you would be comfortable with?
25 MR. NELSON: Well, thank you for your

1 question. You know, the bill of rights is really an
2 upfront disclosure, and we think it should be
3 connected with the seller's carveout. It should be
4 simple and easy to use. And, you know, by providing
5 the information to a participants on the funds, their
6 cost, someone's compensation, what role they're
7 playing in the transaction, we think goes a long ways
8 towards information participants so they make better
9 long-term decisions.
10 You know, we're certainly in favor of doing
11 what is in the best interests of clients and
12 customers, I should say, in that regard. And we think
13 a fulsome disclosure such as the customer bill of
14 rights really makes great progress towards that.
15 MR. HAUSER: So in terms of the fulsome
16 disclosure, at least as outlined in your bill of
17 rights, it says, "We may receive more compensation,
18 depending on the product or investment select. We may
19 recommend proprietary products." There is nothing, in
20 this document at least, that discloses any of the
21 specifics. It's kind of a generic disclosure that the
22 person talking to you may get conflicted payments. Is
23 there more to your proposal than that?
24 MR. NELSON: There is much more. What
25 you're looking at is a draft essentially. And where

1 you see the words "may or may not" would be more
2 customized to the individual situation.
3 Oftentimes, though, as you can appreciate,
4 when you're entering into an initial conversation with
5 a potential customer, you don't know where that
6 conversation can go, what they may or may not invest
7 in. And so you have to have the appropriate
8 flexibility in any customer bill of rights to make
9 sure that they understand what are the types of
10 compensation that you would be receiving, what are the
11 available investment options that they could invest
12 in, and what role you are playing.
13 You know, these are -- you know, I think it
14 was mentioned earlier in a number of the testimony to
15 -- we think the participants can distinguish between a
16 sales presentation and advice. And there are two
17 different approaches.
18 MR. HAUSER: Why do you think those are two
19 different things really? I mean, I've heard the
20 sale/advice dichotomy being drawn by lots of people.
21 But as a rule, you know, don't -- aren't both things
22 happening? Aren't people looking to your
23 representatives for professional guidance in how to
24 manage their money, even as they also understand that
25 you may be selling them something?

1 MR. NELSON: Not necessarily. You know, I
2 think, yeah, that's a fascinating question because in
3 every commercial transaction, as it was identified
4 earlier, there is someone who is providing the service
5 or product, and there is someone who is consuming or
6 purchasing that, that product or a service.
7 You don't necessarily know what types of
8 services or products that someone may ultimately
9 select from, and there could be a wide range. So, you
10 know, in your characterization, I'm not sure that's
11 completely fair to say that all participants want
12 advice, because some may want more advice, some may
13 want just some education and some information.
14 MR. HAUSER: But before your representatives
15 make a recommendation to somebody on what -- how to
16 invest their retirement assets, do they make any
17 inquiry into their individual circumstances?
18 MR. NELSON: Sure.
19 MR. HAUSER: And do they try to ensure that
20 at a minimum that recommendation is suitable for them
21 in light of their particular circumstances?
22 MR. NELSON: Again, it depends on the types
23 of recommendations that might be coming. If it comes
24 through, for example, an managed account solution,
25 that could be covered under SunAmerica, so it's a

1 different type of a transaction or a service, if you
2 will.
3 MR. HAUSER: What do your representatives
4 call themselves in their dealings with your customers?
5 Do they call themselves salesmen, or do they use some
6 other nomenclature?
7 MR. NELSON: Representative of Voya
8 Financial.
9 MR. HAUSER: That's it? They don't call
10 themselves advisors or consultants or investment
11 professionals? What --
12 MR. NELSON: We have --
13 MR. HAUSER: Do you have a preferred
14 corporate term that your people use?
15 MR. NELSON: We do.
16 MR. HAUSER: What is that?
17 MR. NELSON: Huh?
18 MR. HAUSER: And what is that?
19 MR. NELSON: Well, you know, we have about
20 6,000 employees and lots of different titles, okay?
21 MR. HAUSER: Yeah.
22 MR. NELSON: So in fairness -- and I'm not
23 going to go through all 6,000 titles for you, save you
24 the torture there. However --
25 MR. HAUSER: That's too many categories to

1 manage, I would think.

2 MR. NELSON: It takes a lot to be able to
3 distinguish the different types of roles. And so I
4 think it depends on whether you're talking about a
5 call center rep, you're talking about a representative
6 that's working with advisors and TPAs distributing
7 401Ks, or you're distributing 457-403B plans, or
8 retail advisors as well.

9 MR. HAUSER: Okay. So let's maybe just take
10 the latter. Do they call themselves advisors when
11 they're dealing with their customers?

12 MR. NELSON: In our Voya financial advisor
13 network, many of them would, yes.

14 MR. HAUSER: And do you have brokers? What
15 do they call themselves? I mean, representatives --
16 who other -- what are some people directly interfacing
17 with customers? What are some of the other terms they
18 used to describe themselves?

19 MR. NELSON: Registered representatives, who
20 would be registered -- you know, FINRA
21 representatives. Sometimes --

22 MR. HAUSER: And they just refer to
23 themselves as registered representatives when they're
24 talking to --

25 MR. NELSON: Account executives, that type

1 of thing, too.

2 MR. HAUSER: Uh-huh. And maybe just one or
3 two final questions. I mean, and maybe I missed it,
4 but -- and it's refreshing in a way, but virtually
5 everybody who has come before us and has testified has
6 said, "we, of course, you know, are okay with adhering
7 to a best interest standard, it's just that your
8 exemption is unworkable."

9 What I'm hearing you say -- and please
10 correct me if I'm wrong -- is actually you're not okay
11 with having a best interest standard imposed on you,
12 either an obligation of prudence or an obligation of
13 loyalty to your customers. You would object to either
14 of those things. Is that right?

15 MR. NELSON: No, that's not a fair
16 characterization.

17 MR. HAUSER: Okay. So could you -- so I may
18 just missing it. But could you explain?

19 MR. NELSON: I appreciate the opportunity to
20 clarify. At Voya Financial, we are in favor of, you
21 know, best interest with our clients, okay?
22 Separating that out, though, the best interest as
23 defined in the proposed regulations is really more
24 aligned with ERISA and prohibited transactions. You
25 don't necessarily have to have it aligned with the

1 prohibited transaction and ERISA definition to do what
2 is in the best interest of clients.
3 MR. HAUSER: Okay. But so for purposes of
4 our regulatory project, you would be opposed -- and, I
5 mean, just please correct me if I'm wrong. I don't
6 want to put words in your mouth. You would be opposed
7 to our imposing an ERISA prudence obligation or an
8 ERISA, you know, loyalty obligation on your
9 representatives, either in their dealings with plans
10 or in their dealings with IRAs. Is that correct?
11 MR. NELSON: Not completely. You know, I
12 think -- you know, we're probably, you know, slicing
13 -- you know, splitting hairs here a little bit. It's
14 -- you know, being able to work in the best interests
15 of -- for clients in the retirement space does not
16 necessarily require, I don't believe, that we need to
17 do it under the umbrella of ERISA or the prohibited
18 transaction rules.
19 So we can be in favor of doing what is in
20 the best interest of clients and making sure that they
21 have the appropriate education, they have all the
22 right information to make informed decisions, that we
23 disclose all appropriate compensation, any proprietary
24 investment options that may be there, or other types
25 of services.

1 You know, I think informing participants of
2 all of that type of information is in the best
3 interest of clients, and we are very much in favor of
4 that.
5 MR. HAUSER: But at bottom, your proposal is
6 we simply impose as set of disclosure obligations, and
7 that's it.
8 MR. NELSON: As separate from the prohibited
9 transaction and ERISA.
10 MR. HAUSER: And those disclosure
11 obligations, in your mind, could they include such
12 things as the precise amount of compensation that the
13 representative is receiving in connection with the
14 recommendation?
15 MR. NELSON: Yes.
16 MR. HAUSER: Okay. So, Mr. Derbyshire, a
17 couple of things. And I apologize. You know, at this
18 point, I've read so many comments, I'm afraid I might,
19 I'm afraid --
20 MR. DERBYSHIRE: You didn't read all 57
21 pages?
22 MR. HAUSER: No. I absolutely -- I read
23 every single page and underlined it and circled stuff,
24 and even, you know, put exclamation points next to a
25 couple of things. But I'm getting a little confused

1 in my own mind between what was in some other people's
2 comments letters. So if I get something wrong here,
3 let me know.
4 But one thing I did think was helpful here
5 was your framework on making the mechanics of
6 executing the contract a little more simple. And the
7 people we talked to yesterday as well, there were a
8 number of suggestions. And I'm sticking right now not
9 with kind of our best interest contract exemption,
10 rather than the new paradigm that you proposed.
11 But I just want to see if you think these
12 things would be significant improvements, and if you
13 think we should go further in terms of the mechanics
14 of executing the contract. What a number of people
15 suggested were, one, in terms of the timing of the
16 contract, that it would make a lot more sense that as
17 to existing customers, it essentially be done by some
18 species of negative assent. You send out a notice to
19 your customers of one sort or another saying here are
20 the new obligations. I mean, here is what we're
21 undertaking to do for you.
22 And that would be kind of it for your
23 existing customer base, unless and until they executed
24 a new contract. Does that make sense? Is that at
25 least an improvement?

1 MR. DERBYSHIRE: For existing customers, I
2 suppose that would be an improvement over a wet
3 signature that has to be returned to you. I still
4 don't think it's necessary to have even a negative
5 consent approach, but --
6 MR. HAUSER: What kind of -- would that be a
7 big operational issue, though, for Fidelity?
8 MR. DERBYSHIRE: It would require mailing
9 out notices to, you know, our 23 million customers
10 potentially affected by this, but --
11 MR. HAUSER: So we can have a conversation
12 about electronic --
13 MR. DERBYSHIRE: The question is whether
14 it's really necessary.
15 MR. HAUSER: Okay.
16 MR. DERBYSHIRE: I'd be more interested to
17 hear what you're going to say about new customers.
18 MR. HAUSER: Okay. So new customers, what a
19 number of folks have proposed is similarly you would
20 execute the contract, I mean the same time you execute
21 an account opening agreement.
22 The contract perhaps could -- it would be
23 adequate that it essentially be signed or executed
24 only by the firm, you know, as opposed to try -- and
25 just the firm just speaking on behalf of all its --

1 you know, the affiliates and call center folks, and
2 that it essentially reached back in time. If the
3 person has decided that they're now going to entrust
4 the money to -- I mean invest the money with you, that
5 it would reach back and cover the recommendations that
6 had been made.
7 But there wouldn't be a necessity for the
8 contract before that moment.
9 MR. DERBYSHIRE: I don't think that works at
10 all, and I'll give you a very simple reason why not.
11 MR. HAUSER: Okay.
12 MR. DERBYSHIRE: We could have a person walk
13 into one of our branches, sit down with our account
14 executive, and have a full conversation, and we
15 recommend to them a Fidelity fund. They could stand
16 up from there and walk next door to Schwab and
17 purchase that fund in their platform. And that's a
18 prohibited transaction under your rule because we have
19 recommended a Fidelity fund, and they have purchased a
20 Fidelity fund. But we have no way of enforcing that
21 the contract be signed, no way of knowing whether they
22 even purchased that particular investment.
23 So, you know, the way the rule is
24 constructed, it kind of assumes that people are
25 sitting down with an advisor. The advisor recommends

1 something, and then they execute on it. But that's
2 not the way the vast majority of our guidance
3 interactions go forward. We give people
4 recommendations. They listen to them. They consider
5 them. They go home. They talk with their spouse.
6 They talk to their brother-in-law, their neighbor.
7 And then they do some of it, all of it, part of it.
8 Who knows who they do it with? We don't know either.
9 So it's really not workable. The only way
10 we could comply with that written contract requirement
11 is that we get signature at the point before we make
12 the recommendation, which would essentially require
13 that the minute someone walks into some of our -- one
14 of our branches, we give them a contract and say,
15 before we talk to you, we'd like you to sign this
16 contract.
17 So that's in the retail side. On the 401K
18 side, we do not have contracts with the participants
19 in our 401K plans. In fact, if I presented a contract
20 to a 401K participant, they'd probably be looking at
21 me like, what is this. I don't have a relationship
22 with Fidelity. You service my account, right? For
23 many of our participants, we are just a service
24 provider to that plan. We do the recordkeeping, et
25 cetera. And so they have no expectation or interest

1 in signing a contract with us. And I think they'd
2 find that an extremely foreign concept.
3 Again, the mechanics of putting that in
4 place would be daunting as well.
5 MR. HAUSER: And you could -- and presumably
6 -- and again, I assume you'd have similar objections.
7 But if a contract were executed with, you know, a
8 fiduciary for the plan as part of an advice
9 arrangement and essentially just made the participants
10 third-party beneficiaries, that would be a problem?
11 MR. DERBYSHIRE: So that would obviously be
12 much more workable because we obviously have contracts
13 with all of our plan sponsor clients for the services
14 that we provide. Again, there is the kind of
15 retroactive repapering of the 24,000-odd relationships
16 we have. But certainly that would be much more
17 workable on the plan side.
18 MR. HAUSER: And then maybe -- now moving on
19 to your --
20 MR. DERBYSHIRE: But could I just introduce
21 something, though? There is one --
22 MR. HAUSER: yes.
23 MR. DERBYSHIRE: -- interesting aspect of
24 this entire rule that I'm not sure anyone has really
25 examined, including plan sponsors, which is what is

1 the plan sponsor's willingness for their service
2 provider to take on a fiduciary role in providing the
3 kind of help that we -- that our plan sponsors expect
4 us to provide to participants?
5 I gave the example before of a typical
6 enrollment transactions, where we're just trying to
7 help someone make a decision, which invariably will
8 result in us tending to suggest a course of conduct
9 that would be investment advice under this rule. If
10 that's made fiduciary in nature --
11 MR. HAUSER: Well, I don't the test is
12 tending to suggest. I think now you're taking
13 language that maybe bothers you, and you're adding an
14 additional level of indirect --
15 MR. DERBYSHIRE: So, I --
16 MR. HAUSER: -- I mean, we've made it pretty
17 clear at this point that we're talking about
18 recommendations in the FINRA sense of recommendation,
19 and that suggestion language is in the FINRA guidance.
20 So it's pretty much the same concept.
21 So does that -- I mean, if we draw the line
22 at what a recommendation is essentially at the same
23 place FINRA does, does it really raise all these
24 issues?
25 MR. DERBYSHIRE: Yes, I think it does

1 because the transaction I just identified for you
2 would be a recommendation under FINRA guidelines --
3 MR. HAUSER: Okay.
4 MR. DERBYSHIRE: -- because it would be
5 identifying a specific investment fund for a specific
6 person in a context where you would expect them to act
7 on that suggestion. So at least at Fidelity, we would
8 view that as a recommendation subject to FINRA
9 suitability requirements.
10 MR. HAUSER: Right.
11 MR. DERBYSHIRE: So --
12 MR. HAUSER: And assuming there is a fee in
13 connection with that -- I mean, I think it is our aim
14 that that be subject to a best interest standard, I
15 mean, just so --
16 MR. DERBYSHIRE: Understood.
17 MR. HAUSER: Yeah.
18 MR. DERBYSHIRE: And we're prepared to do
19 that. It's just the contract that has to be in place
20 before we make that recommendation that was discussed
21 is problematic.
22 MR. HAUSER: So moving on to your proposal
23 about what the -- you know, this, the new paradigm
24 contract, I mean, I could benefit, I think, from a
25 little more detail of what you view the timing of that

1 contract as being.

2 So somebody, whether on a transactional or
3 other basis, somebody talks to a Fidelity person on a
4 -- at a -- I don't know, on the phone, in a Fidelity
5 office, wherever, and they're looking for assistance
6 in narrowing down what is an enormous universe of
7 investment offerings, even if one just looks at
8 Fidelity, to something that fits their selection, I
9 mean fits their individual needs.

10 At what point would you execute this
11 contract the way you're looking at it?

12 MR. DERBYSHIRE: Well, it wouldn't be
13 executed at all. It would be an ongoing commitment to
14 our customers that when we provide investment advice
15 that we would act in their best interest. So we make
16 commitments to customers all the time. We have --

17 MR. HAUSER: No. I must have misunderstood
18 your new paradigm. I thought there would be an
19 agreement that would specify what the terms of the
20 compensation would be, what the terms of the
21 engagement would be --

22 MR. DERBYSHIRE: Yeah.

23 MR. HAUSER: -- what products would be
24 covered and like that.

25 MR. DERBYSHIRE: Okay. So you're moving off

1 to the --

2 MR. HAUSER: Yeah, yeah. No, I'm sorry. If

3 I wasn't clear about that --

4 MR. DERBYSHIRE: That's fine. We've been

5 talking about the exemption for a while. So that

6 would have to be provided at the point of engagement

7 with the client.

8 MR. HAUSER: So the point of engagement

9 meaning when they've decided to spend the money?

10 MR. DERBYSHIRE: No. The point that they

11 start discussions with us.

12 MR. HAUSER: So you'd be prepared to have a

13 contract -- I mean to present them with a contract

14 essentially before you've even begun discussions?

15 MR. DERBYSHIRE: It wouldn't be a contract.

16 It would be a statement as to what is the scope of

17 our advisory services and how we would get paid for

18 those. I think at that point, it would also make

19 sense to include the best interest contract commitment

20 at that point, but it would be an ongoing statement to

21 the customer about the nature of the services that

22 we're providing.

23 And those types of documents are actually

24 available to most customers on our website today,

25 right? So there are -- you know, for investment

1 advisory services, there are ADV statements. There
2 are many disclosures of rep compensation and other
3 things that you can find in our website. I think what
4 we're talking about here is being a little more
5 prescriptive about it and upfront, and making sure
6 that someone has assented to those terms before the
7 discussion takes place.
8 MR. HAUSER: And then how would you -- and
9 so how does the best interest -- I mean, I suppose --
10 so let me, going back -- I hate switching back and
11 forth between your exemption --
12 MR. DERBYSHIRE: Yeah.
13 MR. HAUSER: -- and mine, I guess. But
14 under the best interest contract exemption -- so would
15 a document like that work in your mind for the
16 mechanics of executing a best interest contract
17 exemption were we to move forward with our current
18 proposal?
19 MR. DERBYSHIRE: Again, I'm not --
20 MR. HAUSER: You give them something at the
21 start that lays out essentially the best interest
22 obligations the way we said it?
23 MR. DERBYSHIRE: I think so. I mean, you
24 use the word execution. That kind of --
25 MR. HAUSER: No. I'm sorry.

1 MR. DERBYSHIRE: -- we're back in that
2 because to me that means signing something, and that's
3 the real problem, is getting someone to sign
4 something. So I was going to say we make commitments
5 to our customers all the time. We have a customer
6 protection guarantee that protects customers against
7 data breaches or fraud in their account. And so
8 nobody signs that, but we certainly are accountable to
9 that, and I'm quite sure a court would enforce it
10 against us if it ever came to that.
11 So I think those kinds of commitments are
12 legally enforceable, and should be sufficient in the
13 context of this rulemaking.
14 MR. HAUSER: Okay. I understand. And so --
15 and then once you've agreed on whatever -- I mean, I
16 assume -- so as I understood your proposal, you can
17 kind of define the limited array of products that
18 you're willing to talk to the customer about, what the
19 compensation generally speaking is. Now, are we going
20 to be using that -- or compensation may be affected,
21 you know, by what we recommend stuff? or is this
22 really the customer being told exactly what each
23 things is going to cost?
24 MR. DERBYSHIRE: So I think this actually
25 gets into a lot of what this morning's panels

1 discussed about the balance of information and how
2 much is too much. You know, a regular retail customer
3 coming to Fidelity has a choice of, you know, many
4 thousands of mutual funds, individual stocks and
5 bonds, CDs, you name it, many choices of investments.
6 To incorporate that in any single disclosure would be
7 virtually impossible.
8 But having a range of compensation available
9 that is payable with respect to different options,
10 that could be workable. I think that's something that
11 we need to explore. But the idea is that, yes, I
12 think you should be able to say that my compensation
13 will vary based on the investments that you choose,
14 and here is the range, and here is where you can get
15 precise information about each of those.
16 MR. HAUSER: And then how does the best
17 interest commitment work within that framework? I
18 mean, could, for example, if -- say there was a
19 rollover from somebody, and the way you've -- from
20 some plan. The way you've defined the scope of the
21 agreement, it's only going to cover a certain range of
22 funds, all of which on some level are -- they're
23 essentially equivalents of what the person has on the
24 plan, except they cost more.
25 Are you good to go, or would that be a

1 prudence or a best interest violation under your
2 agreement?
3 MR. DERBYSHIRE: Well, I think you're
4 talking about a couple of things. One would be the
5 recommendation of a distribution from that plan that
6 would then go to these higher fee investments. So the
7 question -- the first question is, is the advisor
8 advising on the distribution. Under the proposal that
9 we're making here, if the advisor wants to do that,
10 they have to undertake a best interest obligation with
11 respect to that advice, and therefore would have to
12 consider the relative cost of the funds in the plan
13 versus whatever else they might be recommending on
14 their platform.
15 The alternative would be that the advisor
16 does not have to advise on the distribution, but
17 they'd have to be very clear about that because if
18 they weren't, they would know that their distribution,
19 quote, "discussion," whatever it entailed, runs the
20 risks of being investment advice.
21 So people would have to be very clear that,
22 "I'm not advising you about whether it makes sense to
23 take a distribution from your plan or not. But if you
24 would like to rollover to an IRA, here are the
25 products and services that I offer on my IRA. And if

1 you choose to do that, then I will advise you on those
2 products and services."
3 MR. HAUSER: And within those products and
4 services, would it be a violation of the best interest
5 commitment for the -- whoever it is, your rep, to
6 steer somebody to one product versus the other based
7 on its earning or compensation for that rep?
8 MR. DERBYSHIRE: At that point, the best
9 interest obligation would kick in. I wouldn't say it
10 would be a violation of the PT rules because the
11 exemption would cover it, but that recommendation
12 would have to be made in their best interests under
13 the definition the Department has proposed.
14 MR. HAUSER: And would you be prohibited
15 from incentivizing your people to recommend products
16 in a way that runs counter to their best interest
17 standard?
18 MR. DERBYSHIRE: I think the way that would
19 be handled is the financial institution is under a
20 best interest obligation itself, and therefore it
21 would be incumbent on the institution to ensure that
22 its representatives adhere to that standard. If they
23 set up a compensation mechanism that resulted in
24 people violating that standard, then the financial
25 institution would be at risk for violating the best

1 interest standard.

2 So I understand it's derivative in the sense
3 that the advisor is going to need to be regulated by
4 the financial institution, but that's the way it works
5 today, okay? Registered representatives, at least
6 broker-dealers, are subject to a very rigorous
7 supervisory structure. And where that supervisory
8 structure requires, because the firm has committed to
9 it, to have someone act in their best interest, that
10 firm better be sure that it supervises its
11 representatives appropriately.

12 So that's how I would manage that.

13 MR. HAUSER: Thank you. And being
14 marginally mindful of how little time I have left,
15 maybe I could just ask one question of Ms. Garrett,
16 and then you guys please feel free to ask additional
17 questions.

18 But, you know, one of the concerns people
19 have expressed is that our proposal could have an
20 adverse impact on small savers. I just wonder if you
21 have a view about that, and if you could comment on,
22 you know, your own willingness to serve small savers.

23 MS. GARRETT: As far as an adverse effect on
24 individuals with more modest account sizes -- I still
25 have a difficulty calling them small savers or small

1 investors or large investors or so forth, so I'm
2 trying to correct my own language. But those with
3 more modest account sizes, currently our organization
4 of about 300 advisors across the country, we have no
5 minimums. So we're serving them currently, and have
6 been for the last 15 years.
7 Another network was mentioned earlier today,
8 the CFP Board representative from the CFP Board and
9 the Financial Planning Coalition, made up of Financial
10 Planning Association, the CFP Board, and NAPFA, totals
11 something in the neighborhood of about close to
12 100,000 advisors. And many of these individuals also
13 work with middle income and more lower income to
14 higher income in the middle, the middle market, the
15 mass market.
16 So there are a number of financial advisors
17 in all kinds of different distribution channels. I
18 think the only ones that are going to have the biggest
19 challenges are those in a proprietary shop, where they
20 have very limited offerings. But those that have the
21 flexibility to provide what they deem the most
22 appropriate for their client will not have any
23 difficulty serving the middle income or lower middle
24 income client at all.
25 And what we're seeing through the last 15,

1 20 years is all financial advisors for the most part
2 are adding fee compensation to their revenue mix.
3 They may be getting some commission, but they're also
4 getting fees.
5 And so if we broaden the definition of fees
6 and not just look at it as assets under management,
7 this 1 percent or whatever, 1.1 percent I heard quoted
8 earlier today as an ongoing annual fee, and start
9 looking at it as a periodic or one-time fee, or an
10 episodic fee, where someone may come in and say --
11 I'll borrow your example. Was it Jane?
12 MR. DERBYSHIRE: Jane, yes.
13 MS. GARRETT: Jane calls up and says,
14 Sheryl, here is my situation. What should I do. And
15 I would talk to her a little bit about -- get more
16 detail, may need to pull out the BIC exemption
17 contract, provide her with what I could -- you know,
18 let her know what I can do for her, pull out the
19 contract if necessary, and have her sign that, and we
20 get busy working in her best interest, and I can
21 provide her with those recommendations. And I
22 actually would be using these two companies, so -- as
23 some of the outlets.
24 So what we're seeing in the marketplace is
25 not only over the last 40 years we've had great

1 changes with what is going on with retirement plans
2 and the individuals' responsibilities of managing
3 their own financial affairs, but the financial advice
4 industry has definitely changed over these last 40
5 years.
6 We didn't have companies represented such as
7 this 40 years ago. So we have a lot of discount
8 brokers. We have a lot of different venues where many
9 financial advisors can go to all these different
10 places and pick and choose which products and services
11 may be most appropriate. And one of the other things
12 that I am so delighted with regarding the proposal is
13 that it covers the distribution of funds.
14 Some of the horror story letters that I have
15 received from financial advisors talk about people
16 mortgaging their houses to make an investment, to take
17 some secure assets -- you know, someone walks into the
18 bank to buy CDs, and they get a fixed annuity. Not
19 that that's necessarily an inappropriate transaction,
20 but if the individual thought it was FDIC insured and
21 liquid, there would be a problem. So we need a lot
22 more clarity.
23 Now, with all due respect to my panelists, I
24 disagree that most individuals now -- I think with
25 both companies, they have likely a lot more do-it-

1 yourself type investors that come to them. But I
2 think the general public, they don't have any idea the
3 difference between someone saying this is the array of
4 funds, or this is the array of investments that I can
5 offer to you, versus these are my specific
6 recommendations.
7 They're not looking for those semantics to
8 try to define what is advice. When someone who holds
9 themselves out as a professional financial advisor,
10 investment advisor, whatever they call themself,
11 registered representative -- I actually had a claimant
12 say she's registered, and she's a representative of
13 the company. That sounded really great. You know,
14 and so the titles don't tell people a whole lot. It's
15 our actions.
16 So when we're giving advice or we're giving
17 a recommendation, or whatever we want to call it, but
18 if it can be construed as we suggest or, you know, "if
19 you were to roll your money over, here is your 401K or
20 your -- excuse me, your IRA options that I could offer
21 you," that's going to be deemed as advice by the
22 majority of people, in my opinion.
23 MR. HAUSER: Thank you very much. And I
24 thank all of you on the panel for your help.
25 Next up.

1 (Pause.)

2 MR. HAUSER: So if you're ready, maybe start
3 with Better Markets here.

4 MR. HALL: Great, thank you. Can you hear
5 me? Good afternoon. My name is Stephen Hall, and I'm
6 testifying today on behalf of Better Markets. Better
7 Markets is a nonprofit, non-partisan, and independent
8 organization established in the wake of the financial
9 crisis to promote the public interest in the financial
10 markets, to support the financial reform of Wall
11 Street, and to make our financial system work for all
12 Americans.

13 We appreciate the opportunity to address one
14 of the most important regulatory initiatives in the
15 last four years aimed at improving Americans'
16 retirement security.

17 The DOL has developed an excellent rule that
18 will provide retirement savers with much stronger
19 protections against the damaging conflicts of interest
20 that have been allowed to persist among financial
21 advisors for literally decades. We commend the DOL
22 for its proposal, and we strongly support it.

23 At this point in the debate, it is settled
24 that gaps in the DOL's 40-year old rule have created a
25 flawed system, one that allows advisors to put their

1 own interests ahead of their clients'. While not all
2 advisors take advantage of this system, far too many
3 do.
4 It is also settled that workers and retirees
5 in this country are suffering terrible losses as a
6 result. By conservative estimates, the damages add up
7 to tens of billions of dollars per year. The focus
8 now is on industry arguments designed to defeat or
9 weaken the rule, and to preserve the status quo.
10 At this hearing, I'd like to address several
11 misconceptions that industry opponents have
12 disseminated about the rule, and then I'll close by
13 highlighting one of the single most important ways
14 that DOL can strengthen its proposal.
15 First of all, opponents of the rule have
16 fostered the misconception that the DOL's proposal is
17 a radical new approach that deviates from the law. In
18 reality, however, the DOL's proposal is a measured and
19 reasonable effort to close loopholes that never had
20 any statutory basis, and to bring its rule into better
21 alignment with what Congress actually said and always
22 intended in ERISA.
23 ERISA's definition is clear and simple. It
24 provides that a person becomes a fiduciary by
25 rendering investment advice for compensation with

1 respect to retirement plan assets.
2 Yet in 1975, the DOL issued a rule that
3 deviated substantially from this definition and added
4 elements that had no statutory basis. For example,
5 advice is subject to the fiduciary duty only if it is
6 given regularly, and only if it serves as the, quote,
7 "primary basis," for an investor's decisions. These
8 elements have undermined the DOL's ability to protect
9 retirement savers from conflicts of interest, as
10 Congress intended.
11 The DOL's new proposal eliminates these
12 loopholes. In addition, it expressly covers
13 recommendations to take a distribution of plan assets.
14 That's a critical juncture in the life of most
15 retirement savers, when the protections of the best
16 interest standard are more important than ever.
17 With these basic modifications, the DOL has
18 vastly improved upon its current rule, not by
19 stretching the boundaries of ERISA, but by more
20 faithfully implementing its letter and spirit.
21 Second, industry opponents have complained
22 that the rule prohibits established compensation
23 models unless advisors comply with an allegedly
24 burdensome and complex exemption. In fact, however,
25 advisors have no entitlement to preserve their

1 conflicted compensation models under the law, and the
2 DOL's exemption is appropriately conditioned on
3 reasonable and necessary safeguards.
4 There is no question that commissioned-based
5 compensation creates impermissible conflicts of
6 interest under ERISA. The DOL's decision to offer an
7 exemption allowing those models to persist is an
8 accommodation, not an entitlement. And while the best
9 interest contract exemption does impose a variety of
10 conditions on the privilege of receiving commissions,
11 that is what the law requires. Under ERISA, the DOL
12 may not create prohibited transactions exemptions
13 unless they adequately protect the interests of plans
14 and plan participants.
15 In short, advisors who currently receive
16 commissions have three choices: They can comply with
17 the reasonable conditions of the best interest
18 contract exemption; they can arrange their fee
19 structures to eliminate such conflicts of interest; or
20 they can stop providing investment -- retirement
21 investment advice. Under any and all of these
22 scenarios, investors and plan sponsors will be far
23 better off, free from the conflicted advice that has
24 victimized them for decades.
25 And we will see no advice gap whatsoever.

1 Contrary to their alarmist predictions, brokers and
2 insurance agents are almost certain to adjust to the
3 new rule rather than withdraw their services. That
4 has been the pattern with every major financial reform
5 in the last century, literally since the early 20th
6 century: dire warnings about upheaval in the
7 financial sector followed by adaptation and ever-
8 growing profits on Wall Street.
9 More importantly, if those advisors really
10 do abandon their clients, an established and growing
11 population of fiduciary advisors stands ready,
12 willing, and able to serve all retirement savers,
13 regardless of account size, and they will do so under
14 very affordable fee structures.
15 Third, industry opponents have argued that
16 we should rely on the SEC to address the gaps in the
17 standard of loyalty applicable to advisors. This
18 argument has no basis, and it has been advanced solely
19 to defeat or delay the DOL's rule. The SEC has no
20 legal authority to issue or update any rules
21 implementing ERISA. Congress gave that responsibility
22 clearly to the DOL, recognizing the unique importance
23 of tax-advantaged retirement assets, and the need to
24 protect them under a separate regime, applying the
25 highest possible standards of loyalty and care.

1 Furthermore, the SEC lacks any authority to
2 regulate advice about investments that are not
3 securities. Yet, retirement accounts routinely
4 include a variety of non-securities investments,
5 including insurance products and even commodities.
6 Unlike the SEC, the DOL has broad authority over these
7 assets as well as any, quote, "moneys or other
8 property," close quote, of a plan.
9 Nothing in section 913 of the Dodd-Frank Act
10 changes this assessment. Section 913 contains no
11 suggestion that Congress intended the SEC's authority
12 to take precedence over DOL's regulation of retirement
13 investment advice. On the contrary, in section 913,
14 Congress could have taken the opportunity to
15 subordinate the DOL's authority, or to link it in some
16 way with the SEC's oversight, but it chose not to do
17 so.
18 As a practical matter, forcing DOL to wait
19 for the SEC means indefinite delay, years at a
20 minimum. The SEC is just beginning to decide whether
21 it should embark on a rulemaking to enhance advisor
22 standards under the securities laws. The agency is
23 still mired in indecision, even though five years ago
24 Congress expressly authorized it to act, and the SEC's
25 own staff strongly recommended that it move forward

1 with a rule. Workers and retirees cannot afford to
2 wait any longer, as their retirement savings are being
3 depleted by conflicts of interest every day.
4 Finally, the DOL can make the rule even
5 stronger by prohibiting the use of mandatory
6 arbitration clauses. Without meaningful private
7 remedies, even the most powerful set of conduct
8 standards cannot adequately protect investors.
9 However, under the proposed best interest contract
10 exemption, advisors can insist that clients enter pre-
11 dispute binding arbitration agreements, thus limiting
12 an investor's right to seek remedies in court. This
13 provision should be eliminated for two reasons.
14 First, it's not what Congress intended. In
15 the ERISA declaration of policy, Congress expressly
16 stated that its goal was not only to establish
17 standards of conduct, but also to provide, quote,
18 "ready access to the federal courts," closed quote, so
19 that plan participants could seek appropriate
20 remedies. In accordance with that policy, the statute
21 gives plan participants the right to file actions in
22 federal court for violations of the fiduciary duty.
23 Second, allowing advisors to insist on
24 arbitration leaves investors with a terribly
25 inadequate substitute for judicial remedies. As the

1 DOL has noted, many arbitrations under the best
2 interest contract exemption would be subject to
3 FINRA's arbitration process. Unfortunately, that
4 system is a grossly deficient dispute resolution
5 mechanism. Consider just the most obvious defects.
6 First, it is not a fair process, as even so-
7 called public arbitrators are allowed to have had
8 extensive careers in the financial industry. Second,
9 it severely limits discovery, to the detriment of
10 investors. It does not require panels to actually
11 apply the law or to explain their awards. It produces
12 awards that typically fall well short of actual
13 damages, and the attorney's fees that are necessary to
14 bring a claim. And finally, it provides extremely
15 limited avenues for appeal, even when significant
16 unfairness or injustice has occurred.
17 By favoring arbitration and raising the
18 specter of burdensome litigation in the courts,
19 opponents of the proposed rule are in effect saying
20 that they do not want to be held accountable. That's
21 no justification for weakening the rule.
22 In closing, I'll reiterate our view that the
23 DOL rule is an extremely important reform that will
24 benefit millions of Americans saving for retirement,
25 and we hope it is finalized as soon as possible.

1 Thanks very much.
2 MR. HAUSER: Thank you.
3 Mr. Campbell?
4 MR. CAMPBELL: Thank you, Deputy Assistant
5 Secretary Hauser and the other members of the panel
6 for this opportunity to discuss the proposal. I'm
7 here today representing the U.S. Chamber of Commerce,
8 which is the world's largest business organization,
9 representing the interests of more than 3 million
10 businesses of all sizes, sectors, and regions,
11 although most of our members are small businesses.
12 Our members strive to provide quality
13 retirement benefits, and they take their
14 responsibilities as plan sponsors and fiduciaries very
15 seriously. Our members are the people the Department
16 intends to help with this rule. They're the
17 recipients of advice, and we think that you should
18 listen closely to our concerns.
19 Our members, especially small businesses,
20 have been very clear. As proposed, we don't think
21 this rule would help us. It would hurt us.
22 Now, of course, our members want financial
23 advisors to act in their best interests. They're
24 fiduciaries themselves. However, our members believe
25 that this overly broad, overly complicated, overly

1 restrictive, and fundamentally flawed proposal will
2 result in less advice, fewer choices, and more cost.
3 They believe the rule as proposed will restrict their
4 choices of advisors and service models, again
5 especially for small businesses.
6 Now, with that said, it's time nonetheless
7 to fix the rule. And so we're here to offer our
8 comments and testimony and thoughts to do exactly
9 that.
10 You know, unfortunately, the proposal's
11 regulatory burden and the choice limitations it
12 imposes fall hardest on those very small businesses
13 that already have the most difficult time offering
14 plans. Working with an advisor makes a small business
15 with less than ten employees twice as likely to offer
16 a plan at all. And for small business with less than
17 50 employees, they're more than 50 percent more likely
18 to offer a plan when working with an advisor.
19 Now, our members are concerned, and believe
20 that this proposal, with its massive new compliance
21 and legal liability cost for advisors, will make it
22 infeasible for a portion of those advisors to continue
23 to serve the small plan marketplace, negatively
24 affecting plan formation due to a lack of advice.
25 Now, some platform providers may step in to

1 offer some turnkey plans designed for unadvised
2 businesses, if the final rule permits that, which is a
3 separate discussion. But this can't fully replace the
4 value of an advisor, especially for small businesses
5 offering IRA-based retirement plans like SEP and
6 Simple IRAs.
7 Now, we also know that there is a large cost
8 to participants who do not have access to advice. And
9 in 2011, the Department found that partly due to the
10 restrictions of the prohibited transaction rules, the
11 same rules that this proposal would expand more
12 broadly, lack of access to advice and the resulting
13 preventable investment mistakes cost retirement savers
14 $114 billion in 2010 alone, and you estimated that
15 that cost will be more then 100 billion annually going
16 forward. Well, note that this cost is several times
17 greater than the estimated cost of conflicted advice
18 that's the subject of this proposal.
19 Now, I don't have time today to cover all of
20 the issues we raised in our very extensive comment
21 letter, but we do want to hit a few of those that we
22 think are particularly significant. First and
23 foremost, we object to the discriminatory effect that
24 this proposal would have on our small business
25 members. It permits large plans, those with more than

1 100 participants, to retain the choice of advisors and
2 service models that are best suited for their needs,
3 but it denies that choice to small businesses and
4 individuals.
5 Small plans have the same legal obligations
6 as large plans, and they deserve access to the same
7 choice of advisors as large plans. It's interesting
8 that the Department has consistently stated that these
9 kinds of determinations are based on the individual
10 facts and circumstances of a plan. But here the
11 Department is choosing to substitute its one-size-
12 fits-all universal judgment for that of all the small
13 plans and individuals as to what is in their best
14 interest.
15 The denial of choice is unfortunately a
16 consistent theme in the proposal. For example, the
17 likely effect is to substitute fee-based accounts for
18 transaction-based accounts, despite potentially higher
19 cost for consumers who would prefer one over the
20 other.
21 For example, the BIC exemption prevents
22 advisors from discussing certain types of assets, even
23 if they're in the recipient's best interest. Our
24 members understand the difference between sales and
25 advice, and they want the choice of both for their

1 plans and IRAs. So any final rule should adopt the
2 Department's approach from 2010 and carve out sales
3 discussions for all plans and IRAs, not just large
4 plans.
5 Second, our members are concerned about the
6 loss of a vital educational tool in Interpretative
7 Bulletin 96-1. Redefining asset allocation models
8 referencing the plan's investment options as fiduciary
9 advice would significantly disrupt plan sponsor
10 educational efforts. Removing a proven tool without
11 evidence of abuse is a mistake. Forcing participants
12 to connect the dots themselves between asset classes
13 and available investments undermines the purpose of
14 providing the education.
15 Third, we believe the proposal's definition
16 of advice will confuse participants about when they're
17 receiving fiduciary advice. The proposal requires --
18 removes the requirement that there be a mutual
19 understanding, and the retention of this concept is
20 critical. Fiduciary status determines the respective
21 expectations and obligations of the recipient and the
22 advisor, and there has to be a mutual intent to
23 protect those expectations.
24 In addition, the proposal creates a new and
25 undefined term, which is advice specifically directed

1 to the participant, the recipient. It's not clear
2 from the proposal what it means. It's not defined and
3 not really explained. And this isn't a minor
4 ambiguity. This is a major source of potential
5 confusion at the intersection between the marketing of
6 products and the provision of fiduciary advice.
7 So we ask that the Department retain the
8 requirement of a mutual understanding, and eliminate
9 the "specifically directed to" language in any final
10 regulation to prevent confusion and unnecessary
11 litigation.
12 Fourth, we think the proposal will
13 negatively effect the requests for proposals that our
14 members use to select and monitor platform providers.
15 The platform provider carveout reads that information
16 must be provided, quote, "without regard to the
17 individualized needs of the plan."
18 This simply does not work in practice. The
19 platform provider must discuss with the plan how its
20 services would meet the individualized needs that are
21 outlined in the request for proposal.
22 And if plan fiduciaries are unable to have
23 meaningful discussions with the platform providers
24 about individualized services and investments
25 available due to platform provider concerns about

1 becoming a fiduciary, then our members won't receive
2 the information they need to properly select and
3 monitor. And we believe the Department should remove
4 this language from the platform provider carveout.
5 Now, fifth, we object to the BIC exemption's
6 limitation on the assets that advisors may discuss.
7 This approved list of assets provides no additional
8 protection from conflicts. Those are already
9 addressed elsewhere in the BIC exemption.
10 It also presents a whole list of practical
11 problems because it depends on the asset, not the
12 account. An IRA might hold both listed and unlisted
13 assets in the same account, making it difficult to
14 understand how this new standard would apply to the
15 advisor, and this is especially true in a transition
16 rule, when the new rules goes into effect.
17 Further, the list prevents an advisor from
18 discussing an unlisted asset, no matter how much doing
19 so is actually in the best interests of the IRA owner.
20 And again, we're dealing with tens of millions of IRA
21 owners with an array of different interests. And it's
22 hard to imagine how a single standard is going to
23 cover that.
24 Again, we don't believe the Department
25 should be substituting its own judgment on a one-size-

1 fits-all basis for the professional and impartial
2 judgment of advisors who are complying with BICE. The
3 list should be removed. But alternatively, if you're
4 unwilling to do that, there are certain common
5 investments, like discretionary account management and
6 non-publicly traded REITs that should be added.
7 Sixth, the new state court causes of action
8 established by the BIC exemption are a major flaw in
9 the proposal. To begin with, we don't believe the
10 Department actually has the authority to create in an
11 exemption alternative remedies to ERISA's exclusive
12 remedies for participants.
13 Further, the ambiguity of the subjective
14 conditions that are in the exemption will result in
15 class action lawsuits in state courts, despite good
16 faith efforts to comply. This large legal liability
17 risk will likely prevent many advisors from using BICE
18 as proposed, and therefore rollover and other advice
19 services available to participants and IRA owners will
20 be reduced, which is against their best interest.
21 We also in general have concerns about both
22 BICE and the general applicability in the rollover
23 area. The Department needs to clearly state under
24 what terms, under what conditions, a rollover would
25 result in a -- a rollover advice would result in a

1 prohibited transaction for which an exemption, BICE or
2 otherwise, is necessary.
3 Seventh, the disclosure requirements in BICE
4 will be nearly impossible to achieve in just eight
5 months, and extremely costly to the recipients who
6 will ultimately pay. Also, as FINRA pointed out in
7 its comment letter, the disclosures conflict with
8 securities laws and regulations regarding predictions
9 of future performance for some advisors. Any final
10 rule, we believe, should use general rather than
11 individualized disclosures, such as illustrations of
12 the effects of fees over time.
13 We also note that in implementing EFAST-2,
14 the electronic filing system, the Department itself
15 took about three years, and it's unreasonable to
16 expect the private sector to do an even more difficult
17 system design in just eight months.
18 Last issue to discuss -- I thank you for the
19 indulgence on the time -- is that we're concerned that
20 the division of guaranteed income products between
21 BICE and 84-24 is going to be confusing to
22 participants and undermine efforts to provide
23 retirement income. Instead of receiving apples to
24 apples information to compare guaranteed income
25 products, an IRA owner evaluating, for example, a

1 variable annuity and an equity index annuity will get
2 different disclosures that aren't readily comparable
3 for what appear to the individual to be similar
4 products in essentially the same category.
5 We think this is confusing, and we believe
6 that all annuity products should be provided under 84-
7 24 rather than BICE.
8 Lastly, we would say given these issues --
9 MR. HAUSER: We can stipulate that that's
10 just a partial list for that.
11 MR. CAMPBELL: Indeed. There is a lot to
12 cover in this regulation. Lastly, we would say
13 because there is a lot to cover, because of all these
14 issues, and the fact that there -- you know, as these
15 days of hearings have shown -- we believe that really
16 the Department needs to go forward with providing all
17 interested parties a formal second look at your
18 conclusions to these questions so that we can ensure
19 that there is appropriate discussion and opportunity
20 for the public to comment.
21 MR. HAUSER: Thank you.
22 MR. CAMPBELL: Thank you.
23 MR. HAUSER: Mr. Collins?
24 MR. COLLINS: My name is Joe Collins.
25 MR. HAUSER: Would you mind pulling the mic

1 there? Thank you.

2 MR. COLLINS: Oh, use the microphone. Okay.

3 I'm a certified fraud examiner. I became a fraud

4 examiner after the stock market disaster of 2008 that

5 kind of comes -- still going on today. I call it a

6 disaster because it was a disaster for me and a lot of

7 people.

8 So what is a certified fraud examiner? I

9 have specialized experience and training in the

10 prevention, detection, and investigation of fraud.

11 Donald Cressey years ago created what is called the

12 Fraud Triangle. The Fraud Triangle basically -- you

13 start at the top. You have an unspoken need that you

14 need to fill, like you got a girlfriend on the side or

15 a drug habit or debts or a quota; an opportunity to

16 commit a crime, meaning an opportunity to take

17 something from somebody else; and the ability to

18 suitably justify that crime.

19 Dr. Joseph Wells, who is a certified fraud

20 examiner and CPA, said 25 years ago that deterrence of

21 fraud yields greater results than prosecuting fraud

22 after the fact. So you need to know what fraud is. I

23 was a financial advisor series seven licensed broker,

24 licensed by FINRA, from 1998 to 2009, for a very large

25 financial planning company. I suspected and reported

1 fraud in my company, and they ended my career.
2 So my key message points are going to be
3 this. If your moral compass is broken, everything you
4 do is going to look suitable to you. The goals and
5 training I received were in some cases designed to
6 benefit me in the company at the expense of the
7 client. This was indicative of what I call a deviant
8 corporate culture.
9 We need to change the culture. We need to
10 change the incentives. We need to work on prevention
11 and deterrence rather than trying to prosecute them
12 after they've already ripped off the client, okay?
13 So I haven't done this before, so there is a
14 quote. And, Tim, if you would help me by completing
15 the quote, if you know it. "In the land of the blind,
16 a one-eyed man is --"
17 MR. HAUSER: Go ahead.
18 MR. COLLINS: "-- king." In the land of the
19 blind, a one-eyed man is king. And what we have in
20 America is a lot of people who are completely blind,
21 who know nothing about how financial services works,
22 other than a checking account and a savings account
23 and buying a car.
24 I support the fiduciary standard of care.
25 Giving conflicted advice should be made fraudulent.

1 It is fraudulent. We should remove the incentives to
2 commit fraud. I mean, our clients are conflicted
3 enough. I mean, they're trying to decide are they
4 going to buy the Ford F150, or are they going to buy
5 the Tahoe, say? I mean, they have all this conflict
6 going on anyway. Why do we need to add do it?
7 Early in my career, I had this -- I'm still
8 trying to figure out what it was. It was a thought, a
9 vision, that I might have to stand in front of a judge
10 some day and give an account of every decision I made,
11 every recommendation that I made to my clients. Yet
12 here we are. I made a decision early on in my career
13 to follow a couple of principles. Life is short. Do
14 the right thing, always.
15 I'm 55 years old. I've got, what, 20, 30
16 years more to go? That will go by fast. Give clients
17 the unvarnished truth, whether they like it or not.
18 It's not all smiley-faced and happy letters, telling
19 them how great they're doing. There are problems you
20 need to deal with, like getting a will so that what
21 you have goes to your family and not somebody else.
22 And then take care of widows and orphans in their
23 distress. And keep yourself from being polluted by
24 the world.
25 The system as I see it is -- I guess one way

1 you could call it is biased. The other way you can
2 call it is rigged. That was at my company.
3 I brought this to the attention of my
4 compliance officers. Clients were put in wrap
5 accounts and left there for years without any contact,
6 and they paid -- every month, they paid a fee. IRA
7 rollovers into annuities -- sorry, I don't agree with
8 the non-publicly traded REITs because they pay 7
9 percent, and you put the money on Weingarten -- well,
10 once a month, and they still have their money.
11 What I was taught early on was WDYWFY. Do
12 you all know what that is? WDYWFY, "What Do You Want
13 For Yourself?" This was developed by my CEO and
14 executive vice president, who is still on consult to
15 the company. The WDYWFY model goes like this, okay?
16 First you have a goal. Goals are great.
17 You record your business, your personals, your self-
18 development goals. You know, it's kind of faster
19 horses, younger women, older whiskey, more money.
20 Have a plan. Determine your personal and
21 self-development goals. You know, I plan to have 600
22 clients, make a million dollars a year, $100 a day, 20
23 appointments a week, 2,000 fees, 5,000 commissions.
24 That's my goal. That's what I'm working towards.
25 Implement your plan, okay? So I got to

1 sell, let's see, seven annuities. I've got to sell
2 three theme roles (phonetic) this week. I've got to
3 sell some DI, some long-term care, and put $100,000 in
4 front-load funds because that's where I make the most.
5 So you control the direction. You learn to
6 keep score. You redirect, engage the help of
7 enablers, okay? Sales managers who can help you
8 achieve your goals, and you throw off discouragement.
9 You learn how to channel your emotions in challenging
10 circumstances. I mean, when Grandma doesn't put her
11 $400,000 into a variable annuity, that can kind of get
12 emotional because you didn't make your car payment.
13 Having a plan is great. But when the plan
14 conflicts with what your clients need to achieve, I
15 have a problem with that. Take, for instance, a
16 client came to me, and they had -- the couple had
17 $80,000 in credit card debt. I refused to take their
18 money. I refused to take their rollovers, said leave
19 them where they are. They were there. They were
20 fine. They're in good stuff. Until they paid off
21 their debts and build a cash reserve.
22 It took three years. What did I get paid?
23 Nothing. Was it the right thing for the client? Yes.
24 Was it the right thing for the company? Not so much.
25 They were never -- a client who had paid wrap fees

1 for seven years, they put in 52,000. They went to
2 26,000. They had an average of $34 to $55 taken out
3 of their account every month. And the branch manager
4 who was supposed to be managing that account spent 99
5 percent of her time recruiting, and no telling how
6 many more accounts she had.
7 I mean, it was -- I mean, think about if
8 you've got a few million dollars paying you 1 percent,
9 and that check just comes in every month. I mean,
10 it's more like what they call a multilevel, mailbox
11 money.
12 I had another client, a very good client.
13 We became good friends. He took me out to a property
14 after we had worked together like six or seven years.
15 He had brought me $580,000. We turned it into 1.2
16 million, and he had retired. And he wanted to buy
17 this place. Smart guy, one of the two geniuses I've
18 ever known.
19 And so we went out, and we walked the
20 property. We got soaking wet, 40 acres, built a
21 house, put in roads, put in bridges, and all this
22 stuff. And we get back, and what do you think? And I
23 said, do you really want to go through this. And he
24 just looked at me really mad, and he told several
25 months later he wanted to deck me right there. But he

1 said it was the best advice anybody had ever given
2 him.
3 What did I get paid? Zero. What did the
4 company get? Zero. But it was the best thing for the
5 client.
6 The author of the WDYWFY wrote in one of his
7 books, getting what we want is good. Our goals can be
8 at the same time selfish and morally aligned. Let me
9 say that again. 'Getting what one wants for oneself
10 is a rightfully selfish process, provided that what
11 one wants is in alignment with our moral compass.'
12 MR. HAUSER: So, Mr. Collins, you have about
13 one more minute.
14 MR. COLLINS: Okay.
15 MR. HAUSER: And I know that you -- your
16 letter indicated you both had concerns about the
17 alignment of incentives at the company, but you also
18 had a concern that our exemption -- our rule really
19 wasn't going to do much. And I find these criticisms
20 to be therapeutic.
21 MR. COLLINS: Okay.
22 MR. HAUSER: So I do want to give you a
23 chance to tell us.
24 MR. COLLINS: All right. If you get a
25 chance, send somebody down to Austin in the next

1 couple of weeks. There is a mutual fund company that
2 is opening an office there. And they're flying in
3 brokers from -- and I won't mention names. They're
4 putting them up in $700 a night hotel rooms, $600
5 bottles of sake, and there was one $30,000 dinner for
6 40 people.
7 And when you hear them talking, and they're
8 going, yeah, I'll sell that, yeah, I'll sell that,
9 yeah, I'll sell that. We'll buy something else on
10 Monday. And they're out there getting wined and
11 dined. And, yeah, I don't think that's taking care of
12 clients. I think that's what is called payola. We
13 had that in the radio business. We don't need 12B-1
14 fees. We don't need backdoor payments, okay?
15 We don't -- I wanted to be able to look my
16 client in the eye and say the only money that I will
17 receive is the money that you pay me for the advice
18 that I give you, or the things that you may implement,
19 okay, that you bought from me.
20 I tried to turn off the 12B-1 fees. My
21 company said no.
22 MR. HAUSER: So could you bring it to a
23 close?
24 MR. COLLINS: Okay. A couple of things that
25 can be done immediately. We found in fraud

1 examination that if you have an employee sign an
2 honesty statement when they start, it will reduce
3 fraud -- I think is was somewhere between 10 and 30
4 percent. That's something that can be done
5 immediately. You just sign a statement that says, I
6 promise to do the best thing for my client always.
7 It's real simple.
8 Statement review meetings can be implemented
9 immediately. That's where you take that 19 pages --
10 and they only look at the first two -- and you go
11 through it page by page. You show what happened. You
12 show what you're paid. You show them what is going on
13 with their accounts. And if they ask how much you got
14 paid, show them your comp statement. Then there is no
15 doubt who is getting paid, why you're doing it, what
16 you're doing it for.
17 We need to protect our whistleblowers. It's
18 called whistleblower protection programs. DOL manages
19 I think 22 now, okay? It's called whistleblower
20 protection, not crime scene investigation after the
21 fact.
22 So I think Christine Lagarde said it best.
23 She's the head of the IMF. She said it's called the
24 financial services industry. It's a service industry.
25 It should serve others before itself.

1 MR. HAUSER: Okay. So let's maybe stop
2 right there, and we'll move to questions. Thank you
3 very much.
4 You know, Mr. Campbell, you had such an
5 lengthy list. Each item on it, I think, would have --
6 you know, would take up an enormous amount of time,
7 and I really don't want to do that. But I do want to
8 ask you about a couple of things. The first is, you
9 know, there have been -- I mean, I assume that the
10 Chamber would welcome -- and I just wondered to what
11 extent this resolves in your mind some of the concerns
12 about small businesses' access to fiduciary advice.
13 But a number of people have suggested, one,
14 that at least in the plan context, that we go back to
15 a rule that says that when you give somebody an asset
16 allocation, you can illustrate the suggested
17 allocation with the specific items on the front menu
18 as long as you include all of the designated options
19 on the front menu that fall within that category, at
20 least assuming the fiduciary overseeing the fund is
21 independent of the advisor, and the advisor doesn't
22 have an interest, you know, as between the various
23 funds on the fund menu.
24 Does that, you know --
25 MR. CAMPBELL: Well, I have to say, I got a

1 little lost in the list of your conditions there. If
2 what I heard you say is that advice can be provided
3 with asset model -- asset allocation models and
4 corresponding investments that meet each of the asset
5 classes, yes, I think that's exactly what we think --
6 MR. HAUSER: If you specify all of the
7 designated -- all of the options that fall within each
8 of the classes under the plan, I mean, starting there
9 and --
10 MR. CAMPBELL: I think that would be
11 perfectly reasonable to provide the -- all of the
12 investments available in the plan menu that fit that.
13 If what you also said is then anybody couldn't be
14 including any of the options related to the provider
15 who is related to the education, that I think is a
16 restriction that's unnecessary because again, the
17 asset allocation model is not a fund-level
18 recommendation. It simply allocates -- it's talking
19 about a model allocation to a class. So if that class
20 happens to include an investment that's related to the
21 provider of the education, I don't see that as a
22 conflict that's of the sort that this regulation is
23 intended to address.
24 MR. HAUSER: I see. And, I mean, just
25 asking about the seller's exception, you're -- you

1 know, you and, as I noted on the previous panel, a
2 number of people have drawn a sharp distinction
3 between a sale on the one hand and advice on the
4 other. And I guess I'm just going to confess I don't
5 understand the distinction.
6 To me, these -- you know, they go -- you can
7 both have a sale, and you can have, you know, advice
8 connected with that sale, and the question I have is
9 if somebody is holding themselves out as essentially
10 as an investment professional, and if they're giving,
11 you know, the sort of advice that rises to the level
12 of a specific investment recommendation in kind of the
13 FINRA sense, why would -- and they're getting a fee in
14 connection with that. Why should there be any
15 additional carveout from the obligation to act in the
16 customer's best interest?
17 MR. CAMPBELL: Well, you've said a couple of
18 interesting things there.
19 One, you used the phrase "a customer's best
20 interest." That's not what you're actually talking
21 about in this proposal. You're talking about ERISA
22 fiduciary status and the accompanying effects of the
23 prohibited transaction rules, which is in my mind a
24 separate question from what is in the best interests
25 of the participant.

1 As you well know, under ERISA, I can make
2 for you what is, by anyone's estimation, the best
3 possible recommendation for you, and it nonetheless be
4 prohibited for me to do so simply because of the
5 structural relationship I have with the investment or
6 with the client.
7 That's where the ERISA standard, the ERISA
8 fiduciary standard, as well as the prohibited
9 transaction standard, goes well beyond the question of
10 what's in the best interest. That's why we have
11 presumably the BIC exemption and a whole host of other
12 exemptions. It goes right to the nature of your
13 question, which is sales activity has, associated with
14 it, relationships that are not permissible typically
15 under an ERISA-prohibited transaction regime. That's
16 why you have the exemptions to allow that activity.
17 So it's not a question of, why can't I act
18 in the best interest while being a salesperson. I
19 believe that I am acting in your best interest when
20 I'm being a salesperson if I'm doing that job
21 properly. The problem is ERISA doesn't view those as
22 two separate questions -- or as one question. They're
23 two separate questions.
24 MR. HAUSER: I'm not sure I -- so if the
25 exemption essentially mandates that you act in your

1 customer's best interest, and it's essentially
2 calibrated to achieve that, but in a workable way, as
3 I understand the Chamber's position at this point, it
4 would still be objectionable to the Chamber to
5 subject, you know, the advisor in that circumstance to
6 any fiduciary obligation. So why?
7 MR. CAMPBELL: Well, again, that's not what
8 I said. The issue isn't whether they're acting in the
9 best interest or whether that's a prudent fiduciary
10 recommendation. The question is that as a
11 salesperson, can I in fact engage in that activity
12 without running afoul of the prohibited transaction
13 rules, separate from the quality or utility or value
14 of the recommendation itself.
15 MR. HAUSER: Right. But then -- I mean, and
16 the answer is under the statute, if you give
17 investment advice for a fee to a plan or an IRA,
18 you're a fiduciary. And the Department of Labor's
19 charge and the default is that, yes, you're prohibited
20 from giving that advice on a conflicted basis. It's
21 the Department's charge to then write exemptions to
22 the extent that they're appropriate.
23 And I guess my question is what you're
24 saying is that, as I understand it, that when the
25 person makes --

1 You know, even when the person makes an
2 individualized recommendation in a context where
3 they're holding themselves out as an investment
4 professional, and the plan customer is looking to them
5 for professional guidance, that there are still
6 circumstances that you would call sales in which they
7 should neither have to give prudent or loyal advice
8 under ERISA's fiduciary rules, nor should they have to
9 comply with any exemption, even if that exemption were
10 to do nothing but require them to adhere to the
11 prudence and loyalty obligations. Isn't --
12 MR. CAMPBELL: That's not what I was saying.
13 What the --
14 MR. HAUSER: Well, but is it correct? I
15 mean, let's --
16 MR. CAMPBELL: Well, the word that you used
17 earlier, which I think is an important one, is
18 "workable" with respect to the exemption. The
19 question is can I, acting as an agent for a particular
20 brand of products, for example, nonetheless make a
21 prudent recommendation, even though I'm only an agent
22 for that narrow brand of products.
23 And if an exemption is written in such a way
24 that I can go ahead and do that, I can be compensated
25 for it. We would want appropriate disclosures and so

1 forth. Then that's an entirely different situation
2 than saying: does the BIC exemption do that? Which I
3 don't think the BIC exemption does.
4 MR. HAUSER: Okay. So in concept, you don't
5 have a problem with our imposing a fiduciary
6 obligation, at least in that circumstance, if the
7 exemption works?
8 MR. CAMPBELL: If by fiduciary you mean that
9 I'm making a prudent recommendation, again which we've
10 been throwing around the phrase "best interest,"
11 certainly. If what you mean is that it has to have an
12 exclusive duty of loyalty such that I'm not able to
13 represent a narrow employer for whom I'm an agent, or
14 that I can't be appropriately compensated for that,
15 then, no, I don't agree with it.
16 The question is what do you mean, and that's
17 what the whole issue is, is what is workable.
18 MR. HAUSER: Well, you can be appropriately
19 compensated. But --
20 MR. CAMPBELL: And to that point, if I could
21 just say, we've had a lot of exchanges over the course
22 of the last two days in which the Department has said,
23 well, of course we didn't mean that, of course you can
24 do X, Y, and Z. The reason in the comments we brought
25 up questions where we perceived ambiguities is not

1 because we just wanted to have fun and be here.
2 It's because the problem is we have to
3 adhere to these regulations by the letter. So where
4 there is ambiguity, that's potential legal liability.
5 It's a potential inability to know what the actual
6 compliance obligation is.
7 So I appreciate you saying that. I'm just
8 saying unless it's written down in the final rule,
9 it's very hard for us to just accept, oh, well, of
10 course you intended for us to be able to compensated.
11 The question then is when and how, and how does that
12 work in practice, and what is the legal liability
13 associated with those decisions.
14 MR. HAUSER: So there are multiple levels of
15 ambiguity in a process like this. I mean, the purpose
16 of the notice and comment process in significant part
17 is to ferret out people's concerns about, you know,
18 the initial proposal, and then make revisions to
19 respond to perceived ambiguities. And, you know,
20 obviously there are both ambiguities that I think are
21 legitimately identified that need to be clarified.
22 There are ambiguities, to be completely blunt about
23 it, that are talking points to be used in advocacy
24 efforts to defeat the rule.
25 We're trying to respond to all of these

1 things. And regardless of how -- you know, what
2 happens in the final rule, you can count on our
3 continuing to work with people to the extent they
4 identify ambiguities. And as a general proposition,
5 the agency's interpretation of its own regulations get
6 deference. So we'll be able to continue to resolve
7 those ambiguities. So I absolutely appreciate these
8 efforts, and that is part of what the approach is
9 about.

10 But let me ask you, just with respect to
11 investment advice, one of -- and the seller's
12 exception. One of the points that keeps being made
13 for the need for a broader grandfather --
14 grandfathering of existing arrangements is that people
15 have prepaid for this advice in many of these
16 arrangements.

17 This is a point made over and over again in
18 the comment letters. So in your view of how a
19 seller's exception would work, would it encompass any
20 of these arrangements where somebody has prepaid for
21 the advice?

22 MR. CAMPBELL: Well, I think this is less a
23 question of the seller exemption per se than the
24 broader transition rule question. My concern is the
25 rule as proposed has no transition rule whatsoever,

1 except within BICE.
2 MR. HAUSER: No. And I understand the
3 perceived need for a broader grandfather provision,
4 and that's certainly something we're looking hard at.
5 I'm just wondering conceptually if when you're
6 thinking about what a seller's exception would look
7 like, would it ever encompass an arrangement in which
8 part of the fees on an ongoing basis include something
9 that's being denominated as an ongoing payment for
10 advice? Because that is the rationale for a lot of
11 the grandfather relief requests.
12 I mean, it seems to me if you think there is
13 a distinction between sales and advice, then would it
14 really -- shouldn't that be problem -- shouldn't it be
15 problematic to give a seller's exception that extends
16 to a compensation stream that is for advice?
17 MR. CAMPBELL: Well, I think that's an
18 interesting question. I haven't thought about that.
19 That's something that we can certainly look at. I'm
20 not sure off the top of my head I can conceive of an
21 example of exactly what you're referring to, but
22 that's certainly something we can look at and discuss
23 later.
24 MR. COLLINS: Well, I can. I managed about
25 $17 million, and I think I had 6 million in wrap. And

1 that was in an average of like 90 basis points. And I
2 usually talk to clients at least twice a year. Some
3 clients I talk to once a month. And I always know
4 what was going on. I always kept updating to make
5 sure that we were still in the right place.
6 I don't know how people handle 600 to 1,000
7 clients, but I got fees for advice because I advised
8 people on the six key areas of financial planning.
9 And I got a fee for assets under management, okay?
10 But if they're getting a match on their 401K, why
11 would you roll it over? It's -- I think it works as
12 long as you're taking care of the client and doing the
13 right thing for the client.
14 MR. HAUSER: So let me just -- Mr. Campbell,
15 let me just -- I mean, I don't want to beat this dead
16 horse much more than it's worth. But, you know,
17 trailers are commonly, you know, rationalized in that
18 fashion. And on page, you know, 38 of the July 17,
19 2015, you know, letter from the Chamber, they refer to
20 the fact first in many cases customers that paid an
21 initial sales charge for which they purchased advice.
22 I'm just curious, you know, how that
23 interacts with the seller's exception because it seems
24 like there is a little bit of a consistency issue
25 there. If any transaction would be subject to the

1 seller's exception, that would also be one that earns
2 this kind of ongoing charge. But anyway --
3 MR. CAMPBELL: Yeah. Well, in the comment
4 letter, we were addressing the transition rule. And
5 what we were saying there is on some date certain,
6 universally everything must change, except for one
7 limited transition rule in the BIC exemption, which is
8 only available for assets that are on the special
9 list.
10 So we were pointing out that this transition
11 rule makes no sense in that it's going to apply asset
12 by asset, not by account, only for ones eligible for
13 BICE. And on top of that, you were essentially, by
14 not having any transition rule, disrupting contracts
15 that two parties had made in good faith that were
16 valid under current law. And if that included things
17 like paying for advice, a front-end load to pay for
18 advice on the back end, that disrupting that contract
19 would deny participants the -- or IRA owners or
20 whomever the benefit of the bargain they had made.
21 So that was the context in which we were
22 offering that comment. That's why I said I hadn't
23 thought about it in your -- in the context of our
24 question. But it's something I'd certainly be happy
25 to get back to you on.

1 MR. HAUSER: Understood. And then this is
2 my last question, although it does have two parts. So
3 on your observation that there should be a mutual
4 agreement to trigger fiduciary status, there are two
5 issues I have with respect to that concept.
6 The first is just the danger of abuse, I
7 mean, that essentially it enables somebody to hold
8 themselves out as an investment professional upon whom
9 their customer can rely and, you know, have a whole
10 set of communications maybe extending over quite a bit
11 of time, all of which are proceeding upon this
12 relationship of trust.
13 But then in the text of an agreement
14 somewhere, you know, write language along the lines
15 of, you know, that the guidance that I've been
16 providing should be viewed as educational in nature,
17 not individualized, and not intended to serve as a
18 primary result basis for your investment or tax
19 planning decisions. And now you can say it wasn't
20 mutual.
21 That worries me. And I wonder if you think
22 the mutuality in any sense turns on that kind of
23 provision and agreement or that kind of disclosure,
24 how we guard against abuse. And the second is just a
25 legal question, which is while certainly one can agree

1 to be a fiduciary, ERISA's great innovation in the
2 fiduciary definition is that usually fiduciary status
3 turns on a functional activity.
4 It's not a question of did you or didn't you
5 agree to something. It's a question of did you do the
6 thing that makes you a fiduciary. And in this
7 statute, it says, gave investment advice for a fee to
8 a plan or an IRA. That's fiduciary activity. There
9 is no agreement requirement in that text.
10 So if you could just respond to those two
11 observations, and then I'll turn it over.
12 MR. CAMPBELL: Yeah, no. First of all,
13 that's a very good question. I don't think the intent
14 of anyone who is objecting to the removal of mutuality
15 from that definition is saying, yee-haw, this is a
16 great way to get out of the contract by saying, nope,
17 it's not mutual. That's not the intent at all.
18 The concern is rather the opposite, that
19 because of -- particularly when you combine it with
20 the "specifically directed to" language, if I have a
21 current client, and I send them a letter in the mail
22 that's addressed to them by name, that discusses, you
23 know, hey, here is a new investment we have available,
24 maybe you should give me a shout and we'll talk about
25 it, is that now fiduciary advice that's

1 unilaterally --
2 MR. HAUSER: No. That's not fiduciary
3 advice. And our education definition clearly says
4 it's not. Really, it's -- as does the definition of
5 what counts as advice. It has got to be a
6 recommendation, which essentially means a call to
7 action, a suggestion that you pursue a specific
8 investment or a specific investment strategy.
9 So clearly you can talk --
10 MR. CAMPBELL: So just to be clear, so
11 you're -- I just want to make sure I understood this
12 because this wasn't something that we were able to
13 divine from the proposal.
14 MR. HAUSER: Oh, no --
15 MR. CAMPBELL: The Department's position is
16 that it has to be the FINRA definition of
17 recommendation under your --
18 MR. HAUSER: Well, the Department's position
19 as articulated in the regulation is that first it has
20 to be a recommendation. That's what the -- that's
21 what the rule literally says. It uses the word
22 recommendation.
23 There is a definition of recommendation in
24 the rule, which uses -- you know, which refers to --
25 let me see if I can actually just pull the thing out -

1 - which refers to something that -- a means of
2 communications based on content, context, and
3 presentation would be reasonably viewed as a
4 suggestion that the advice recipient engage in or
5 refrain from taking a particular course of action.
6 And then further in the preamble, we explain
7 that we used FINRA concept as a touchstone, and we
8 specifically ask people to comment on whether we
9 should adopt the FINRA recommendation.
10 So that's not just an ambiguity. That's
11 something we laid out for people and tried to make as
12 clear as possible. We do keep hearing from folks that
13 even a casual conversation in which there is nothing
14 approaching a recommendation would be covered by this
15 rule. But that at least is plainly not correct.
16 MR. CAMPBELL: Well, I think that's a
17 helpful clarification. I would technically note that
18 saying, "we use this as a touchstone, and we ask the
19 question as to where they actually apply it," is
20 different than saying, "it actually applied in the
21 regulation." Either way, I think that's a helpful
22 clarification that's appreciated.
23 The broader point I was making, though, is
24 that when we have a new term like specifically
25 directed to, we have to figure out what that means.

1 And so if it can be a unilateral act to make a
2 recommendation by virtue of terms like this that we
3 haven't seen before, that's a concern because it makes
4 it difficult for either party to know when in fact
5 fiduciary advice has been provided or relationships
6 have been established.
7 And so that's -- our view is, mutuality is
8 inherent in any contract, and therefore ought to be
9 included in this as well.
10 MR. HAUSER: And if we adopt that
11 recommendation concept as articulated by FINRA, you
12 don't have that mutuality of agreement concept there,
13 do you ?
14 MR. CAMPBELL: Well, I think at the end of
15 the day, there is enough -- I think there is benefit
16 to including it because at the end of the day, what it
17 really means is would an objective third person
18 looking at this identify that these two parties
19 intended to engage in this activity. To me, that's
20 what a mutual understanding is. And I think it should
21 be in the contract.
22 I think when you take it out of the
23 definition, it indicates that the Department is saying
24 something that's inherently different about this
25 relationship than it was before. And I don't -- you

1 know, when I see a change in a regulatory definition,
2 I ask why. What is different about it. And to me,
3 that's the purpose of it.
4 MS. LLOYD: So there has been some
5 conversation on this panel about the list of assets in
6 the best interest contract exemption. And I wanted to
7 ask you, Mr. Campbell -- you said a couple of times
8 that the exemption prevents advisors from discussing
9 certain assets. And I was wondering if you could
10 explain what you mean by that, how the exemption would
11 work to prevent that from happening.
12 MR. CAMPBELL: Yeah. The exemption is
13 conditioned on advising regarding assets, and assets
14 are defined as a list of specified assets. Those
15 assets that are not on that list -- therefore, if the
16 advisor needs the BIC exemption to give the advice,
17 they can't effectively advise on assets not on the
18 list, or else they're committing a prohibited
19 transaction.
20 MS. LLOYD: Okay. So it's not that it
21 prevents it. It's just that we are not proposing an
22 exemption to permit advisors to recommend those
23 assets.
24 MR. CAMPBELL: I would say that's a
25 sophistry. If I can't do something without committing

1 a prohibited transaction, then your creation of the
2 list is preventing me from doing it.
3 MS. LLOYD: Well, but can't you recommend it
4 in a non-conflicted compensation structure?
5 MR. CAMPBELL: Yeah. I didn't say that you
6 couldn't advise on it. I said the exemption prevents
7 you from advising on it. If you don't need an
8 exemption, obviously you can advise on whatever you
9 want. If, however, you need the BIC exemption, then
10 you have to advise only on assets that are on the
11 list. And again, our concern is we see absolutely no
12 reason why you would limit the list in the first
13 place.
14 The BIC exemption, as you proposed it, would
15 already result in no unlevel compensation, no
16 differential compensation for that advisor unless it's
17 related to a neutral factor.
18 I would argue that's an example of the
19 ambiguity that would result in more litigation. But
20 nonetheless, there is no additional protection that
21 list provides. I view it simply as the Department
22 asserting its own views as to what the right
23 investments are. And I think that's in contrast with
24 the entire history of ERISA and the statute, and an
25 inappropriate step.

1 MS. LLOYD: Well, could I ask the other
2 panelists if they agree with that? I think that has
3 been addressed in some of your comment.
4 MR. HALL: Yes. On behalf of Better
5 Markets, we think that the list of permitted assets
6 under the BIC is appropriate and necessary. And I
7 think philosophically it arises from the fact that
8 this is an exemption. And it is necessary then to
9 design a set of layered protections to safeguard
10 investors because basically a conflict has been
11 allowed to persist.
12 With respect to the particulars, I think to
13 your point, there certainly is -- investors who really
14 want products beyond the list can get them. And in
15 fact, advisors who want to recommend them can
16 recommend them. And there is a variety of
17 alternatives from both sides of that coin to make
18 assets beyond that list eminently available.
19 I think the list is broad, presumptively
20 broad enough to accommodate most investor needs. I'll
21 note that in the release, there is even the suggestion
22 that if there are products that meet the essential
23 criteria, which is transparency, liquidity, and fair
24 pricing, then members of the industry could come
25 forward and seek to address those separately. I think

1 it's an appropriate restriction.

2 MS. LLOYD: Well, I was going to see if Mr.

3 Collins wanted to --

4 MR. COLLINS: I haven't seen the list, but

5 if you don't understand what it is, then don't sell

6 it. Non-publicly traded REITs, they were pushed on me

7 for 11 years. I never once sold them. I didn't

8 consider them because they weren't liquid. I didn't

9 make the decision because I got to meet quota, and

10 they pay 7 percent. That's conflict.

11 MS. LLOYD: Okay. Thank you. I thank the

12 panel.

13 MR. HAUSER: Maybe, Mr. Hall, if I could ask

14 you one more question. I'm just thinking about this,

15 this notion that we should permit people, when they're

16 giving asset allocation education in the plan context,

17 to couple that with the specific, you know, fund

18 options that are on the plan lineup, as long as they

19 include all the fund options that match that asset

20 allocation. Is that something that you think make

21 sense, or is that something that concerns you?

22 MR. HALL: I think that on the relative

23 scale, that's an adjustment that would cause less

24 problem than some others that might be considered

25 regarding the rule.

1 It's an improvement, in short. We still
2 would have the concern because as the release explains
3 -- and we embrace this thinking -- if you have an
4 allocation model, asset allocation model, and you
5 populate it with specific assets, even if they happen
6 to be to the extent of what is available in some
7 sense, you are still confronted with the essential
8 reality that that's tantamount to a recommendation.
9 MR. HAUSER: Okay. Thank you very much.
10 And thank you all.
11 MALE VOICE: Thank you.
12 (Pause.)
13 MR. HAUSER: Last panel for the day.
14 (Pause.)
15 MR. HAUSER: Whenever you're ready.
16 MR. McSHEA: Do you want me to start?
17 MR. HAUSER: Sure.
18 MR. McSHEA: Okay, great. Thank you very
19 much. Good afternoon. It's the last panel after two
20 long days, so we appreciate your time and patience.
21 My name is Greg McShea, and I serve as the general
22 counsel for Janney Montgomery Scott. We're happy to
23 be here and grateful for the opportunity to offer our
24 firm's perspective on the Department's fiduciary
25 proposal.

1 Prior to today, our firm has been actively
2 involved in the Department's rulemaking efforts since
3 2009, working closely with our securities industry
4 peers to develop a higher standard of care that is
5 satisfactory to everyone, to all parties involved,
6 regulators and regulated alike, and most importantly
7 the retirement investors that all of us are here to
8 serve.
9 At the outset, I'd like to make it clear
10 that while Janney is opposed to the proposal as
11 written, and as reflected in our comment letter, we
12 are undeniably in favor of a uniform higher standard
13 of care, one that will apply to all investment
14 relationships, not just individual retirement
15 accounts, or IRAs.
16 So by way of background, Janney Montgomery
17 Scott is one of the oldest full-service financial
18 services firms in the country, tracing our routes back
19 to 1832. For over 183 years, our firm has been
20 providing investment advice to the very constituents
21 that this proposal is intending to address. We have
22 done so, we believe, by endeavoring to act
23 consistently in the best interests of our clients,
24 regardless of the technical legal standards of care
25 that might apply.

1 Ours is an advice business. And while we
2 have other business lines, our primary business is
3 serving those individual clients and families that
4 this rule is intending to address. We're not the
5 biggest firm, and you've heard from some today who are
6 bigger than us. We're not the smallest firm. You've
7 heard from others that are smaller than ours.
8 As a middle market, regional broker-dealer,
9 we have 740 advisors who provide tailored solutions in
10 a face-to-face environment, helping the roughly
11 125,000 families that we serve. Our clients entrust
12 $68 billion in their assets with us, a material
13 portion of which are held in IRAs.
14 To emphasize the importance that personal
15 advice has on our approach to serving our client base,
16 we do not offer a discount or client-directed, online
17 trading feature. We don't have a robo-advisory
18 platform, and we don't have a centralized 800 number
19 call-in type center for processing transactions. Our
20 model mandates that our clients and financial advisors
21 actually communicate with one another to come up with
22 the solutions that make the most sense for them.
23 Against that backdrop, my remarks today
24 aren't going to restate the full array of complexities
25 and legal issues associated with the proposal or the

1 companion BIC exemption. My intent is just to
2 highlight from our firm's perspective where our
3 primary business model is predicated on advice how we
4 believe the proposal would actually achieve perversely
5 the exact opposite results of what it's intended to
6 achieve.
7 Let me begin by emphasizing that Janney
8 supports the DOL's efforts to enhance investor
9 protection. We acknowledge and agree with the DOL's
10 basic desire to adopt a fiduciary standard to apply to
11 IRAs. We believe that a higher standard of care would
12 go a long way to improving the level of trust and
13 confidence that individual investors have in the
14 financial system, and in service providers more
15 specifically.
16 Investors deserve to have their interests
17 placed first. And in this regard, our interests are
18 aligned. That said, we think that the approach being
19 taken by the Department is unnecessarily complicated.
20 And as you heard yesterday from Mr. Bentsen of SIFMA,
21 the process of getting to this fiduciary standard is
22 probably as important, if not more important, than our
23 shared outcome.
24 So as written, we believe that the proposal
25 just simply doesn't work, and will have lasting

1 negative unintended impacts as compared to other
2 approaches that have been proffered that can achieve
3 the same or similar result with far less investor
4 confusion, disruption, and expense.
5 So just a few comments. My first comment
6 would be that we still think it's in the investor's
7 best interest, in the interest of retirement savers,
8 that the Department stand down and defer to the SEC
9 and FINRA to adopt a uniform standard of care that
10 applies to all investors.
11 Both the SEC and FINRA favor that approach.
12 And as the DOL is aware, SIFMA has proposed a higher
13 best interest standard of care, one that works within
14 the existing regulatory framework, and will be far
15 easier to implement than what is currently proposed.
16 Respectfully, we don't believe that the
17 process that is being taken by the Department is the
18 right approach to achieving the goal of a higher
19 standard of care. We see the proposal as confusing,
20 increasing costs to retirement savers, and practically
21 eliminating access to investment education, advice,
22 and choice those investors enjoy today, particularly
23 for the smallest retirement savers who need advice the
24 most.
25 So we would hope to avoid the unneeded

1 confusion by this proposal, and end up with an outcome
2 that has a uniform standard that applies to all
3 investment accounts, with one set of rules and one set
4 of pricing options for all of our client accounts,
5 both taxable and tax preferred.
6 At this juncture, with the majority of the
7 securities industry, I believe, in favor of a uniform
8 standard of care, including its regulators, we would
9 hope that the Department take the necessary time to
10 substantively collaborate with the SEC and FINRA to
11 create that uniform fiduciary standard.
12 The proposal, as we see it, eliminates
13 investor choice, and increases cost. Our business
14 model is predicated on the notion that our clients
15 value the advice that our financial providers -- that
16 our financial advisors provide. We offer our clients
17 a choice. They can either work with their advisor in
18 a fee-based environment, or in a commissioned-base
19 account. These -- and they operate under the Advisors
20 Act of 1940 in the former case, or under the SEC rules
21 and FINRA rules in the latter.
22 These two legal constructs provide different
23 options and advantages to our customers as they
24 choose. In some cases, clients have both. And at
25 their discretion, our clients are willing to pay

1 competitive rates for that advice based on their
2 chosen account structure -- whether it's commission or
3 fee-based -- that is best suited for them. No
4 different than any other professional service where
5 the value of the service and method of compensation
6 may vary from one provider to another. Whether it's
7 legal services, accounting services, or some other
8 professional services.
9 As written, the proposal jeopardizes our
10 ability, we believe, to continue providing commission-
11 based accounts to our IRA customers when that may be
12 the preferred and best option for them. IRA customers
13 may then be left with transitioning to higher cost,
14 fee-based accounts, when that may not be preferable;
15 going it alone through the use of low-cost or robo-
16 providers where there is little to no advice provided,
17 notwithstanding the DOL's acknowledgment that IRA
18 investors are in dire need of education and advice; or
19 in the worst case, foregoing any investment advice
20 altogether and withdrawing their assets. And I think
21 we all would agree that that's the worst outcome.
22 Higher cost advisory accounts are especially
23 problematic for our existing customers, who have
24 chosen brokerage accounts that they prefer. And under
25 the existing structure, to avail ourselves of the BIC,

1 which I submit to you is an unworkable option for us,
2 that would lead today roughly 40,000 of our customers
3 without an option. What happens to those customers,
4 many of whom are smaller accounts, savers just
5 starting out, with limited means?
6 And the shame of it is ours is a firm that
7 does not segment away smaller client accounts. And
8 we're happy to serve those accounts.
9 There are a myriad of reasons why the BIC
10 exemption is unworkable. At this juncture, and as
11 it's proposed, we would not avail ourselves of it,
12 the complexities associated with it. If you look at
13 the Deloitte letter that was attached to the SIFMA
14 comment letter, there would be 32 new requirements
15 under the BIC exemption that firms would have to
16 comply with.
17 Not knowing the magnitude of the liabilities
18 associated with the BIC, the increased costs and
19 regulatory and legal exposure that comes with it, we
20 would not -- we would not avail ourselves of the BIC.
21 So in conclusion, we believe that there are
22 significant flaws with the proposal, that it will
23 curtail investment education and advice, eliminate
24 choices for our clients today, add unnecessary
25 complexity and confusion into the retirement saving

1 process, and increase costs for retirement saving and
2 investing. The BIC is simply unworkable.
3 So we appreciate the time, and I'll be happy
4 to entertain any questions you may have.
5 MS. McNEELY: Good afternoon. I'm standing
6 between you and the end of the day, right? I'm Juli
7 McNeely. I'm the national president of NAIFA, the
8 National Association of Insurance of Financial
9 Advisors. I want to thank you for allowing us to be
10 here today. I'd like to introduce my client, who I
11 have brought with me, Dr. Jen Knoll. She is going to
12 address this panel first, and then I will follow up
13 after her.
14 DR. KNOLL: Thank you for allowing me to
15 share my consumer experience as a small employer and
16 as an individual investor and retirement saver. I've
17 been a dentist for almost 13 years. That's what I
18 know. I purchased my primary practice, Sparta Dental
19 Center, seven years ago, and three years ago I opened
20 a second location in Arcadia, Wisconsin. I have 12
21 employees, and plan to hire at least two more soon.
22 A significant amount of my time and
23 financial resources have been focused on running and
24 building my practices. Because that demands so much
25 of my time and energy, I've relied on other

1 professionals to assist me and provide advice as
2 needed, such as lawyers and accountants and, of
3 course, my practice consultants, and Juli, my trusted
4 financial advisor.
5 Juli and I have been working together for 11
6 years, and she is a trusted advisor to me. We've had
7 countless meetings, some that involved a product sale,
8 and others that were simply discussion, idea sharing,
9 and advice.
10 Some may say that I could handle these
11 financial decisions on my own without Juli. But quite
12 simply, I value her expertise. Juli has helped me
13 understand more about insurance, retirement planning,
14 and investing than I would ever have time to learn and
15 implement on my own.
16 Working with Juli allows me to focus on what
17 I do best, seeing my patients and running my business.
18 I'm very comfortable with the compensation
19 arrangement that Juli and I have. I'm aware that
20 other compensation models exist. I also know that
21 Juli puts my best interests first. And not only that,
22 she works with all my valued employees who are saving
23 a small portion of their wage via our Simple IRA.
24 My employees appreciate the opportunity that
25 they have to consult with Juli on an individual basis,

1 and they are thankful that they have a resource to
2 save for retirement with our plan.
3 I know I have right and responsibility to
4 choose which advisors I work with. I understand that
5 in business, I will pay fees for services provided to
6 me. But I also need advisors that value my time. I'm
7 on my fifth lawyer in seven years because my time
8 hasn't been valued. On the other hands, Juli will
9 take as much time as is needed to explain a product or
10 service. She travels three hours roundtrip to meet
11 with me, and she will work around my busy practice
12 schedules.
13 I'm so fortunate to know her, and to be here
14 with her today, and I'm really happy to turn it back
15 over to her now.
16 MS. McNEELY: Thank you, Dr. Knoll. I just
17 want to be clear I'm here representing NAIFA today,
18 which is thousands of other advisors that do what I
19 do. But I do also want to give you a glimpse of my
20 practice so you can get an understanding of where I'm
21 coming from and the filter that I'm using with the
22 comments I'm going to make today.
23 Our firm has been in existence for 45 years.
24 My father started it 45 years ago. We are located in
25 Spencer, Wisconsin, a town of 1,925 people. I have

1 three support staff and three other advisors who work
2 directly with clients on an ongoing basis.
3 I also want to make it clear that I am both
4 a fee-based advisor and a commission-based advisor.
5 And that I think is an important distinction. I also
6 want to let you know a little bit about my client
7 base.
8 I have 52 small business clients, of which
9 Dr. Knoll is one of them. All of those employers have
10 less than 20 -- or the employers have less than 25
11 employees, and we typically work with them to provide
12 the benefits to their employee base, both in group
13 benefits such as group life, group short-term and
14 long-term disability, and also in retirement plans.
15 I also have 484 individual clients, again of
16 which Dr. Knoll is one of those. The average account
17 size for my client base is about $71,000. The
18 services that we provide those individual clients is
19 retirement planning, college funding, and investment
20 savings for any future goals that they might have.
21 The key for my practice is that we focus on
22 creating new savers. We really feel it's important
23 that advice is given to all individuals regardless of
24 the account size that they have. It's important to
25 distinguish that my clients all at this point have

1 chosen the commission-based model. And I think that
2 that's important to keep in mind.
3 I firmly believe that everyone should have
4 access to advice, and I firmly believe they should
5 also have a choice as to how they compensate their
6 advisor and who they work with on an ongoing basis. I
7 think over the last few months there has been some
8 distinction between fee-based advisors and
9 commissioned-based advisors. We should hopefully all
10 be able to get along, but there are some distinct
11 differences that I want to point out today during my
12 time.
13 I happen to believe that the fee-based
14 advisors in some ways win with this proposal, and I
15 want to explain what I mean by win. Win from my
16 perspective is that they are going to continue to
17 operate as they always have, whereas as a
18 commissioned-based advisor, I will have to change some
19 of what I do when I serve my clients.
20 Fee-based advisors also tend to work with
21 wealthier clients. And working with wealthier clients
22 allows you some things that you don't necessarily have
23 if you work with smaller accounts. I would also tell
24 you that one of the things that fee-based advisors
25 tend to do is they tend to not use annuities because

1 their clients, being wealthier, do not necessarily
2 need an annuity because they can self-annuitize.
3 I've also seen fee-based advisors not
4 recommend annuities because it removes that annuity
5 from their assets under management, and therefore
6 reduces the annual income that they receive. I'll
7 talk more about annuities in a minute.
8 I'm also not completely positive -- although
9 I've heard some people today say that they would take
10 any size account, I'm pretty sure that many of fee-
11 based advisors would not look at most of my clients'
12 accounts. Like I said earlier, I have a fairly low
13 average when it comes to clients I work with.
14 My minimum investment is 50,000 to work with
15 a fee-based account, and many of my clients are under
16 that threshold. I personally have 21 clients out of
17 my 484 that have over a half a million dollars in
18 investments, and that's only 4 percent of my total
19 client base.
20 I also want to just touch on quickly about
21 the costs regarding this proposed rule and the
22 consequences to consumers. One piece that I think has
23 not really been explored completely is the loss of
24 advice, the cost to consumers for the loss of advice
25 that they receive or do not receive as a result of not

1 having an advisor to turn to.

2 I have clients who come into my office or

3 prospects that come into my office, and they've just

4 left an employer, and they have, say, $5,000 sitting

5 in their old 401K. They don't really know what to do

6 with that account, and we of course coach them through

7 that process, provide them advice, and talk them

8 through what can be a daunting process if you're not

9 familiar with what you have available to you.

10 If that individual consumer decides to cash

11 out that account, they have taxes, penalties, and of

12 course an even bigger expense of not having anything

13 saved for retirement. That's my biggest concern with

14 the cost of this rule. It's the cost of lost advice

15 over time. I don't believe that anybody should not

16 have access to advice. And anything that we do to

17 hinder individuals from having access should not be

18 done.

19 I believe that this proposal will result in

20 fewer employer plans, fewer participants in retirement

21 savings account, and I think will lower savings

22 overall. And I know that that is not what the

23 Department has intended it to be.

24 I want to specifically speak about the BIC

25 exemption because that's really where I operate in my

1 practice, where I would see myself having to fall if
2 this rule went into place. I do think that the BIC
3 exemption is a very confusing thing to clients, and I
4 think we certainly need to look at ways of simplifying
5 that process.
6 I think it is unworkable, and I think the
7 primary reason it's unworkable is in the
8 implementation. I do think that it's going to be very
9 costly and time consuming. In 2010, I changed broker-
10 dealers, and I went to a new broker-dealer because
11 that broker-dealer offered me some better technology
12 to serve my clients.
13 During that time, I had to repaper all of my
14 clients. It took my firm about a year to get as many
15 clients as we could repapered done. And it also at
16 that time caused us to lose a good number of our
17 clients. They're still sitting at my former broker-
18 dealer because they refused to sign paperwork. We
19 made multiple attempts to make that happen, and it's
20 just -- some clients just don't like more paper.
21 So that is a huge concern of mine, is the
22 implementation, and at what point do we have to sign
23 the contract. At the very least, the contract should
24 not be required before the point of sale. I think
25 that's a really important clarification to make.

1 I also want to talk just briefly about the
2 threat of litigation over the contract provisions, and
3 just touch on a couple of things I could talk more
4 about. I want to touch on a couple of things. I
5 believe the best interest standard will generate some
6 litigation in two specific areas.
7 One is variable annuities. I think there is
8 some disagreement as to whether variable annuities
9 belong in retirement planning, but I will tell you I
10 have clients who come to me and specifically ask to be
11 put in variable annuities. They list a number of
12 reasons, one being guaranteed income stream.
13 And when you're looking at middle income
14 Americans, a guaranteed income stream is a very
15 important thing to them. They also are concerned
16 about longevity risk. One of the biggest things I get
17 is a client that's concerned about running out of
18 money. And lastly, I think they want the full upside
19 of the market.
20 The second piece that I think could cause
21 some additional litigation is proprietary products. I
22 think that many individuals -- consumers work with
23 advisors that have a basket of proprietary products
24 because of the relationship that they have and the
25 strength of that company. And so I think that that

1 could also be a place where we could see some
2 additional litigation.
3 I would be happy to answer any questions
4 that you have, and I really do appreciate you giving
5 us the time to meet with you today.
6 MR. HAUSER: Thank you.
7 MR. PEIFFER: Thank you. My name is Joe
8 Peiffer. I am an attorney, and hopefully I will
9 respect your time here today. I appear here today as
10 the president of the Public Investors Arbitration Bar
11 Association, also known as PIABA. It's an
12 international bar association comprised of attorneys
13 that represent victims of financial abuse.
14 Collectively, our members have seen tens of thousands
15 of victims of conflicted advice.
16 I myself have represented over 500 such
17 investors. Last month, PIABA submitted a detailed
18 comment letter to the Department of Labor in support
19 of its proposal to update the definition of fiduciary
20 advice under ERISA.
21 I'm here on behalf of the investors myself
22 and my colleagues have represented. These are people
23 who invariably trust their financial professional.
24 They don't -- they think they're getting advice. They
25 don't think they're getting sales. And I think they

1 can still get advice under this rule. They'll just be
2 getting unconflicted advice.
3 The vast majority of the retirees that I've
4 seen and my colleagues have seen have placed most of
5 their life savings with the broker. None of the
6 people that I've ever represented realized that the
7 broker might be held to a standard anything below that
8 of a doctor or an attorney.
9 It's no wonder that investors believe that
10 brokers already have to live up to a fiduciary duty.
11 Brokerage firms advertisements already say things like
12 they will, quote, "not rest until their client knows
13 she comes first," or state flatly, quote, "Our
14 advisors are ethically obligated to act with your best
15 interest at heart." There are dozens of examples of
16 advertising like this.
17 Academic studies that have looked at this
18 issue conclude what is obvious to anyone that has met
19 an investor that has been the victim of conflicted
20 advice, that is, investors do not know the duties that
21 their financial professionals owe to them.
22 One thing is clear. Right now, the very
23 same brokerage firms that advertise like fiduciaries
24 routinely contest that they owe a fiduciary duty to
25 clients. We see here today everyone from the

1 financial industry coming up here and saying they're
2 in favor of best interest standards, but when it comes
3 to being called to account for their behavior, they
4 routinely contest that any sort of fiduciary duty
5 exists.
6 The Department of Labor rule would go a long
7 way towards holding firms accountable in retirement
8 accounts for the duties that these firms already
9 advertise like they have. The lack of this duty has
10 real-world consequences for retirees and investors
11 saving for retirement. The statistics are frankly
12 staggering.
13 The White House Council on Economic Advisors
14 estimates that 17 billion is lost by investors every
15 year to conflicted advice. That means that since
16 Dodd-Frank asked the SEC to study this issue,
17 investors have lost almost 80 billion from brokerage
18 firms' conflicted advice. I don't think we need to
19 wait any longer.
20 What does this mean on an individual level?
21 Almost every week we see a retiree come into our
22 office who just lost a substantial amount of their
23 life savings. These are often proud, strong workers
24 that have saved, paid off their house, put their
25 children through college, and built a nest egg, all on

1 modest salaries. These retirees often break down,
2 literally break down, in my office when I explain to
3 them how their money was lost to conflicted advice,
4 and how the broker might not have a duty to put their
5 interest in living a long and happy retirement ahead
6 of the broker's interest in earning commissions.
7 I've had a client that ran out of money and
8 had to rent a room from his ex-wife. I had a client
9 -- I had clients that lived with me because they
10 couldn't afford the gas and lodging to get back and
11 forth in a protracted arbitration hearing. I've even
12 had clients attempt suicide. I know the devastation
13 that losing your life savings to conflicted advice can
14 have on hardworking Americans. This rule will make it
15 better, and that is why I am so passionate about
16 getting it passed.
17 An example of how this rule would help.
18 I'll tell you a little bit about a group of Niagara
19 Mohawk employees I represented in upstate New York.
20 These blue collar workers had built up enough years of
21 service that they could live out their retirement by
22 taking monthly pension checks and supplementing that
23 with the money they had saved.
24 However, the broker advised them to pull
25 their money out of their traditional pensions and roll

1 that and all of their savings over to the brokerage
2 firms. If these investors had left money in their
3 pension plan, the broker would have made no
4 commission, but the investors would have had
5 guaranteed monthly income.
6 After following the broker's advice, my
7 clients had lost more than half their life savings,
8 had no pension income, but the broker had made large
9 commissions. And when called to account for his
10 advice, the broker and his firm denied they had any
11 fiduciary duty to these clients as to the rollover.
12 My clients lost this case, and they're now
13 living on Social Security and the small amount of
14 savings they have left. The DOL rule would directly
15 address this problem by making any broker that gives
16 rollover advice a fiduciary. Anyone looking at this
17 from the perspective of a fiduciary would realize that
18 a guaranteed income for healthy folks in their sixties
19 was in the best interests of the clients.
20 Without such a rule, brokers are free to
21 argue that they met the, quote unquote, suitability
22 standard that is currently in play. They can take
23 their commissions and not worry about being held
24 accountable for whether what they did was in the
25 retiree's best interest, and that should stop.

1 We've all heard from the industry that this
2 rule is too costly, and that it will prevent smaller
3 investors from receiving advice from a broker.
4 However, the statistics don't bear that out. The
5 overwhelming majority of respondents to a survey of
6 financial industry participants said that extending of
7 fiduciary standard to brokers, quote, "would not price
8 investors out of the market for advice."
9 Indeed, right now there are a handful of
10 states that impose a fiduciary duty on brokers. And
11 there has been studies done on those states, and there
12 is no less access to financial services in states that
13 already have a fiduciary duty. So I believe that
14 argument is a red herring.
15 But even if you're going to compare costs, I
16 think it's helpful to keep in mind that it is
17 investors that are paying dearly for this conflicted
18 advice now, to the tune of $17 billion annually. This
19 rule should help prevent these conflicts on a macro
20 level, and hopefully will lead to less, not more,
21 lawsuits because it will stop it on the front end.
22 The members of PIABA and myself see the
23 effect of this conflicted advice on an individual
24 level. One of my clients worked at a chemical plant
25 for a major corporation at an $80,000 a year job,

1 until he got the conflicted advice that he should cash
2 out his pension and roll all his savings over to the
3 broker. He was out of money before he was eligible
4 for Social Security, and he had to take a job at the
5 very same plant he worked at for $10 an hour stocking
6 the vending machines.
7 This rule won't help him or any of the other
8 retirees I talked about earlier because it's too late
9 for them. But swift action to confirm a strong
10 fiduciary duty will help prevent this from happening
11 to other retirees in the future, and ensure that if it
12 does happen, brokers and brokerage firms that breach
13 this duty will be held accountable.
14 Thank you very much.
15 MR. HAUSER: Thank you.
16 (Pause.)
17 MR. CAMPAGNA: Yes, I do.
18 Ms. McNeely, I am referring to your comment
19 in some of these questions. You said that we should
20 exclude any kind of advice about distributions that is
21 not investment advice. We have a section of our
22 investment education provisions that deals a lot with
23 what can be provided without crossing the lines. Are
24 you thinking of -- what exactly are you thinking of
25 when you make -- when you say that there are things

1 that are investment -- related to -- that are related
2 to distributions that aren't investment advice.
3 MS. McNEELY: That are or are not
4 investment?
5 MR. CAMPAGNA: Are not.
6 MS. McNEELY: I'm not exactly sure what
7 you're referring to, but I will say that I believe
8 that the distribution process certainly can have a
9 significant amount of investment advice. I think
10 that's an even bigger reason why you need to have an
11 advisor, because the accumulation phase is vastly
12 different than the distribution phase. So perhaps I
13 misunderstood your question, but that -- to me, you do
14 need advice on the distribution side as well.
15 MR. CAMPAGNA: Coupled with a specific
16 investment recommendation, or do you see a distinction
17 between the actual advice as to taking a distribution
18 and where you place -- where you're placing that money
19 or --
20 MS. McNEELY: Well, I think that depends on
21 the client. I mean, when I meet with a client, I have
22 multiple conversations about what their needs are. So
23 do they need liquidity? Are they looking for tapping
24 this money at a later date? So I really think that
25 that depends on the client's situation. I don't know

1 that I could give a blanket statement on that, but
2 certainly the distribution itself requires a thorough
3 look at their situation.
4 MR. HAUSER: May I ask you about that?
5 MS. McNEELY: Uh-huh.
6 MR. HAUSER: You know, both -- and I think
7 you've described to me before your interactions with
8 your customers, and it was nice to hear your testimony
9 as well.
10 DR. KNOLL: Thank you.
11 MR. HAUSER: But I think that, as I
12 understand it -- and maybe this is especially with
13 respect to annuity products, that's a fairly drawn-out
14 kind of process. Can you maybe describe a little bit
15 of that? And then -- and just so you know where I'm
16 heading, I'd just like to get your sense of -- I mean,
17 do you view yourself as just as a salesperson? You
18 know, what do you think your relationship is with your
19 customer?
20 MS. McNEELY: I don't view myself as a
21 salesperson, although we do have NAIFA members that
22 put themselves out there as a salesperson. I view
23 myself as an advisor, and that's how I establish
24 relationships with my clients.
25 I think as it relates specifically to

1 annuities, I think they have a very good or a strong
2 purpose to have them in a retirement plan, especially
3 when you're talking to individuals who haven't had the
4 ability to put huge sums of money away. They're more
5 middle income consumers. I think that it provides
6 them certainly a way to annuitize or cover their base
7 living expenses with some guarantees, and that's why I
8 typically use an annuity product in a plan that I put
9 together for my clients.
10 If they have a set list of monthly expenses,
11 I want to make sure that we cover those so we know
12 they're going to be covered all the time. And then we
13 also talk about liquidity and what they need in an
14 immediate term. So we have separate baskets or things
15 that we utilize money for, and annuities have a very
16 specific purpose from my perspective, and they serve a
17 very specific person -- purpose for a middle income
18 consumer.
19 MR. HAUSER: And so I guess I just want to
20 maybe describe our thinking a little bit with respect
21 to a business model like yours, and get your sense of
22 it. I mean, we do want to permit, you know, these
23 different kinds of compensation streams to continue.
24 We're not trying to do something that makes, you know,
25 essentially an unworkable exemption for you.

1 But at the same time, we do think it's
2 important to hold people like you who hold yourself
3 out as an investment professional and help customers
4 to a standard of prudence in putting your customer
5 first, and like that. And that's really the aim. I
6 mean, so I think you believe you already do that.
7 MS. McNEELY: Uh-huh. I do.
8 MR. HAUSER: And so what we're really
9 looking for in this contract exemption is just that
10 you make kind of an upfront commitment with your
11 customer that that's what you're going to do. And to
12 make -- and because we recognize the way this market
13 is currently structured and the way the rules work
14 right now, we've also tried to --
15 You know, we haven't tried to supplant FINRA
16 arbitration, so if somebody were to bring a claim
17 against you, you know, it probably would be heard in
18 arbitration rather than in court. And I would think
19 that minimizes some of your legal exposure.
20 And we are open to ideas on how to make the
21 contract a simpler sort of document. You know,
22 something may be done closer to the point of sale,
23 something that could be incorporated into an account
24 opening agreement, or something you otherwise do
25 anyway, and maybe with just a notice to your existing

1 customers. You don't have to go through this whole
2 exercise again.
3 So, I mean, I appreciate your concerns about
4 workability and about maybe the notice provisions and
5 the like. But, I mean, if we get that right, do you
6 think that's going to be a problem for you? If we
7 manage to deal with the notice issues, the disclosure
8 issues, and we get this contract, you know, to a point
9 where it's closer to the point of sale, and it just
10 commits you in a binding way to adhere to these
11 standards, is that something you think you'd be
12 comfortable living with?
13 MS. McNEELY: Well, first of all, let me
14 just state that I do believe I already put my client's
15 best interest first. I've told you that before.
16 MR. HAUSER: Yes.
17 MS. McNEELY: I think that the BIC has some
18 concerns, and I think if we could get to an agreement
19 on these concerns, I think that would go a long way.
20 Number one, I think the timing of when that contract
21 needs to be signed. Does it have to go back to
22 existing clients, or is it just for new relationships
23 going forward?
24 I do think it does need to be at the point
25 of sale. I think it becomes very cumbersome to have

1 an expectation of signing that BIC prior to making
2 recommendations and/or signing paperwork. That's
3 where I'd rather see it, is at the time --
4 MR. HAUSER: And our thought if we did that,
5 was that -- while it could be essentially when the
6 money transfers that the promise of the commitment
7 would be the representations you made that got you to
8 that point adhere to this best interest sort of
9 standard.
10 MS. McNEELY: And I would be comfortable
11 with that. Obviously, I had a good amount of time
12 working with that client, gathering information before
13 I could make a recommendation, and I would be fine
14 with that, that period or that conversation being
15 utilized in that contract.
16 I think the next concern I have is the
17 definition of best interest. I already talked about
18 in my comments about variable annuities and
19 proprietary products. I have a real concern about
20 those being viewed or a sticky point where there could
21 be undue litigation just because of the nature of
22 those two things.
23 I also think that the contract -- the BIC
24 right now is --
25 MR. HAUSER: I'm sorry. Which two things

1 are --

2 MS. McNEELY: The variable annuity. I

3 talked about it in my comments, where some believe

4 variable annuities aren't appropriate. I happen to

5 believe they have -- serve a very strong purpose in a

6 financial plan.

7 MR. HAUSER: And proprietary?

8 MS. McNEELY: And proprietary products.

9 Those are two things I think are sticky points.

10 MR. HAUSER: And I assume you would want us

11 to say something on both points to acknowledge their

12 -- you know, that they can play a legitimate role in

13 certain circumstances. Is that the idea?

14 MS. McNEELY: I just don't want to leave it

15 up to interpretation --

16 MR. HAUSER: Okay.

17 MS. McNEELY: -- because I think that's

18 where we get into a slippery slope.

19 The second -- the third thing is really the

20 warranties that are currently listed in the BIC

21 exemption. Right now, as an advisor, I don't have

22 that information. That would have to come from the

23 administrator or the vendor of that product. And

24 quite honestly, if I have a client who has three or

25 four products they're utilizing in their plan, I now

1 have to get separate contracts from each of those
2 three vendors, with all of the information.
3 And that becomes a very cumbersome process
4 for advisors, and I think very confusing for
5 consumers. I also think it's a costly process to
6 implement. I have shared with you the example of my
7 broker-dealer change. I think any time that you have
8 to go through a whole new process, it adds complexity
9 and cost. And I think ultimately that could get
10 passed on to consumers.
11 And I also think the annuity piece is a
12 really confusing piece. Some annuities fall under 84-
13 24, and some fall under the BIC. And I would prefer
14 to see that be in one under the 84-24. I think that
15 would hopefully clear up some of the confusion because
16 I use annuities in all situations. I talk about the
17 different kinds of annuities with every client, and we
18 determine which is best for them.
19 So those are the main areas I think that we
20 have to be concerned with the BIC exemption.
21 MR. HAUSER: Thank you.
22 And, Mr. Peiffer, I don't know if you heard
23 much of the testimony we've had the past couple of
24 days, but a lot of people, not so much on the industry
25 side of the ledger, but on the other side have been

1 very critical of our permitting binding arbitration.
2 Since that's where you do your work, I just wonder
3 what your views are on that?
4 MR. PEIFFER: Well, my view and PIABA's view
5 is that investors should have the choice to go to
6 court or to have arbitration. In our comment, we
7 chose not to fight on that particular issue at this
8 particular time. I think it's more important to us
9 that we get this rule passed than it is that we end
10 mandatory arbitration.
11 It would be better for my clients to get --
12 and better for investors if this rule was in place,
13 even though I think arbitration is bad for clients,
14 too, and bad for investors, too. This rule is
15 important.
16 MR. HAUSER: And, you know, sometimes, not
17 -- every now and again -- I wouldn't say it's a
18 majority kind of representation from the folks that
19 are coming before us. But every now and again,
20 somebody will say, you know, "there really isn't much
21 difference between the suitability standard and the
22 best interest standard." I wonder if you could just
23 tell me if you agree with that.
24 MR. PEIFFER: I disagree with that
25 completely. Suitability standard, it says the

1 guidance that FINRA gives is, the requirement that the
2 broker's recommendation will be consistent with the
3 customer's best interest does not obligate a broker to
4 recommend the least expensive security or investment
5 strategy. However, least expensive may be quantified
6 as long as the recommendation is suitable, and the
7 broker is not placing his or her interest ahead of the
8 customer's interest.
9 Think about that. We had someone from
10 Fidelity up here who said they'd be happy to be held
11 to the standard of a doctor. Now, think about this.
12 Think about a doctor or a lawyer that would be free to
13 recommend a more expensive, less effective, conflicted
14 alternative so long as the recommendation was not
15 broadly inconsistent with the broad direction of the
16 client's health or legal interest.
17 You couldn't have that. You have to have a
18 fiduciary standard. It's different. And one way you
19 could tell for sure it's different is that every time
20 I called the brokerage firms to account for their
21 misbehavior, they denied that a fiduciary duty exists,
22 and point me to the suitability rule. They wouldn't
23 do that if there was no difference.
24 MR. HAUSER: Thank you.
25 MR. PIACENTINI: Ms. McNeely, I'd like to

1 ask you about -- you've made a couple of references
2 now to a recent change in broker-dealer.
3 MS. McNEELY: Uh-huh.
4 MR. PIACENTINI: This is something we see a
5 lot in the news, you know, that advisors do change
6 from one broker-dealer to another. I get the sense
7 that there is competition among the broker-dealers to
8 have more advisors come and work for them and bring
9 their accounts and use their services.
10 You specifically referenced improving the
11 technology that you could use and offer to your
12 clients. I wonder if you could elaborate a little bit
13 on that, but also maybe tell me whether there are
14 other important considerations that might -- you're
15 aware of that might have led you or other advisors to
16 change from one broker-dealer to another.
17 I know that, you know, they do have
18 different product platforms they might offer you.
19 They have different compensation arrangements.
20 MS. McNEELY: Well, I did a fairly extensive
21 search when I -- before I made the decision to make
22 this change. And I will tell you, the products that
23 are available from one broker-dealer to the next are
24 not very much different. So that wasn't a factor for
25 me at all.

1 What really was a factor was this technology
2 piece. My former broker-dealer really didn't have
3 sort of a vision of how they could serve us as brokers
4 and help us better serve our clients. And this -- the
5 broker-dealer that we chose actually had that for us.
6 And for me, that made all the difference in the world.
7 If I have a broker-dealer who is going to
8 help me with consolidated statements and analyzing
9 existing accounts, providing me better training and
10 education, why wouldn't I want to go with a broker-
11 dealer that does that for me, because then I can
12 better serve my clients.
13 So it really was about being able to better
14 serve my clientele, and then also just, you know,
15 having a broker-dealer with a vision for moving us
16 forward in the future. It had nothing to do with the
17 products. It had nothing to do with compensation. My
18 compensation was the same in both places. It really
19 was where I saw the future.
20 MR. PIACENTINI: So it sounds like you were
21 able to deliver better service or service less
22 expensively because of a better technology support?
23 MS. McNEELY: Well, it cost me a little more
24 as an advisor. I have to pay a technology fee now
25 that I didn't have before. But that is a fee that I

1 think is worth it because it does, like I said, allow
2 me to better serve my clients. It's worth it.
3 MR. PIACENTINI: Thank you.
4 MR. CAMPAGNA: Again referring back to your
5 comments, the comment letter, you talked about
6 expanding the seller's exception to have all plans,
7 not just, you know, these sophisticated plans that we
8 refer to. Do you have any idea of what additional
9 conditions or additional notion of sophistication we
10 should apply in that regard, or do you have just a set
11 idea that all plans should be part of the seller's
12 exception?
13 MS. McNEELY: Uh-huh. Well, I will just
14 start by saying that I am not someone who would be
15 using this exception. So I very much operate in that
16 BIC world, in the advisor world. So I know other
17 NAIFA members, though, that do. And they put
18 themselves out there as a salesperson, and have much
19 more of a transactional approach to how they serve
20 consumers.
21 I will say that we'd be happy to work with
22 you on getting you additional information,
23 specifically how we would like to see the seller's
24 exception changed and modified. But that would be
25 something I'd like to follow up with you on, if that's

1 okay.
2 MR. CAMPAGNA: And with respect to the
3 education exception.
4 MS. McNEELY: Uh-huh.
5 MR. CAMPAGNA: You were saying that this
6 should basically go back to 1996, when we included
7 reference to specific investments. There has been a
8 great deal of discussion regarding what if a plan
9 fiduciary approved the options. Couldn't the
10 investment allocation also include the investments
11 that the particular fiduciary approved?
12 Do you have any views of that? And how
13 would that apply in the IRA marketplace or for
14 directed brokerage?
15 MS. McNEELY: Well, I think that from my
16 perspective education is certainly something that
17 leads up to a product sale or an agreement between you
18 and the client to move forward.
19 I don't know that I would ever at any point
20 want to stop in a discussion and have something
21 signed. And so I think we as advisors should be able
22 to advise our clients, educate our clients up until
23 that point. And once the decision is to move forward,
24 then I think we obviously have to comply with one of
25 the exceptions that you referred to.

1 So I would say from my perspective, the
2 education piece needs to be a little bit broader than
3 what your current rule states. And I think that we
4 have to have the ability to educate both on the plan
5 level and on the IRA level to the point to we take
6 them to making a decision on a recommendation given.
7 MR. HAUSER: All right. Well, we thank you
8 all very much for your help. And that ends today.
9 We're back, I think, at 9:00 again tomorrow. Somebody
10 is back.
11 (Whereupon, at 5:02 p.m., the public meeting
12 in the above-entitled matter was adjourned, to
13 reconvene at 9:00 a.m. the following day, Wednesday,
14 August 12, 2015.)
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REPORTER'S CERTIFICATE

DOCKET NO.: N/A

CASE TITLE: Conflict of Interest Proposed Rule, Related Exemptions, and Regulatory Impact Analysis Hearing

HEARING DATE: August 11, 2015

LOCATION: Washington, D.C.

I hereby certify that the proceedings and evidence are contained fully and accurately on the tapes and notes reported by me at the hearing in the above case before the U.S. Department of Labor, Employee Benefits Security Administration.

Date: August 11, 2015

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