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: 1 through 349

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Date: August 10, 2015

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

Monday,
August 10, 2015

The parties met, pursuant to the notice, at 9:02 a.m.

ATTENDEES:

Government Panel:

PHYLLIS BORZI
Assistant Secretary, EBSA

TIM HAUSER
Deputy Assistant Secretary for Program Operations

CHRISTOPHER COSBY
Office of Policy and Research

JOE CANARY
Office of Regulations and Interpretations

LYSSA HALL
Office of Exemption Determinations

WILLIAM TAYLOR
Office of the Solicitor
Plans Benefits Security Division

JOE PIACENTINI
Office of Policy and Research

KAREN LLOYD
Office of Exemption Determinations

APPEARANCES: (Cont'd)

Panel 1:

On behalf of AARP:

DAVID CERTNER, Legislative Counsel and Legislative Policy Director

On behalf of Committee on Investment of Employee Benefit Assets:

CHARLES VAN VLEET, Chief Investment Officer, Textron Inc.

On behalf of Financial Planning Coalition:

MARILYN MOHRMAN-GILLIS, CFP Board Managing Director, Public Policy and Communications
V. RAYMOND FERRARA, Chairman and CEO, ProVise Management Group LLC

Panel 2:

On behalf of AFL-CIO:

SHAUN C. O'BRIEN, Assistant Policy Director for Health and Retirement

JAMES D. KEENEY, Attorney

On Behalf of Securities Industry and Financial Markets Association:

KENNETH E. BENTSEN, JR., President and Chief Executive Officer

APPEARANCES: (Cont'd)

Panel 3:

On behalf of Consumer Federation of America:

BARBARA ROPER, Director of Investor Protection

On behalf of Insured Retirement Institute:

NICK LANE, IRI Chairman of the Board of Directors
Head of U.S. Life & Retirement, AXA

On behalf of Investment Company Institute:

DAVID BLASS, General Counsel

Panel 4:

On behalf of Business Law Institute, University of Mississippi School of Law:

MERCER BULLARD, Director

On behalf of Financial Services Roundtable:

FELICIA SMITH, Vice President and Senior Counsel for Regulatory Affairs

MICHAEL FINKE, Professor
Director, Retirement Planning and Living, Texas Tech University

Panel 5:

On behalf of America's Health Insurance Plans & Blue Cross Blue Shield Association:

JON BREYFOGLE, Groom Law Group Chartered

On behalf of Groom Law Group Chartered:

STEPHON SAXON and THOMAS ROBERTS
Representing a Group of Insurance Company Clients

RON RHOADES, Program Director, Assistant Professor of Finance, Gordon Ford College of Business, Western Kentucky University

APPEARANCES: (Cont'd)

Panel 6:

On behalf of Penn Mutual Life Insurance Company:

MAURICE L. STEWART, Executive Consultant, Retired General Agent

On behalf of Plan Sponsor Council of America:

STEPHEN McCAFFREY, Chairman of PSCA Board

BARTLETT NAYLOR, Public Citizen

Panel 7:

ARTHUR B. LABY, Professor, Rutgers University School of Law

On behalf of Hilliard Lyons:

JAMES R. ALLEN, Chairman, Chief Executive Officer, J.J.B. Hilliard, W.L. Lyons, LLC

On behalf of Raymond James:

SCOTT STOLZ, Senior Vice President, Private Client Group Products & Solutions

I N D E X

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P R O C E E D I N G S

(9:02 a.m.)

MR. HAUSER: Okay. We'll get started in just a moment. If everyone could please turn off their cell phones. Before I introduce Phyllis Borzi I've got a few logistics, unfortunately, to get through, so that's where we're going to start.

Good morning. Welcome to the Department of Labor. This is the Employee Benefits Security Administration's public hearing on the proposed conflict of interest rule, exemptions, and regulatory impact analysis. I'm Tim Hauser, the Deputy Assistant Secretary for Program Operations at EBSA.

Before an introductory statement from EBSA's Assistant Secretary, Phyllis Borzi, there are a few procedural and safety matters to cover. The hearing is being broadcast via streaming video which is available: http://www.dol.gov/live. There must be a better way of saying that.

Notice of today's hearing was published in the *Federal Register* on June 18, with an invitation to interested persons to testify on the Department's proposal. The rule and the proposed exemptions were published for public comment in the *Federal Register* on April 20, 2015.

The proposals, along with the Department's complete regulatory impact analysis were posted on the Department's website at www.dol.gov/ebsa. We also posted the public comments submitted on the proposals, the request to testify, and the full agenda for the hearing, all of which can be found there.

This hearing will continue starting today through August 11, 12, and 13. We'll begin each day at 9:00 in the morning. We have 25 panels. For the most part, there are three people on each panel. We'd like the panelists to stick to the 10 allowed minutes.

It's really important to stick to that schedule because we have such a full agenda, so many people, so much to talk about. Accordingly, we will be strict in enforcing the 10 minute allotment.

The plan is to have the panelists present their testimony, and then the government panel members will have an opportunity to ask some questions. We're not accepting questions from the audience.

With regard to panel questions, the government panel members are interested in developing the public record as fully as possible, and you shouldn't draw inferences or conclusions about our views or positions based on the way we framed a particular question.

Today's hearing is being transcribed. The hearing transcript will be available to the public on EBSA's website hopefully within about two weeks following the close of the hearing, but it could be longer.

Witnesses will testify in the order in which they appear on the hearing agenda. To assist us today we have a few requests for those testifying. First, it would be very helpful if before you testify you could identify yourself, your affiliation, and the organization that you're representing, if any.

Second -- repeat myself -- please limit your remarks to the allotted 10 minutes. We'll call your attention to our timer which will assist in monitoring time. Where is that? Okay. I can't see it, but you can, I hope. Third, please remember to speak into the microphone. That's critical for us to get a complete and accurate transcript.

Also, make sure speakers -- or, also, it helps us make sure speakers are correctly identified in the transcript during the Q&A session, so please identify yourself each time you speak.

As part of the hearing, we're reopening the comment period today. We'll keep the rulemaking record open for approximately two weeks after the posting of the hearing transcript on our website to allow public comment regarding the hearing or generally, on the proposed rule, exemptions, and regulatory impact analysis. We'll announce the exact closing date when we post the hearing transcript.

All public comments and written testimony will be made available to the public on EBSA's website and must be submitted in accordance with the methods for submitting comments set forth in the June 18th *Federal Register* notice of this hearing.

We plan to break for lunch at 1:15 and return for afternoon sessions at 2:15. There is a cafeteria on the sixth floor of this building which is generally open until 2:00, and there's a snack bar on the fourth floor which is usually open until 4:00 p.m.

Now I hope you don't need the following warning, but in the even of an emergency in the building, an alarm will sound. There are two types of alarms. The loud, long continuous tone means we'll need to evacuate to an external assembly area outside the building. An intermittent tone, followed by a public address announcement, means that we will stay in the auditorium and shelter in place. If either of these alarms sound a person in a yellow hat or vest will tell you what to do.

MS. BORZI: And there he is, back there.

MR. HAUSER: And there you see him. That is a multi-talented person. Please do not plug laptops, phones, and the like into the sockets on the wall. Having cords in the walkway creates a bit of a hazard. Finally, please make sure your cell phones are turned off or silenced.

Now that we're through that I'd like to introduce Assistant Secretary Phyllis Borzi for her opening remarks.

MS. BORZI: Thank you. Thanks, Tim. Good morning. I just want to say a few words this morning to open up this four day public hearing. First, I want to thank all of you for coming and participating in this crucial dialogue about our proposal to update a 40 year old regulation on the definition of who is a fiduciary. I particularly want to welcome those of you who are in the auditorium and those of you who are watching this through the live stream.

I know the subject matter of this hearing sometimes might sound a little bit technical, but this hearing and this project is far from a dry exercise. The fiduciary definition is central as to how the law protects retirement investors. When advisors are fiduciaries they must give advice that's in their customer's best interest and protect investors from harmful conflicts of interest. In other words, they have to put their customers first.

Unfortunately, our current rules are outdated and fail to ensure that all financial advisors act in the best interest of retirement investors. The 1975 rule makes it too easy for advisors, brokers, consultants to evade fiduciary status and to evade their central fiduciary obligation to put the retirement investor first.

Unless the advisor meets each and every part of a rigid, outdated, five part test with respect to each individual instance of advice, the advisor is not a fiduciary with respect to that advice and need not act in the customer's best interest.

Whatever that rule's benefits were when it was first promulgated 40 years ago, the status quo doesn't adequately protect today's retirement investors and undermines the protective purposes of the broad fiduciary provisions in ERISA and the tax code.

The retirement landscape has changed profoundly in the intervening years. When the current rule was issued in 1975 -- and it looks to me like there are a few people out there who probably remember that day -- the majority of workers didn't need to worry about how to invest retirement savings. 401(k) plans didn't exist, IRAs had just been created. Retirement investors looked to defined benefit plans and professional money managers to ensure the security of specific benefit promises.

Today the assets in 401(k) plans and IRAs exceed $14 trillion. Rather than receiving guaranteed defined benefits, individual plan participants and IRA investors now have substantial responsibility to manage their own money. They are called upon to make important investment decisions themselves and to shoulder the risk of running out of retirement money just when they need it the most.

As a result, these advisors often depend on professional -- these investors -- excuse me -- often depend on professional advisors to help them navigate their way through the financial complexities of the retirement marketplace so they can reach a secure retirement.

We strongly believe that individuals need this assistance in making these decisions because there's no GPS that an individual can rely on to help them reach their retirement goals. Unfortunately, under the current ERISA rules individuals have a hard time figuring out who they can trust to give them this vital information and assistance.

It's not illegal for advisors to steer the retirement investor to particular products based on the financial interests of the advisor and the firm rather than based on the investor's best interest.

As the Secretary has said many times, this is not a case of bad people doing bad things, it's about good people operating within a structurally flawed system, and it's that system that we're trying to change.

Our regulatory impact analysis concluded that IRA investors can expect to lose more than $210 billion over the next 10 years as the result of the under performance associated with conflicts of interest. Our regulatory proposal aims to address this problem by re-examining the types of advisory relationships that should be held to a best interest standard.

So the Department's conflict of interest proposal has a very straightforward goal: to align the best interest of the customer with those of the advisor in the firm. Simply put, we want to create an enforceable best interest standard that requires advisors to put their customer's best interest first.

That is our north star.

Undoubtedly, there are many, many ideas on how to implement a best interest standard or mitigate the harmful impact of conflicts of interest. We've already received many suggestions on ways we can improve the rule and the associated exemptions, reduce the possibility of unintended consequences, and enhance the workability of the exemptions.

For example, commentators have offered suggestions on ways to reduce the implementation challenges associated with the contract requirement in the best interest contract and principal transaction exemptions, ease the transitional challenges by adjusting the timelines for compliance and reconsidering the scope of the grandfathered transactions, clarify the availability of exemptions for services, rollovers and other transactions affected by perceived ambiguities or omissions in the text of our proposal, adjust or expand the categories of assets covered by the exemptions, simplify the disclosure and data retention requirements, provide additional guidance on acceptable policies and procedures to mitigate conflicts of interest, and reiterate that the rule does not extend to advice on the purchase of such noninvestment contracts as health and disability insurance policies, as well as life insurance policies that don't have an investment component.

We believe that this is clear in the rule, but to the extent there's ambiguity, we can remove all possible doubt.

I'm heartened by the thorough input we've received through the comment period and through dozens and dozens of meetings. We look forward to continuing this dialogue by hearing your views on the proposal and by adding your testimony to the public record. With your help we will publish a final rule that is both protective and reasonable. So once again, thanks so much for your participation and your help.

Before I turn this over to Tim, though, I want to say a special word of thanks to all of our hard-working and dedicated staff who have been working on this proposal for five, roughly five years, and especially to the folks who helped put this hearing together. This has been a difficult and time-consuming task and we're grateful to all of you.

So now I'll turn the proceedings over to Tim Hauser, my deputy assistant secretary for program operations, and we'll start with the first panel. Thank you again all for being here today and for participating in this important step in the process.

MR. HAUSER: And I'd like to thank all of you for giving us so very much to read. So if we could start with the first panel, and we'll begin with Mr. Certner.

MR. CERTNER: Thank you, and good morning. My name is David Certner and I'm legislative counsel and legislative policy director for AARP. As the largest nonprofit, nonpartisan organization representing the interests of older Americans and their families, AARP appreciates the opportunity to testify in support of the Department's proposal to update the definition of fiduciary investment advice under ERISA.

Last month AARP submitted two detailed comment letters to the Department, one in support of the rule, and one in support of the best interest contract exemption. I would be happy to answer questions on our comment letters, but today I would like to take a step back and really discuss the importance of this rulemaking effort.

A major priority for AARP has long been to assist our over 38 million members and, indeed, all Americans, in accumulating and effectively managing the assets they will need to supplement social security so that they can maintain an adequate standard of living in retirement.

Unfortunately, both economic trends and changes in employer provided benefits have made the goal of achieving and maintaining an adequate income in retirement more challenging. It is hard enough to save for retirement. Conflicted investment advice should not be one of the barriers that millions of Americans face as they work to save for their retirement.

Over 80 million households are counting on employer-sponsored plans and IRAs to supplement social security for their retirement security. In order to ensure adequate retirement savings, investors need to know that the advice provided by financial service professionals is solely in their interest.

In fact, investors currently expect and believe that all financial advisors are already acting in their best interest and this view has been encouraged by most financial advisors whether they are acting as fiduciaries or not.

AARP believes that the proposed rule would appropriately subject more advice to ERISA's fiduciary and conflict of interest rules, and the related proposed exemptions would permit established business models to continue to be available, preserving choice for individuals in the marketplace, while minimizing conflicts of interest that affect the quality of the advice.

The need for this rule is urgent. The potential negative impact of conflicted advice is enormous, costing retirement investors billions of dollars every year. GAO has estimated that $20,000 in a 401(k) account that had a one percentage point higher fee for 20 years would result in an over 17 percent reduction -- over $10,000 in the account balance.

Over a 30 year period the account would be about 25 percent less. Even a difference of only half a percentage point, 50 basis points, would reduce the value of the account by 13 percent over 30 years.

The Department has found that the negative impact of conflicted investment advice is increasing as boomers retire and move money from protected ERISA plans to IRAs. Indeed, the Department found that conflicted advice could cost retirees between 12 and 24 percent of their retirement savings over 30 years.

Acting on its clear jurisdiction in the retirement arena, we think the Department is compelled to act to fulfill its role to protect those deserving of a secure retirement. That is the purpose of this rulemaking.

Make no mistake about the importance of this rule. In 2008 when the markets crashed and the retirement accounts typically lost about 25 percent of their value over a short period of time, everyone understood how devastating those losses were. Retirement plans were disrupted and standards of living dropped. We knew as a nation we needed to act.

Twenty-five percent losses due to conflicted advice can be just as devastating to retirement security. Just because the losses may be hidden and over time do not make them any less meaningful.

Conflicted advice can result in cost and losses other than direct higher fees and expenses. For example, investors may end up with higher risk investments and they may incur excessive transaction costs.

Conflicted advice also frequently leads to the purchase of investments that underperform in the market, and, as the Department points out, when investors end up with less money to spend there is a significant loss to the economy, as well as to the individual.

In particular, AARP is concerned about IRA investors who are closer to retirement and may be more vulnerable to the negative impact of conflicted advice because the assets they have are larger, they may lack strong financial literacy skills, and they're making significant, and often one time, decisions to move retirement savings from more protected employer-based plans into significantly less protected IRAs.

In addition, we agree with the Department that individuals with modest balances, some call it the small savers, can be most negatively impacted by the detrimental effects of conflicted advice. In short, they have fewer economic resources, and any additional cost or losses can diminish what little savings they already have.

Because the impact of conflicted advice is so great on individuals who are close to retirement, our members have responded to this proposed rule by submitting over 60,000 individual petitions to the Department with comments in support of investment advice and the best interest of those saving for retirement.

In general, the public is overwhelming in favor of the goal of this rulemaking. According to an AARP survey, more than nine in 10 respondents favored requiring retirement advice to be in their best interest, and nearly nine in 10 plan sponsors said that they would favor such a requirement.

The goal of this rulemaking is not only broadly supported by the public, but is long overdue. The dramatic shift since 1974 when ERISA was enacted from defined benefit plans, in which advice was generally provided to more significant employer fiduciaries, to participant-directed defined contribution plans has been well-documented.

At the time of the initial regulation IRAs were brand new and today's most popular retirement vehicle, the 401(k) plan, had not yet been created. Today, most Americans with retirement savings are in individual account plans and are therefore solely responsible for their investment decisions.

In addition, as account holders change jobs or approach retirement age we have seen a significant movement of assets from employer-sponsored plans to IRAs. Indeed, the amount of assets in IRAs now exceeds that of defined contribution plans, with most of the money in IRAs having come from the employer plan.

As participants retire or terminate employment they are encouraged to move their 401(k) assets into IRAs, and they are moving from a heavily regulated system with fiduciary protection to one without similar protections.

The sums involved are significant. The Department has noted that such rollovers will total more than $2 trillion over the next five years alone. This same money with similar tax subsidies and a similar national interest to ensure retirement security should enjoy similar regulatory protections.

It is important to underscore that for many people, if not most people, the account balance in their 401(k) or IRA represents the bulk of their personal savings. As a result, the distribution decision will often determine the value of a working lifetime of retirement savings.

Few financial decisions will be as important as the determination of when, and how, to take a distribution from a retirement plan or an IRA. Accordingly, it is essential that an advisor providing guidance at this critical juncture be subject to ERISA's fiduciary duties.

Along these lines, AARP supports the Department's determination not to require investment advice to be provided with any particular frequency. AARP believes that the current requirement that advice must be provided on a regular basis ignores the reality that distribution advice may be a one time transaction, but also be the largest, most significant, and potentially irreversible, decision that can be made with retirement savings. The proposed rule would close this, and other, loopholes.

In short, since ERISA's enactment 40 years ago, retirement plans and investments have so significantly changed that there is no longer any justification, if there ever was one, for the current regulations' narrow definition of fiduciary investment advice.

The Department of Labor is the agency clearly responsible for ensuring fairness and transparency in retirement security. With this proposal the Department has made great strides to protect the retirement savings of millions of Americans.

Today's proposal is the result of nearly five years of discussion and debate among all stakeholders. The time has long passed to ensure that advice provided to those who spend a lifetime working to save and invest for a secure retirement is in their sole interest.

We thank the Department for its thorough and thoughtful proposal, and for the opportunity to provide AARP's comments today, and in, our written comments. I'm happy to answer any questions, and to even give back two minutes of time.

MR. HAUSER: Thank you.

Mr. Van Vleet?

MR. VAN VLEET: Good morning. My name is Charles Van Vleet. I'm a assistant treasurer and CIO, chief investment officer, for a company called Textron. Textron's out of Providence, Rhode Island. We're a Fortune 500 company. We have 85,000 participants in our $10 billion worth of ERISA-managed retirement assets.

More importantly, I'm here today representing CIEBA. CIEBA is the Committee for Investment of Employee Benefit Assets. CIEBA represents over 100 of the Fortune 500 companies, in excess of $2 trillion worth of assets.

CIEBA proudly, on behalf of 17 million retirees, has always participated and, under the full fiduciary standard, so I'd like to represent that perhaps we have been already maintaining the standards, I think, that are being advocated here by this proposal and by the good guidance of the Department of Labor and this committee.

We thank you, Mr. Hauser, for all the

reading material you give us sometimes. But again --

MR. HAUSER: You're welcome.

MR. VAN VLEET: -- I think we have built together, I'm very proud to say, a very strong institution that I think should be carried over into the IRA space. I think that's the important point, really, I just want to make here today.

We give great care and concern, again, to the 17 million participants that we have $2 trillion worth of employee benefit assets that we manage under ERISA guidelines. We feel that same care and diligence should be extended in the role of our environment.

My company and CIEBA, in general, is fairly neutral about whether participants stay within the plan, or roll over into an IRA, or take other choices, but we would like to believe that, or we'd like to ensure -- and we support your efforts to that end -- that when they roll over, they continue that same care going into the IRA environment.

So I'm going to give you back a full eight minutes because I have a very, very simple conclusion here today, a very simple observation. First, my commendations for your great work that's been done, and by fellow panelists as well, and that -- it's very simple -- we believe that participants who have had the fiduciary standards within the plan should maintain those same standards outside of the 401(k) environment. Thank you very much.

MR. HAUSER: Thank you.

MS. MOHRMAN-GILLIS: Good morning, and thank you to the members of the panel for the opportunity to testify at this hearing. My name is Marilyn Mohrman-Gillis and I'm managing director for public policy and communication at the Certified Financial Planner Board of Standards.

I'm testifying today on behalf of the financial planning coalition, which is comprised of CFP Board, the Financial Planning Association, and the National Association of Personal Financial Advisors.

The coalition was formed in 2009 around a set of principles that include support for the fiduciary standard of care in the delivery of financial advice. We believe that a strengthened fiduciary rule under ERISA is essential for America's retirement investors, and we strongly support the Department's re-proposed rule.

We believe that the coalition brings a unique perspective to the table. Our stakeholders and members are committed by virtue of their CFP certification or their FPA or NAPFA membership codes of conduct to provide financial planning services under a fiduciary standard.

They provide fiduciary level service across business models -- investment advisors, broker/dealers, insurance producers -- and across compensations models -- commission-based models, as well as fee-based models.

When CFP Board adopted a fiduciary standard of conduct in 2007 many firms and industry organizations made arguments similar to those being made about the Department's re-proposed rule today. They asserted that CFP Board's fiduciary requirements were unworkable with their business models, and that CFP professionals would be required to rescind their certification if they were required to operate under a fiduciary standard.

Contrary to those predictions, the number of CFP professionals has grown by more than 30 percent, to over 72,000 today, since CFP Board established a fiduciary standard. Many firms, to their credit, are recognizing the value of CFP certification and are supporting it for their advisors.

Based upon our own experience working with firms on compliance with our rules, we believe that the re-proposed rule can work for advisors. Now that doesn't mean that it's perfect, and in our comment letter the coalition offered the Department concrete suggestions to make it more workable across business models.

Many argue that the rule will eliminate the broker/dealer business model and force advisors into fee-based models that will be more expensive for consumers. This is not consistent with our reading of the rule itself or with our experience in implementing a fiduciary standard.

The best interest contract exemption is a principles-based business model neutral exemption that allows advisors to receive commissions and still comply with the fiduciary standard under ERISA. To those who say that the BIC requirements are unworkable, we point to CFP Board's standards of professional conduct which contain requirements similar to those under the BIC exemption.

Under our standards, CFP Board professionals when providing financial planning are required to act in the best interest of the client, exercise reasonable and prudent judgment, execute a written contract with the client, identify and mitigate conflicts of interest, and provide disclosures, including full cost of products and services and compensation paid to the CFP professional and the employer.

In short, CFP professionals today are operating under these BIC-like requirements with both commission-based, not just fee-based business models.

Our experience also belies the notion that advisors who are required to obligate themselves to act in the best interest of the client will be unable to serve middle-class clients.

Today there are thousands of CFP professionals, and FPA and NAPFA members across the country who provide fiduciary level services to everyday Americans either under commission-based business models, or for fees with no, or very low, minimum asset requirements.

If our experience is any indication, firms and advisors are more likely to adjust their policies and procedures than to abandon their middle-class clients.

Retirement investors face a perfect storm in today's financial services marketplace. With ever increasing responsibility for their own retirements and the need to choose from an increasingly complex set of financial products and services, retirement investors more than ever need competent financial advice that's in their best interest, yet the regulatory framework allows advisors' interests to be misaligned with the interest of retirement investors, resulting in the loss of billions of dollars in retirement savings.

The need for a strengthened fiduciary rule under ERISA is long overdue. The coalition urges the Department to move as expeditiously as possible to make needed adjustments in the re-proposed rule and promulgate a final rule. Thank you.

MR. FERRARA: Members of the panel, thank you for the opportunity to testify. My name is Ray Ferrara. I'm chairman and CEO of ProVise Management Group, a financial planning firm based in Clearwater, Florida. I am a CFP professional and a member of the Financial Planning Association, on whose board of directors I've previously served. I also served on the CFP board of directors 2009 through '14, and in 2014 served as their chair.

I'm a practitioner and a small business owner and I testify today on behalf of the Financial Planning Coalition. This testimony focuses on my experience providing advice to retirement plans under ERISA, as well as providing financial advice under a fiduciary standard of conduct across different business models.

Even though a majority of advisors try to do the right thing, the Department's re-proposed rule is needed to protect retirement investors. Many in the industry say that the re-proposed rule is unworkable, too costly, and will force advisors to abandon the middle-class clients. Based on our firm's experience, we don't share those views. We believe that with some refinements and clarifications the rule is workable.

ProVise provides advisory, brokerage, and insurance services under compensation models that include flat fees, assets under management, and commissions. The firm's minimum requirement for assets under managements on a fee basis is $25,000, and for clients with lesser amounts, we serve them on a commission basis.

Since 1988 ProVise has been a registered investment advisor with the Securities and Exchange Commission. Most of our financial planners are registered representatives of a broker/dealer which is a member of FINRA. We are also licensed to sell insurance products.

Ten of our 12 financial advisors are CFP professionals, and although not legally required to provide brokerage and insurance products at a fiduciary standard of care selling annuities and mutual funds, we strive to do so because it's simply the right thing to do.

Many prospective clients come to us as they are considering rolling assets out of an ERISA retirement plan. Unfortunately, some of them come to us after receiving advice that is not in their best interest.

As an example, a state employee was advised to move 100 percent of her retirement assets into a single product which carried a large and long surrender charge. Fortunately, she was referred to us for a second opinion before the money was moved and we were able to structure a retirement option which met the prospective client's goals and objectives, but without surrender charges and with much lower costs.

ProVise advises 18 small business owners with their 401(k)s who collectively have $100 million in assets and 1,850 plan participants with an average account balance of $51,400. Whether providing advice on a commission or a fee basis, we do so in the best interest of the client.

Many of the BIC requirements are similar to the standards of professional conduct that I have voluntarily agreed to comply with as a CFP professional. ProVise enters into a written contract with our clients outlining the scope of service. We disclose likely conflicts of interest, we disclose accurate and understandable information related to our compensation, and we make a commitment to provide financial planning services under a fiduciary conduct, standard of conduct.

For over 25 years we have profitably absorbed the small additional cost of serving -- can I borrow their time? Thank you. For over 25 years we have profitably absorbed the small additional cost of serving as fiduciaries and not experienced undue compliance issues.

Under the re-proposed rule we will need to incur minor costs to develop a best interest contract for those who have not practiced at a fiduciary standard in the past. Their cost may be higher, but the consumer benefits far outweigh these costs.

Finally, the argument that the rule will diminish the availability of services to middle-class Americans is simply not credible. ProVise has successfully served middle-class clients under a fiduciary standard of care for years. The re-proposed rule, with some refinements and adjustments, will still allow us and everyone else to provide advice using a commission or fee model.

For anyone claiming that they are not -- that they are unable to serve the middle-class clients under the re-proposed rule, ProVise and scores of CFP professionals, and FPA and NAPFA members across the country would be happy to fill the gap.

In closing, we fully support the Department's effort to strengthen consumer protection under ERISA and look forward to working with the Department as it refines the re-proposed rule. Thank you.

MR. HAUSER: Thank you. So I'd actually like to start by asking the panel about a couple areas in which you've suggested in your comment letters that we might improve the rule.

Maybe I'd like to start with a suggestion that was made in the comment letter from the Financial Planning Coalition which was a set of suggestions on how we could change the timing and execution of the contract requirements. I wonder if one of you could just walk through what your ideas are on that score.

MS. MOHRMAN-GILLIS: I'd be happy to start. Our goal in our comment letter was to suggest that the execution of the contract could be done consistent with the existing business models, so looking at the type of client and being flexible and add the business model.

So with regard to existing clients we suggested that there need no, you need not have the client execute the contract. Rather, it could be done through notification to existing clients and negative consent of the client.

For new clients we believe that you can choose a time that coincides with the engagement or the account opening agreement that exists in the various different business models. We went through suggestions for how that would work for the planning model, the advisory model, the broker/dealer model, and the insurance model.

Happy to answer any further questions, but that's the concept of the flexibility.

MR. HAUSER: Thank you. Can I ask, too, one of the things that struck me about your comment letter was that, you know, one of the common critiques I think we received from a number of the groups is that, is an expression of concern about the potential for litigation, particularly in the class context.

If somebody executes a contract we don't permit, you know, binding arbitration provisions in the class context and there's been a lot of anxiety about that. Your letter expressed support from that, yet at the same time it seems to me that you're potential targets of such litigation, so I guess the question is what gives?

MS. MOHRMAN-GILLIS: Ray, do you want to start?

MR. FERRARA: Sure. I'd like to start. As I mentioned in my testimony, we have been involved as a fiduciary since 1988 when we became a registered investment advisor firm with the SEC, so we have been subjected to what you are trying to attempt to do with the ERISA plan since that time. We have not had any undue compliance issues.

In fact, I would suggest that when you are working in the client's best interest that you have the potential to reduce litigation, not increase it.

MS. MOHRMAN-GILLIS: I would just add on the -- we believe that the bar to a class-action lawsuit is very high. In order to certify a class you have to have a systemic problem that cuts across clients.

In many instances, whether or not an advisor is operating under a fiduciary standard of care is a very individual facts and circumstances type of case, and so at this point in time, under the proposed, re-proposed rule by the Department, we believe that most of that would be handled through the arbitration process and that there would be relatively few cases that would end up in class-action litigation.

Those would have to be systemic abuses of the policies and procedures to mitigate conflicts across the board. So that was a further comment.

MR. HAUSER: Yes, David?

MR. CERTNER: If I could add. I think the Department has made a huge concession to the securities rules in permitting mandatory binding arbitration for individuals, which obviously is a big barrier for them in getting relief in the current process. Mandatory binding arbitration generally is not very helpful to individuals who are affected.

That's what makes it even more critical that class-actions be permitted. Because, again, as we've just noted, there's a heavy bar to get to a class-action, and generally you have to show that there is a large, systemic failure going on. Certainly in those situations class-actions are appropriate and should be permitted.

MR. HAUSER: Do you think we've drawn the line in the wrong place when it comes to individual claims?

MR. CERTNER: Our preference is always against mandatory binding arbitration in any circumstance, including this one.

MR. HAUSER: Mr. Van Vleet, would you like to weigh in on this?

MR. VAN VLEET: Nothing to add. Thank you.

MR. HAUSER: Okay. Thank you. Then there's one other area I'd just like to ask you about which there seemed to be a critical consensus, on this panel anyway, which has to do with a provision -- the way we structured the education advice line.

You know, the -- our rule contains a fairly lengthy provision describing categories of communications that we would treat as nonfiduciary education and therefore are really not subject to the best interest standard or the obligation to, you know, execute a contract or the like.

There's one instance, though, where we cut back a bit from our previous guidance and that has to do with asset allocation guidance. We indicated that, while generally speaking, if you have a communication with a plan participant that kind of suggests broad guidelines on the allocation of their assets between various categories of assets, that that was fine, that could be nonfiduciary education, but that if you go so far as to attach a specific product reference to that guidance, we would have treated that as fiduciary. The proposal would treat that as a fiduciary communication.

I think our thinking was, I mean, you know, so imagine I'm giving this advice and I, or having this communication and I say, you know, I suggest that, well, for somebody at your stage of life and with your years to retirement it would be normal to put and appropriate to put 60 percent of, or 70 percent of your assets in a large value cap, 20 percent of your assets in a bond fund of some sort, and 10 percent in a money market fund, and then for good measure I say, and by way of illustration, or such as, you know, the Hauser S&P 500 fund, money market plus fund, and fixed income bond fund.

That would be bad advice, but that felt like specific advice. But I think what each person on the panel said, if I understood you -- and I know this is a long wind up -- but if I understood what everybody on this panel has said, you thought, at least in the context of a benefit plan where there was fiduciary oversight over what those options were, a better course would be to go ahead and let, you know, people populate that kind of asset allocation guidance with the specific options on the fund menu.

So I suppose one possibility would just be to say as long as the person making the communication is, doesn't have a financial interest with respect to the advice and they're illustrating the asset allocations with all of the options that are available on the plan that fall within those classes, that should be nonfiduciary.

Is that the suggestion? Do you think we should draw the line somewhere else and just --

MR. CERTNER: Yeah. I mean that's the suggestion that AARP has made and it's because the plan already has a fiduciary who's taking the responsibility on all the investment choices to begin with.

So at that point, when you're telling somebody here's the asset allocation, let's say 60 percent large cap, you already have in the plan, presumably, one or more large cap examples. To put, illustrate those and list those I think is really almost more educational than it is steering.

I understand the concern about steering inappropriately, but here, where you have a plan fiduciary already selecting the potential investment options in the plan we think you have that extra layer of protection so that you can then populate it with all the parts of the plan that already meet whatever that asset allocation would be.

MR. HAUSER: Mr. -- I'm sorry. Go ahead.

MR. VAN VLEET: If I may. CIEBA has given some thought to this and fully endorses, as you had suggested, Mr. Hauser, that, yes, you should be able to populate that final step as long as you're wearing, again, that fiduciary hat. So CIEBA would support drawing the line on that side.

MR. FERRARA: From a practical standpoint, after I gave the asset allocation to the client, the next thing that the client is going to say is, well which one of the funds in the 401(k) should I put them into, or it might even be so basic as to say, well which one is that large cap value fund?

So to suddenly inject the BIC exemption at that point and have to present a contract, it really is not practical. I would agree with the comments that have already been made. If you have the fiduciary oversight to a plan already, it seems to me that it is a little bit a double jeopardy.

MR. CANARY: Can I ask a couple follow ups on that? So what are your thoughts on whether that should apply, and, if so, how it would work in the IRA market.

MS. MOHRMAN-GILLIS: Well one of the things, if you actually are making specific suggestions about products that fall into each of those categories, we believe that that then does become advice.

One of the suggestions that we made was that -- and this gets into another concept which is allowing for that precontract communication, essentially marketing your services, saying what you could provide to the client -- if you end up providing advice before the BIC contract is actually executed, then that, the contract obligations to provide advice in your best interest would be retroactive to that advice.

So in Ray's example, if the client said, well what belongs in that asset category and he makes that recommendation prior to the time there is a BIC contract in place, that that recommendation would be subject to a fiduciary standard, a fiduciary obligation.

MR. CANARY: So let me clarify a little bit. I think we were talking about what is generally referred to as the education provision --

MS. MOHRMAN-GILLIS: Right.

MR. CANARY: -- where, if I understood it correctly, the consensus was that for a 401(k) plan or ERISA plan, that there should be some flexibility added into the proposal to allow investment options to be identified in certain circumstances and still constitute education.

So in an IRA space where potentially you have unlimited access to investment options, how would you be able to identify all of the investment options that would fit within an asset class as part of an asset allocation?

MR. CERTNER: I think that's a difficult question to answer because I think there has to be some kind of fiduciary overview somewhere in there.

One way that maybe is potentially something to look at is if you do have presumably some kind of a model that's at work here for an individual, even in an IRA context, if you have that model, essentially an objective model that can be blessed as a fiduciary model, then as long as that model is spitting out a certain number of examples, that may be something that could fit within the fiduciary definition as well.

MR. CANARY: Thank you. And would the same concepts apply if you're dealing with a brokerage window in a 401(k) plan where you may not have, again, a limited platform, or even I guess a mutual fund supermarket where you may end up accessing sort of all the funds that are a particular provider or all the funds that would be available in the marketplace as opposed to a more limited selection?

You'd be using some sort of a model to generate the elements that are added into the education piece.

MR. FERRARA: So often when you are using a brokerage window the, one of the plan participants may have his or her own ideas as to how that money should be invested. It's not the advisor that's involved in it at all. In fact, it might create some liability for the fiduciaries of the plan depending upon what that individual has chosen to do with their own assets.

So if the advisor is getting advice at that level outside of what the plan provides to the plan participants, then I think that a fiduciary standard of care would come into play, but if the client themselves or the plan participant themselves is choosing those assets, we need to make that distinction as well.

MR. CERTNER: Although this may be inconsistent, I think the brokerage window model should not be permitted in this case because you do have a plan model that does have a asset allocation there. And anyone going to a brokerage window, who tend to be, quite frankly, higher income people who have advice from elsewhere, that should not be part of this model.

MS. LLOYD: Can I jump in with some questions? Going back to the contract, the best interest contract exemption, Mr. Certner, in your comment you made the point that you think the contract requirement is critical for our ability to have an exemption that meets the standards under ERISA 408(a). Can you talk about that a little bit more?

MR. CERTNER: Right. I want to emphasize our agreement that the timing of the contract is really not as critical as the contract itself because the contract allows for the enforceability, and then, therefore, as we have the enforceability, then you can meet the exemption. So we have to have an underlying rationale to meet the exemption.

Here it is -- with the contract, what it's really creating is the enforceability here, right, because otherwise the individual has no enforcement mechanism. So now you're creating a contract, right, which we think then it gives you the premise to then have the exemption.

So when the contract is signed, quite frankly, is less important than the fact that you have the contract and the enforceability itself. We do think, of course, there needs to be appropriate disclosure to individuals, even perhaps if the contract is being signed later on, so that the individual can make some informed decisions up front.

The signing of a contract can be later on. For example, when some of the other papers would normally be signed in any of these arrangements.

MS. LLOYD: Thank you. And then for the Financial Planning Coalition folks, since you have a lot of experience engaging in contracts with your clients I just wondered if you had a reaction to some of the points made in the comments about the fact that a client might feel uncomfortable being presented with a contract. Is that something that you experience in your practice?

MR. FERRARA: I would offer that the way I read the proposal at the present time, before I even talk to the client about getting any individual advice I would have to present a contract. I think that that would be rather intimidating. I think it would be very uncomfortable for the client, it would be uncomfortable for us.

As a standard practice, when working with a client through our registered investment advisory they have a contract, whether it's for financial planning services, investment management, et cetera, and all of our clients understand and are comfortable with that, but that's only after we've already gone through the process.

MS. LLOYD: Thank you.

MR. PIACENTINI: Okay. I've got just two questions I'd like to ask, the first one for Mr. Van Vleet. So if understood correctly, you said that you thought that the ERISA fiduciary standards were well-established, worked well, and that you would like to see them generally at least extended to the IRA space.

One of the cautions that has come up in some of the comments that we've heard on the proposal is that at the moment of decision about distributions, right now people often get some guidance from call centers of one kind or another.

It might be a call center associated with a provider who's already serving the plan, it might be a call center, you know, in a sales development exercise, reaching out to plan participants who might be eligible for distributions.

There's been some concern about whether

raising the standard of conduct around that call center interface would disrupt the ability of participants to get help with their decision about distributions, and that some might, you know, not be as well-equipped to make those decisions in their own best interest.

Do you have experience with, you know, how participants in large plans interface with call centers and whether you think that the kinds of standards that are in our proposal, in fact, would be helpful or not in that context?

MR. VAN VLEET: Well I have experienced not only through our participants, but in my family. I think all of us perhaps have a, have close to us family who have retired after 25 years and get that phone call and, my brother called me up quickly and said, well they've told me that I have to leave the plan and what should I do.

We believe, again, that entire conversation, if it's captured under the fiduciary standards, I -- it might well be the most appropriate move for someone. I just have not experienced it. I think that it currently is not covered under fiduciary standards. I think it should be covered under fiduciary standards, that, the initial right from that initial phone call. Again, CIEBA and my, and personally, I am fairly indifferent at that point about whether to stay in the plan or go out.

I fully recognize that I think a financial advisor brings, can bring much more to a relationship than just financial advice. I often think of, you know, my father-in-law lives with me and I'd bring him to the dentist once a year and he actually looks forward to the occasion because he gets a lot more than dental advice.

He goes there, they've been family friends for 30 years, they catch up about, you know, how's your kids, and how's your health, and what are you doing, and by the end of it he also got some good dental care advice.

But people are willing to pay a premium. My father-in-law is more than willing to pay a premium because he's getting more than medical advice. So I fully embrace, and endorse, and support the idea that people in an IRA environment might be getting more than financial advice, and they might be more than willing to pay a premium for that advice.

I fully embrace that. I just want disclosure. I want to make sure's that there's, again, a -- there's a disclosure of what is the cost of that advice and what are the benefits of that advice.

MR. PIACENTINI: For purposes of the call center in our discussion about whether to take a distribution, though, you said you believe a fiduciary standard should apply there.

MR. VAN VLEET: Yes.

MR. PIACENTINI: Thank you. And then I have one question for Mr. Ferrara. If I understood correctly, you said that your smaller accounts -- I think you said under $25,000 -- you currently serve in a commission model, but that for all of your customers you do adhere to a best interest standard of conduct.

So the proposed best interest contract exemption is, you know, an effort to establish a set of protections to make sure that those two things work well together, right? That you can pay by commissions, which depending on how that's structured may sometimes introduce conflicts, but you can also have an environment where a best interest standard works well.

Can you comment on whether you think that's the right approach? I heard you say that there were some adjustments, but maybe, also, if there are some certain protections that you think that really ought to stay in the best interest contract exemption.

MR. FERRARA: So in working with clients, regardless of their size we strive to serve their best interests, and I think we do a reasonably good job in accomplishing that.

If I can, I happen to be one of the people who the Secretary addressed and said they actually remember when ERISA started in 1975. I had actually been in business four years already, so long before IRAs were created, money market funds, and many of the things that we have today.

We had a regulatory environment at that time that allowed people to sell mutual funds under a contractual basis where you get 50 percent commission in the first 13 months that went into those plans.

Six months after I got into the business they, significant changes were made to that and we had to figure out in a regulatory environment how we would sell product for eight and a half percent and thought we were all going to starve. Then five and a quarter, then three, then one.

The one thing I've learned after 44 years in the financial services industry is that it's very adaptable and it will make itself work, particularly when you're talking about $14 trillion. As I said before, I don't think it's only good for our clients to take care of their best interest, it's simply good business for us. If we continue to do that I think that we will all be able to be in a much better place and feel better at night when we go home.

MR. PIACENTINI: Thank you.

MR. CERTNER: If I could just comment on the fiduciary standard for a call center. We may be talking about one of the most important decisions an individual is going to be making, taking a distribution.

The idea that we will have spent all this tax money and subsidizing a plan with all these rules to help people be covered and accumulate assets with fiduciary standards, and funding standards, and nondiscrimination rules, and the whole set of rules that we have through ERISA, and fiduciary duties, and conflict of interest, and suddenly end up with some person in a call center advising somebody about perhaps the most important decision of their life with no standard makes absolutely no sense in the context of ERISA or our national interest in making sure people have a secure retirement.

MR. CANARY: Yeah. Can I switch topics a little bit to what's been called the seller's carve out or the counter-party carve out? I think, looking at your comments, generally, you either want to tighten up what we proposed or leave it alone, if I've read your comments correctly.

Could you talk a little bit about whether you think a seller's provision should reach down to a retail market dealing with participants, and beneficiaries, and plans, or IRA investors.

MS. MOHRMAN-GILLIS: Well I would just say that we think that the Department of Labor's proposal, re-proposal really got it right in most respects related to the seller's carve out. We thought that the original proposed carve out in the 2010 rule was not protective of investors.

The one place where I think that there's a question about whether or not small participant-directed plans should be entitled to use a seller's carve out, we would prefer to see that the BIC contract exemption to small participant plans be provided, as opposed to allowing for the seller's carve out for that, for the small plans.

MR. CERTNER: And I would just add, for all the reasons that we've discussed about the lack of sophistication at the individual level, it doesn't seem to make any sense to have a seller's carve out at the individual level. It's just too problematic.

MR. CANARY: Mr. Van Vleet, do you have --

MR. VAN VLEET: Nothing to add. The experts are here.

MR. CANARY: Thank you.

MR. HAUSER: Okay. Unless there's anything else you'd like to add, I think we'll move on to the next panel. Thank you very much for your thoughtful comments.

(Pause.)

MR. HAUSER: Mr. O'Brien?

MR. O'BRIEN: Sure. Good morning. My name is Shaun O'Brien. I'm the assistant policy director for health and retirement security at the AFL-CIO. I want to -- I just want to let you know I appreciate the opportunity to appear this morning, the first day of this week's four day hearing.

We commend the Department of Labor for conducting such a thorough process with significant outreach to so many different stakeholders. The AFL-CIO has been involved in a great many rulemaking processes over the years and this certainly is among the most expansive and deliberative in which we've participated.

Protecting and enhancing the retirement

security of America's workers and retirees is, and has long been, a top priority for the AFL-CIO. I'd note that we participated in the years long legislative debates over the, that really culminated in the investment advice provisions that were enacted as part of the Pension Protection Act of 2006, and we have engaged in this rulemaking process since it began nearly five years ago.

All of America's workers, but especially those who are union members, have a lot at stake in the private sector pension and retirement savings system. More than four in five union members in the private sector participate in workplace retirement plans. While most are covered by defined benefit plans, more than two in five also participate in defined contribution plans.

Further, more than one in four dollars in ERISA-covered retirement plans, totaling $1.9 trillion in assets, are in collectively bargained plans. Thousands of union members serve as fiduciary trustees jointly with management-appointed representatives in administering retirement plans and overseeing the investment of retirement plan assets.

Union workers and retirees from both the private and public sectors also have money invested through individual retirement accounts. Like nonunion workers and retirees, many of them transfer money out of workplace retirement plans into IRAs when they leave a job.

We commend the Department for its approach to defining the scope of fiduciary advice and for carefully crafting the best interest contract exemption, or BIC. As the Department moves forward to finalize each of these, we offer the following summary comments.

So first, stay true to the broad statutory definition of investment advice and carefully limit any carve outs and exceptions. Financial professionals who are paid to, by retirement investors to provide investment recommendations should be considered fiduciaries.

Frankly, tricks, and traps, and loopholes in the fiduciary definition benefit financial advisors and financial institutions, but harm retirement investors. These kinds of things really have no place in a pension and retirement system whose sole purpose is to benefit workers and retirees.

Second, use your authority to grant administrative exemptions cautiously. Conflicted advisors need to mitigate their financial conflicts and they need to meet a best interest standard of conduct, not just disclosed conflicts, if the statutory standard for granting exemptions is to be met.

We believe the Department has proposed the right framework in the best interest contract exemption, and we endorse its fundamental analysis that material conflicts exist where an advisor's compensation tends to encourage advice that is not in a retirement investor's best interest.

Third, I'd say don't get whipsawed by arguments that are intended to stall protections for retirement investors. For example, before the release of the re-proposed rule and the best interest contract exemption some argued that IRAs should not be covered by the new definition of fiduciary investment advice because the IRS, the agency with enforcement authority, is so underfunded it wouldn't have the resources to do its job.

Now some are unhappy about the proposed exemption for conflicted IRA advisors because the individual retirement investor can enforce the best interest standard using existing contract law. Frankly, you can't have it both ways here.

Fourth, we would say by all means go ahead and provide even greater clarity by addressing questions about which specific communications constitute advice.

In our view -- excuse me -- in our review of comments submitted by financial institutions and others, it appears that some have very specific questions about whether certain types of communications will be considered fiduciary advice, and many of these can be addressed easily through examples and other clarifications in the final release.

So, for example, some have asked whether recommendations that a participant select a specific coverage option in a welfare benefit plan would be treated as investment advice even though such recommendations do not relate to the investment of plan assets.

Others have requested clarifications about whether an investment manager's response to a request for proposals would be considered fiduciary advice. Still others have described the proposed rule as ERISA-fying all communications about distributions options under a plan, apparently without regard to whether a recommendation of any kind is made.

We plan to offer our views on these and

related questions in the comments we will submit at the conclusion of this hearing, and we look forward to more clarity in the final guidance.

Last, time is money. A lot of money. The Department's regulatory impact analysis establishes clearly that the long, outdated investment advice rules are costing retirement investors dearly.

The nearly five years since this rulemaking process began have added up to tens of billions of dollars in excessive fees and expenses, and under performance resulting from conflicted advice, all paid for by workers and retirees. It's time to stop the losses, and the Department needs to finish its job.

I'd like now to dig a little deeper into the treatment of recommendations related to distributions from a plan or IRA. We strongly support extending the scope of the regulatory definition to include distribution recommendations.

For many working people deciding whether, and how, to take a distribution and what to do with it are once in a lifetime decisions. The choices made at this juncture can have significant, even life-altering, consequences, with no do-overs possible in many cases.

A recommendation whether to take a

distribution from a plan or to take one form of distribution over another is, in fact, a recommendation about the value of the plan's investments. This is true whether comparing a lump sum to continued investment through a 401(k)'s investment options, comparing a lump sum to an annuity in a pension plan, or comparing a qualified joint and survivor annuity to a single life annuity.

Let me give you a real life example of the latter that a plan representative shared with me. A pension plan participant and his spouse were advised by a financial advisor who was not otherwise a fiduciary to the plan to reject the default form of benefit, the qualified joint and survivor annuity required for married participants under current law and to elect a single life annuity.

The advisor recommended that they do this and invest the excess of the single life monthly benefit check over the joint and survivor benefit. In this particular instance the advice provided proved to be particularly costly, especially for the spouse. When the participant rejected the survivor annuity with the spouse's consent, as required under current law, the spouse lost her right to valuable retiree health benefits. The advisor either failed to consider this consequence or disregarded it.

This advisor, however, appeared to have been insulated from accountability under the Department's current guidance, even though the advisor clearly was recommending a personalized course of action about the annuity to select and the investment of a portion of the monthly annuity check.

The Department's current view that some distribution advice is a fiduciary act but other distribution is not, distribution advice is not depending on who is giving that advice is the kind of loophole I mentioned above that benefits financial advisors and financial institutions and harms retirement investors.

Last, I'd like to speak briefly to an issue we did not address in our comments on the best interest contract exemption: the permissibility of mandatory arbitration clauses for individual claims. I know Mr. Keeney addressed this at length in the comments he submitted and I'd just like to say that the AFL-CIO agrees with Mr. Keeney's position that the mandatory arbitration clauses should in no instances be permitted in the best interest contract exemption.

We come to this view based on our deep experience with arbitration as a means to settle disputes under collective bargaining agreements. We believe mandatory arbitration clauses do not have a place in the best interest contract exemption.

Thank you. Happy to answer any questions you may have on any of the issues I've raised here or in my comment, or comment letters. Thank you.

MR. HAUSER: Thank you.

Mr. Keeney?

MR. KEENEY: Good morning. My name is James Keeney. I'm a recently retired Florida lawyer who represented individual retirement investors in arbitrations and litigation against securities broker/dealers and their associated persons for 20 years. I'm still an active FINRA arbitrator.

Finally, I'm a former member and trustee of the Public Investors Arbitration Bar Association, PIABA, a group of attorneys who specialize in representing securities investors. I'd like to share my knowledge and experience about securities arbitration.

In my legal practice I saw almost every imaginable type of conflict of interest, self-dealing, and customer abuse committed by brokers and financial advisors. Typically my clients had lost their retirement savings because of conflicted advice, fraud, or other misconduct, often in connection with a 401(k) rollover.

In my experience, retirement investors already think their financial advisor is required to act in their best interest. They don't know if he, or she, is a registered investment advisor regulated by the SEC, or an insurance agent regulated by their state insurance commissioner, or a registered representative regulated mainly by the financial industry itself.

Securities customers need the same unbiased advice they expect from their doctor, lawyer, or pharmacist, but their financial advisor more often acts like a used car salesman. He gives them a sales pitch motivated by higher commissions, sales goals, and meeting monthly quotas to keep his job.

I strongly support this Department of Labor proposal to force financial advisors to act like fiduciaries, but I believe it has a fundamental flaw. It does not permit -- it does not prohibit mandatory arbitration.

Every investor has to sign a customer agreement in order to open a securities account. The best interest contract exemption is self-defeating as it is now written because it will allow brokerage firms to continue including mandatory arbitration clauses in these customer agreements.

Retirement investors will still be forced to waive their Sixth Amendment rights to a jury trial in the event of any dispute with their broker. In doing so they will effectively waive the very fiduciary protections being established by this regulation.

There are at least two major problems with mandatory arbitration of securities customer disputes. First, the very essence of arbitration is that parties put their entire fate in the hands of arbitrators, with virtually no assurance that the result will bear any relation at all to well-established rules or protections of law.

Under Section 10 of the Federal Arbitration Act, arbitration awards must be enforced by the State and Federal Courts and cannot be overturned or modified, except on a handful of extremely limited grounds. You may be surprised to learn that in the Eleventh Circuit where I practiced and at least in two other circuits, manifest disregard of the law is not one of those limited grounds.

Both Federal and State Courts in many parts of our country, including Florida, routinely hold that even the most outrageous refusals of arbitrators to follow the law are not sufficient grounds to vacate or modify an arbitration award. Think about that. The law of course includes federal regulations such as the one proposed here.

So if they flat out say we're not going to follow this fiduciary regulation right in their award, you still can't enforce that against them. You still can't vacate that award in Federal Court. Not in Florida.

The second problem is that securities, the securities industry customer arbitrations are all held at a single private arbitration forum which the industry itself manipulates and controls. FINRA, the Financial Industry Regulatory Authority, is actually an industry trade association. It's not an impartial government agency. Despite minimal oversight by the SEC, FINRA dances to the tune of its largest member firms.

Based upon my extensive experiment, experience with FINRA arbitration, I can certify that the FINRA customer arbitration system is fundamentally biased against retirement investors. FINRA controls access to becoming an arbitrator. FINRA's eligible arbitrator lists include a lot of industry retirees and friends or relatives of industry participants who have had no legal training, as well as a lot of active stockbrokers.

FINRA arbitrator training consists of only a single day of classes. This minimal training is wholly inadequate to make certain that new arbitrators understand the legal rights of investors or the legal obligations of financial advisors.

Lists of proposed arbitrators, from which each party can strike a certain number, are prepared by FINRA staff. The few arbitrators who have voted in favor of substantial awards to customers seem to get stricken much more often, especially by lawyers for the big firms.

FINRA arbitration rules favor the industry in subtle, but important, ways. For example, if an investor believes her broker sold the same risky investment to all of his clients, FINRA's limited discovery rules make it nearly impossible for the investor to obtain the firm's records that would show how many of the broker's customers were sold the same investment.

Because of such subtle aspects of the FINRA rules, there's often no practical way for a customer to marshal the evidence needed to prove her case against her broker.

Lots of strange things happen during FINRA arbitration. Arbitrators sometimes fall sound asleep. They resign as late as the night before a hearing, forcing months of delay due to their own personal activities. They sometimes continue hearings into the night in order to get paid for extra sessions, exhausting themselves and the elderly claimants.

There's no court reporter. The tape recorders used are old-fashioned and unreliable, producing inaudible gaps in the record. If arbitrators forget to turn on the tape recorder or accidentally turn it off, there's no record at all.

FINRA arbitrators are not required to explain why they ruled as they did. An award arrives in the mail saying nothing except, "claimant's claims are all denied". That's it. If any amount is awarded to a claimant it's usually only a fraction of her actual loss. The awards rarely add interest, costs, or attorney's fees, even where state law absolutely entitles the investor to receive them as the prevailing party.

In their secret and unrecorded deliberations FINRA arbitrators can, and probably will, simply choose to ignore the new fiduciary standard. They may continue to apply the much lower suitability standard for stockbroker misconduct. They may even use a yet lower standard, such as their own idea of common sense.

Since there is no record of the panel's secret deliberations, no written opinion, and no evidence of why the panel decided the way it did, the hapless investor will have no recourse. FINRA insists that panel deliberations are confidential and tells arbitrators they must never discuss the case with any of the parties.

State and Federal Courts are generally, as I explained, without power to review FINRA arbitration awards because they must follow their Federal Appellate Court's interpretations of the Federal Arbitration Act. They're limited to those four very, very limited bases of review.

In conclusion, I urge you to recognize that allowing the securities industry to include a mandatory binding arbitration provision in the securities customer agreement is actually allowing a self-defeating loophole in the proposed regulation. It's also a conflict of interest, per se, when you think about it. The firms who are proposing this contract control the arbitration forum itself.

I respectfully request that you cannot

change the proposed -- that you should change the proposed regulation to state that a best interest contract cannot, instead of may, require that individual disputes be submitted to arbitration. Thank you. I'll be happy to answer any questions or submit any additional information if it would be of assistance.

MR. HAUSER: Thank you.

Mr. Bentsen?

MR. BENTSEN: Yeah. good morning. I'm Ken Bentsen, President and CEO of the Securities Industry and Financial Markets Association, the trade association for the broker/dealers banks and asset managers in the capital markets, not a self-regulatory organization. I want to thank the Department for the opportunity to testify today.

Our concerns are not with the best interest standards. SIFMA's members have long called for the implementation of a best interest or uniform standard of care for brokers and advisors when providing personalized investment advice. On that, the record is quite clear. Rather, we disagree with the process whereby one agency is developing yet another standard that will apply to only one sector of the retail investment market.

As FINRA, the self-regulatory organization established by Congress, highlighted in its comment letter, the creation of yet another standard, and one that applies to retirement accounts, will lead to customer investment portfolios being governed by multiple sets of rules. It simply makes no sense that the government would not develop a holistic standard.

We believe Congress recognized this when they adopted Section 913 of the Dodd-Frank Act, which SIFMA supported, and which authorized the Securities and Exchange Commission as the primary market regulator to establish a uniform standard across the entire retail market.

The bifurcation of standards will create confusion for both investors and providers who must comply. We believe the rule as drafted will reduce choice and increase cost, and individual savers will have more, a more complex and confusing landscape.

The proposal is also exceedingly complex and would establish an onerous compliance regime that conflicts with existing securities laws, while subjecting advisors to a new private right of action. In fact, this new -- the new best interest contract exemption and principal trading exemptions are so complex that a number of firms have concluded that they cannot be made operational as designed.

SIFMA commissioned a report by Deloitte analyzing the operational impact that found that the proposed rule package is so broad, subjective, and ambiguous in certain areas that it will be impossible to build operational systems and processes to ensure compliance.

Moreover, the Department's regulatory impact analysis fails to show how this proposal would benefit the public quantitatively, and also underestimates the potential harm it may cause to American investors.

An analysis conducted by NERA Economic Consulting on SIFMA's behalf found the Department's RIA produces estimates that vary widely over an incredible set of values, and the range of numbers is so wide as to suggest no scientific competence in the Department's methodology. As a result, the estimates in the Department's analysis provide little confidence as to the actual benefits, if any, arising from the proposal.

Further, in its analysis of the costs associated with the compliance, the Department greatly underestimates the cost to implement and comply with the rule. Deloitte conducted a survey of SIFMA member firms to estimate the actual cost of compliance and found start up and ongoing costs to be almost double the Department's estimates.

Finally, beyond the complexity of the new best interest contract exemption and principal trading PTE, the rule in attendant PTEs contain so many issues that either dramatically change the existing structure, raise questions of interpretation, or, as we've been told in meetings with the Department, are not what was intended, that we believe the rule is unworkable in its current form and question how the Department could move to a final rulemaking without substantial changes. In fact, the Secretary has publicly stated that the rule will be subject to material changes.

It's worth noting that as our industry has been working to implement hundreds of new rules prescribed under the Dodd-Frank Act, many of which are equally complex and call for new regulatory architecture as proposed by the, as, such as that proposed by the Department, regulators have afforded significantly more time in flexibility and implementation and utilized their exemptive authority to avoid market disruption.

The Department's proposal sets an unreasonable and unworkable implementation schedule and importantly lacks sufficient exemptive relief authority similar to that of the SEC and the CFTC.

If, after reviewing the numerous substantive comments receives, the Department chooses to proceed with the rulemaking, we believe the Department at the very least should re-propose before going to a final rulemaking to avoid unintended market disruption.

Under the existing and comprehensive regulatory scheme administered by the SEC and FINRA, brokers/dealers today are increasingly being held to a higher standard that includes many of the elements of a fiduciary or best interest of the customer standard.

Plus, through the collective action of regulatory guidance, examinations and enforcement, and securities litigation and arbitration rulings, all of which apply to broker/dealers in a more robust and comprehensive manner than the investment advisor model, broker/dealers are running their businesses with a fiduciary standard in mind. In fact, the most common claim in FINRA arbitration is a breach of fiduciary duty.

Although broker/dealer regulation oversight is already quite strong, we nonetheless continue to believe and strongly support for the establishment of a best interest standard for all financial advisors that covers the entire retail marketplace, not just one sector.

While the DOL and IRS have jurisdiction over retirement products such as 401(k) plans and IRAs, brokers' and advisors' conduct with respect to such accounts is primarily governed and regulated by the SEC and FINRA, which the DOL appears to recognize, at least in its reference to the FINRA arbitration processes meaning for investor redress under the rule.

Thus, we continue to advise that the SEC and not the DOL, is the appropriate expert agency to establish a uniform standard of care for brokers and advisors. That said, however, we do not necessarily take issue with the DOL's definition of a best interest standard, which we believe is fairly consistent with SIFMA's longstanding advocacy in support of such a standard.

Rather, we take issues with the hundreds of pages of extraneous conditions, restrictions, and prescriptions on top of its proposed best interest standard that our members believe create an unworkable set of rules in its current form.

We believe the proposed rule has many issues. The Department seeks to turn sales pitches and cold calls into fiduciary conversations. The proposal narrows financial education that only the already educated will understand. The Department's proposal would also pull in all distribution and rollover conversations.

The proposed seller's exception leaves out services entirely, making it impossible for large plan collector trusts or other admittedly sophisticated plans to buy futures clear or trade, or trade securities, or custody their securities.

Furthermore, neither the seller's exception, nor the best interest contract exemption are available to participants, to participant-directed plans with fewer than 100 employees. The best interest contract exemption explicitly, implicitly limits client choice to, on the investments they can make, a dictate unprecedented in ERISA's 40 year history.

It raises significant, in some cases insurmountable, obstacles for broker/dealers, including, by inference, the establishment of level fees between product providers and distributors which has the effect of the government setting fees and ignores market realities.

It requires a disclosure regime that will not only overwhelm the customer with more information than the customer can possibly digest, but also impedes customer transactions and conflicts with existing securities law, such as FINRA Rule 2210, and in some cases may not be able to be constructed.

It will establish, as I mentioned, a new supplemental private right of action, and it will require firms to establish duplicative and redundant compliance regimes, duplicative systems training, client contracts, trade confirmations, and periodic statements, one set for tax-deferred accounts and another for non tax-deferred accounts.

The requirements of the principal trading transaction exemption cannot be met in the context of best execution. Retirement clients will get worse pricing and delayed execution. Financial market fluctuations will create situations where there are changes to prices, credit ratings, or liquidity conditions in the time between the initial transaction disclosure recommendation and the customer's decision to execute the transaction.

For a broker/dealer to stay in compliance with the exemption, and as securities fluctuate in liquidity and credit rating, the investment professional would be allowed to sell a security to a client but not allowed to buy it back, eliminating one of the hallmarks of an orderly securities market.

Our members, most of whom provide commission brokerage and investment advisor fee-based accounts, believe that the proposed rule and the particular -- and, in particular, the best interest contract exemption are so complex and onerous and the liability risk so uncertain that they would likely elect not to utilize the exemption and instead migrate much of their IRA activity to managed accounts.

This would result in greater costs because business and regulatory structure of such accounts, with retirement savers having to pay for services they have already chosen not to buy. Further, it may well conflict with concerns from the SEC, the primary markets regulator, that buy and hold accounts should not be in wrap or fee-based accounts.

SIFMA's asset managers members are concerned that the expanded definition of investment advice will hamper their ability to act in the best interest of their clients. Asset managers will be less able to provide information and education that they, than they are today. They may be restricted in making available services and products, and/or may only be able to do so at a greater expense.

I do want to point out that we felt that the RIA did not include sufficient study at an account level basis. We asked NERA to conduct such a study and what we found was that commission-based accounts would become significantly more expensive when converted to a fee-based account, that investment returns show no meaningful difference between commission-based accounts and fiduciary accounts, and, in addition, we found that fee-based accounts trade much more often than commission-based accounts, which would make sense given what, the structure of the, of fee-based accounts.

We also questioned the Department's cost estimates. I want to point out where others have tried this in the past there have been problems. Most notably, United Kingdom, where they implemented something known as the retail distribution review in 2013.

The RDR sought to address perceived conflicts related to investment advice by banning commission brokerage. While the DOL proposal does not do that, per se, we believe its prescriptions effectively do so. According to a survey conducted by the UK Financial Conduct Authority, several advisors stopped providing retail services.

Just the other week HM Treasury announced a new review to address the shortcomings in the RDR and to ensure that the regulatory environment allows business models to include affordable and accessible advice. We caution the Department to look at what's going on in the UK.

I want to close by reiterating SIFMA's longstanding support for the implementation of a best interest standard for brokers and advisors when providing personalized investment advice to retail clients for all their accounts, not just their IRAs. Congress very recently determined that the SEC was the expert agency to take the lead, and we believe that is entirely appropriate.

We believe that this proposal is far too complex and prescriptive, establishing a myriad of new requirements that will be difficult, if not impossible, to implement, and will result in less education, fewer choices, and greater cost to investors which are not in the best interest of the clients. Thank you for the opportunity to testify.

MR. HAUSER: Thank you. So maybe if I could just start with an observation and a request for you, Mr. Bentsen. With respect to the Deloitte studies, the Deloitte reports come with, you know, a fairly substantial disclaimer. As I read the report, it appears to be an aggregation of information collected from a SIFMA working group, which I take it was a number of your member companies.

For its part, Deloitte's clear that they didn't independently verify, validate, or audit any of the information that was presented by the working group, and nor does the report, to the extent it relied upon survey data, include the actual survey questions.

So one thing I'd ask is just it would be enormously helpful to us if you could provide in this re-opened comment period with the survey questions, to the extent there was a survey, you know, to the extent there was a questionnaire, the questionnaires, the underlying data.

Just, you know, the raw materials, to the extent possible, so that we can assess the representations contained in that report and use them a little more productively.

The other thing that would be enormously helpful is the cost estimates aren't broken down by the various components of the regulation and exemptions, so to the extent the working groups were developing these cost estimates based on these different components, a breakdown would be enormously helpful.

MR. BENTSEN: We would -- Mr. Hauser, we'd be happy to get back with you on that. I will say I think, you know, what we asked Deloitte to do, and what I think they did, was to work with our members to really map out what the operational requirements and compliance requirements are under the best interest contract exemption, as well as under the principal trading PTE.

We think they laid that out pretty clearly, in our view, which is sort of a Rube Goldberg, almost, approach for those who are old enough to know who Rube Goldberg is, but approached and I think underscores the complex nature of this rule proposal, notwithstanding the good intentions of the Department here.

In addition, I would point out in looking at the cost of implementation where we, you know, in the time that we had between receiving the rule and spending time with our members, who in many cases are scratching their heads trying to figure out exactly how would we do this, how would we build systems, could we bifurcate systems, could we use existing compliance systems that we have in place, how -- and in some cases, as pointed out, certain things that are asked for in the disclosure regime that don't really exist today, how would you get that data, how would you do it in the timeframe that is asked for.

So that's where we think the Deloitte report is very useful. Be happy to spend more time with you on that.

MR. HAUSER: Thanks. Yes, we appreciate much of the narrative in the report and I think it will be helpful, but again, to the extent we can get the actual questions, a sense of who it was and how representative they were of the industry that participated, how the costs are broken down, that, too, would be enormously helpful.

Then similarly, with respect to the NERA study it would be enormously helpful, again, if we could get the underlying data and details on the assumptions methods, you know, that were used in coming to the conclusions, and a better sense, for example, of how the particular accounts that were sampled were collected, how representative those accounts were, and how the calculations were performed.

MR. BENTSEN: Again, we would be happy to sit down with the Department and walk through the NERA. I will point -- and the methodology that was used that's laid out in the study in more detail. I would say that I mean obviously with respect to data itself, there are certain proprietary issues that, and privacy issues that, you know, we, ourselves, did not see the data, and obviously, I think the Department understands that as well.

MR. HAUSER: So in connection with the NERA report let me just flag a couple issues that I just think would merit additional explanatory work. One is that there's a fairly lengthy description of kind of a comparison of the cost structure for fee-based accounts and commission-based accounts which extends from about pages 4 to 10 of the paper.

But if you look at a footnote, you know, at the start of that discussion, the footnote says that the fees in the commission-based model exclude fees received indirectly from the account holders such as mark ups, mark downs, 12b-1 fees. That is, after all, a big part of what this issue is about, and that's a big part of what the compensation is that brokers receive in this marketplace.

Now it may be that it's nevertheless an apples to apples comparison in some way and I'm just misreading it, but it does raise a question about whether we're really doing an all in comparison there.

MR. BENTSEN: Well you do have to get to an apples to apples comparison. Certainly you have, you also have commission, you have not commissions, but you have trading costs that also apply with fiduciary accounts, right, and so you have agency costs for trades and the like.

So again, in trying to get to the differential I think that the -- I think that, again, we would be happy to sit down with you and walk through the methodology. I think, nonetheless, that the data shows that there is a difference in the price between fee-based -- and again, keep in mind the vast majority of my members provide both fee-based and commission-based accounts.

The vast majority of American investors, including retirement investors or investors in IRAs, choose commission-based accounts. Nonetheless, our members provide, the vast majority provide both.

There is a fee differential that exists. I think it's proven out in the NERA data, I think it's been proven out in other data as well. But we'd be more than happy to sit down with the Department and walk through it.

MR. HAUSER: And again, our goal wouldn't be -- we -- I would very much like to take you up on that request, but it would be good, too, that whatever the submission is, it be a matter of the public record so everybody --

MR. BENTSEN: Understood. Yeah.

MR. HAUSER: -- can respond and comment on it. And then just the other issue I'd flag and then I promise we'll move off of these reports, but there's also a focus when you're doing the performance comparison, at least as I understood the report, the NERA report, when you're doing the performance comparison between the commission-based and the fee-based structures everything is done based on the performance at the median.

When you're doing a project that's going after the impact of conflicts of interest, I mean I just wonder whether looking at the median is the way to actually ferret out the harmful impact of conflicts. One would think that the -- I mean this is very much a layperson's opinion. My economist here can weigh in.

One would think that the greater part of the problem would probably be in the tails. It would be how people are being advised that aren't at the median, but who are really being steered in inappropriate ways.

MR. BENTSEN: Yeah. I mean I would, I will talk to the NERA folks. I'll leave that to the economist. I would point out that, you know, of course just as there may be conflicts within the commission model, there certainly would be conflicts within the fiduciary fee-based model as well, right, because the desire of the fee-based, you know, is to increase assets under management because that affects their compensation.

It also, you know, goes without saying that there are issues where -- there's no doubt that that tail -- if there is a tail effect, the tail effect would be on both sides.

MR. HAUSER: So let me move off of those two reports and just -- so I appreciate SIFMA's statement that it supports the best interest standard and that it's, as I understand it, the issues with our regulatory project aren't so much how we've defined the best interest standard as how we go about implementing that standard.

So given that, you know, and maybe this is a lot to ask you to assume, but assume we took care of the workability issues in terms of the -- that you've identified in terms of the timing of the contract, the way in which the contract obligations would be imposed, the notice and disclosure provisions, and what we're just down to, really, is the notion of an enforceable up front commitment that your advisors, brokers and advisors are going to adhere to the best interest standard, you know, as we've defined it, including an obligation for prudent advice, for best interest advice, for services that are reasonable in relationship to the fees that are charged, and a requirement that they not create a set of financial incentives that are misaligned with those goals.

You know, an obligation not to incentivize people to violate those terms. If -- would -- is any of that problematic?

MR. BENTSEN: It's a lot to assume --

MR. HAUSER: I appreciate that.

MR. BENTSEN: -- to be fair. You know, I would start by saying that I mean we, the process matters here, in our view. I think that, as I've said in our testimony and we've said publicly, that I don't think in terms of the definition of a best interest standard, a prudent standard, that we have much difference.

We have a difference, you know, in the global process difference that we think this ought to be uniform, it ought to be holistic, it ought to be done at the SEC and then filtered down from there. We can debate that, you know, all we want, but we think that's how the public policy marketplace ought to work.

But as we go down into the process with respect to what the Department has proposed here, we think, in part, and we'll be happy to come back in more detail, but in part, that the imposition of the standard through an exemption is not necessarily the way to go. You know, that it raises the possibility that you could, you know, of the excise tax issue and the like.

So I think we have a broader process question, I think -- but that's one. I think -- and how you're doing it, I think we would structure it different.

To say that, you know, well if you all fix some of the disclosure regime, fix the contract, you know, when a contract has to be imposed, do something with the best interest standard that maybe the industry felt could be workable but is enforceable -- and we think, you know, we would disagree perhaps with my fellow panelists on arbitration. Perhaps we'll talk about that because we do think it's enforceable.

Could we find it acceptable? I mean it kind of depends what it is, and so I think we really have to look at it. There's so much in this rule. Even the panel before, which we may not agree with all of the panelists there, they raised questions, even in support of the rule.

There's so much in this rule. It's so dramatic that it goes back to the point that I made in my testimony that, you know, this is changing the regulatory architecture for one part of the market, so it's going to create some confusion there, but then the firms are going to have to deal with it and they're going to have to figure out how to deal with it in an eight month period.

It's really something where you have to have time to look at it. Where we've been through this in the Dodd-Frank regulation there's been a longer runway, there's been, you know, no action relief, exemptive relief, because the regulators understood -- it's not that they and the industry necessarily always agree, but they understood that they didn't want to be disruptive to the market. Here, we worry that that's not the case. So I think it's a long way of saying we really have to see what it is.

MR. HAUSER: I guess I'm just trying to understand the scope of your concerns, so let me phrase it a little differently. Suppose -- and not --

I mean this isn't a negotiation, I'm not really putting this on the table, but suppose --

MR. BENTSEN: You said it, not me, so I --

MR. HAUSER: -- the exemption simply said you have to make an up front binding commitment to adhere to that best interest standard, you can't have policies and procedures that incentivize people to act contrary to the best interest standard, that's it, and it's only needed for people who actually make recommendations in the FINRA sense.

They're a call to action with respect to investment advice, you know, with respect to a particular investment, to a particular investment strategy, and they get a fee at the end of that route, that's it. Would that be acceptable?

MR. BENTSEN: I mean, again, I'm not in a position to sort of, to answer that. I would say this. That I think I mean one phrase you used, in the FINRA sense, I think would be a very positive development because that would be pushing this back into the securities law context, which is where we think it belongs.

Again, we continue to have concerns about utilizing the exemption itself as the means for doing this. You know, again, it's something that -- far be it from us to say we would negotiate with you all, but, you know, because we don't think we're in that position, but we would certainly be willing to discuss.

MR. HAUSER: So in the ERISA context -- and I appreciate your points about the different regulatory structures that apply in your space, but in the ERISA context the default rule for conflicted investment advice is you can't give it if you're a fiduciary. You have to give unconflicted advice.

So how else would we -- I mean so it's not a question of a best interest contract or a best interest standard so much as you just may not give the advice if you have a conflict of interest, so why does SIFMA, why would you find it problematic for us to say we'll permit you to get those otherwise prohibited compensation streams that are prohibited under ERISA and the Code -- not under the securities laws, necessarily, but under the statute that we regulate -- why would it be problematic for us to say that, you know, we'll let the firm continue to receive those compensation streams just so long as it makes an up front promise to its customer, you know, maybe done the way that was suggested by the financial planning folks that we're going to act in accordance with this best interest standard?

MR. BENTSEN: Well I mean, you know, in part, I'll rest on the 275 pages that we submitted in the comment letters, but I think -- but the other point I think I would make here is that you make the point of things that are already prohibited true to an extent but in the rule you are now actually going further and reaching out through the new exemptions and grabbing new things and saying certain things are allowed and certain things aren't.

Then you're establishing a standard within the exemption that then creates, you know, new liability associated with that. So I think that part of the process, we have a problem with. But again, I'd be happy to come back with you in more discussion on that.

MR. HAUSER: Thank you. Maybe I'll let somebody else ask some questions.

MR. CANARY: Sure. Joe, do you want to go? I have a couple of questions but I think we have enough time.

MR. PIACENTINI: Okay. So let me sort of apologize in advance for picking back up the economic studies. I was going to save those questions but I understand the SIFMA witness that was intended to testify tomorrow on that topic wasn't able to make it after all.

So I appreciate what you said about, you know, we could speculate on what's going on around the medians with respect to fees and with respect to performance but it does occur to me that if NERA had data on 63,000 individual accounts they actually know, or could know, what's going on outside the median.

So I appreciate your offer to follow up with more information from your consultant on the economics. It would be very interesting to actually know what's going on outside the median with respect to performance.

In terms of fees, I appreciate what you said about apples to apples. I think when I think about it -- and I'd appreciate your input -- to me, apples to apples from the point of view of the consumer would be what's the total expense that I would incur in different types of scenarios, and from the point of view of understanding potential conflicts of interest, what's the total amount that's going to be paid to the advisor, either directly or indirectly, that might influence their conduct?

So, again, I don't -- in this case I don't know whether that would be part of the data, that NERA had the explanation and the report didn't get to that, but if that kind of information is there it certainly would be helpful to know the total amounts of expenses facing the consumer and paid to the intermediary, to the advisor.

So let me stop there and -- I mean do you agree with those analytic approaches? Would those be the right questions to ask the consultant?

MR. BENTSEN: Well I mean I think the questions you'd want to ask, I mean I think that the -- on the second question I think -- you know, again, I think I would prefer to sort of run that by the consultant and let them respond to that instead of trying to sort of dig into, you know, their methodology and your question related to it.

MR. PIACENTINI: Then I guess there's one other follow up question and it goes to the comparison of performance in fee-based and commission-based accounts that's presented in the report. The differences that they show at the median across different years range from a negative 1.96 percent to a positive .63 percent. These are differences in annual performance of the accounts.

MR. BENTSEN: Right.

MR. PIACENTINI: The consultant says these differences are small and not statistically significant, so I guess my question is, in your view, are those small differences in performance?

MR. BENTSEN: I think, in my view, what the data shows is that the spread between, the up and down performance between the two accounts shows that in many cases in that sample, in many cases the commission brokerage accounts performed better by I want to say, you know, in some cases 23 basis points or more. In other cases, you know, the spread went the other direction.

MR. PIACENTINI: Yeah.

MR. BENTSEN: So what I think the data shows is, at least in the median, that you -- it is difficult to make the case that there's a material difference in performance based upon the structure of the account, based upon the data that was looked at.

MR. PIACENTINI: Okay. And, yes, the report did show that sometimes the commission-based accounts performed better, sometimes not as well, by a wide margin things did vary --

MR. BENTSEN: Yeah. Right.

MR. PIACENTINI: -- and that across the entire time period, taking an average of the medians, it appeared the commission-based accounts actually performed better across the entire time period in the report.

So anyway, I just would be interested in anything that would sort of clarify exactly how the analysis went behind generating those results and what else we could see to more fully characterize the data and the comparison. Okay.

MR. BENTSEN: All right.

MR. PIACENTINI: Thank you.

MR. CANARY: Mr. O'Brien, a question on scope of the rule. I appreciate your comments on the issue that we've got and on comments dealing with group health plans and disability. A different question.

Think as the proposal is drafted it would cover welfare plans that have a funding policy and use a trust and then make investments as part of that funding policy. Do you have any thoughts on whether that's appropriate, and as a sub question, whether there are any needs for special rules dealing with the rule's applicability to those kind of funded welfare plans.

MR. O'BRIEN: Sure. Thank you. I think, as we indicated in our comments, perhaps buried in a footnote, when it comes to funded welfare plans, where you are making investments with plan assets, it is entirely appropriate to apply the definition of fiduciary investment advice in those situations.

You know, in our discussions with the folks who run these plans, I mean we haven't identified at this point any specific issues or pieces that need to be tailored but it's something we're going to continue to think about and, before we submit an additional round of comments. Perhaps we can follow up then.

MR. CANARY: All right. Thank you. One additional question. The same space. The rule, as drafted, also covers not only IRAs, but other investment accounts that would be treated as plans under 4975 of the Code, including HSAs, or health spending accounts. Do you have any thoughts on whether that's appropriate in terms of the scope of the rule?

MR. O'BRIEN: Sure. Bottom line, simple answer is, yes, they should be covered. If you have a plan or an account with assets that's otherwise covered under the statute and you have investment recommendations being made, yes, they should apply.

I would note that certainly when you look at the marketing materials for HSAs, as an example, they are marketed partly as an additional source of retirement savings and a platform of investment options is often offered. So we don't see the distinction, that a distinction needs to be made in those situations.

MR. CANARY: Thank you.

Mr. Keeney, you said you had experience not only in the FINRA arbitration context, but also dispute resolution in the insurance space. Could you talk a little bit about how the dispute resolution process is different in the insurance space than it is in the --

MR. KEENEY: I'm sorry if I misspoke. I had prior experience with the New York Stock Exchange arbitration and with AAA arbitration before FINRA became the only place you could go. I've had clients who had insurance products. We always went to FINRA arbitration because they were always FINRA-covered products.

MR. CANARY: So you have not -- so you're not able to talk about what would be the dispute resolution system, for example, if you're doing a non security-based insurance product that was not subject to FINRA arbitration?

MR. KEENEY: Not really, except to the extent that securities are involved I think it should be voluntarily arbitration, but not mandatory.

MR. CANARY: Okay. You had a pretty unfavorable characterization of the FINRA arbitration system, at least as it applied to protection for the investor.

MR. KEENEY: Right.

MR. CANARY: Is there, in your view, a way that a rule could be framed that would have a mandatory alternate dispute resolution system or method in place that would be acceptable?

MR. KEENEY: A mandatory --

MR. CANARY: Yes.

MR. KEENEY: -- alternate system? I would not favor any kind of mandatory alternate system. I think a voluntary alternate system would be fine because there you can negotiate who the arbitrators would be or the deciders, what the rules would be, the costs, everything about it.

Once you have a mandatory system, the practicality is that the industry winds up dictating all of that and the investor is just stuck with it.

MR. CANARY: So a mandatory nonbinding would not be an improvement, as far as you can tell.

MR. KEENEY: Well it would be some improvement. Yes. If it wasn't binding then you could go through the process just like a mediation. You can go through a mediation process right now and if you don't agree, then you go to arbitration. If you could go to Court instead, that would be an improvement.

MR. CANARY: Okay. Thank you.

MR. BENTSEN: Could I just make one point on that. You may have a view because you're the expert on this, but the one issue that, as arbitration issues, predispute arbitration's been discussed and Congress has looked at this over the year, obviously the Courts upheld it, the -- is FINRA, and predecessor NASD, you know, mandated that broker/dealers are bound to arbitration if the client requests, and so predispute arbitration largely creates a two way street.

A concern I think with Mr. Keeney's point is that we would be going back to a one way street so that in many respects the broker/dealer -- and I believe, unless there -- I'm not sure how this would work, actually.

This raises some of the conflict questions between, and by that I mean the conflicts between laws and rules of the Department and FINRA and securities laws -- is if you developed a different mechanism, would broker/dealers still be subject to the FINRA/NASD requirement as it relates to these plans, because at the end of the day, regardless of what the DOL rules are, they're not excluding broker/dealers from FINRA regulation.

So it raises a question to -- your question to him I think raises further questions of, you know, what would the impact be on the existing regime that broker/dealers have to live under the securities laws.

MR. CANARY: Thank you. That's a good point. A couple of questions for you. On the counter-party carve out or the seller's carve out, I think your comments suggest that it should be broadly expanded to include IRA investors, participants, beneficiaries, and small employers.

In the provisions we have now there are some required disclosures, acknowledgments, even when we're talking about large money managers or large employer plans. What kind of communication do you think would be sufficient so that the investor in that retail space, as we have envisioned it, is put on fair notice that things that may come across as investment recommendations are really just sales pitches?

MR. BENTSEN: I think I'd say a couple things here. First of all, obviously, you know, we try to address this in our comment letters. The point we're trying to make is selling is selling. That, you know, has been recognized in earlier precedents.

I think it also raises, and this kind of came up in the previous panel where I think that the panelists were in agreement with the Department largely but they raised the point that this is an area where words really do matter and so it is very complicated.

I think what we would say, and an example would be -- and I'm sort of going from selling into education as well so maybe I'm conflating these a little bit but I think it's a point worth making -- is to some extent there are, I think, efforts being made to address this, particularly with respect to the rollover situation, which is something I know the Department cares a great deal about.

There you already see activities, you know, by FINRA under 1345 where they're trying to establish policies and procedures that firms have to follow, and the firms are obviously adopting those, or have adopted those, to be in compliance.

So our concern is, and again, I think we, it's better stated in our comment letter, but our concern is that you're being overly restrictive in your approach to the seller's exception as it relates to, you know, IRAs and smaller plans. It's a very complicated area, I think, to, for the Department to work through. Understanding what your intention is it's, we think it's very difficult, but we try and address it in our comment letter.

MR. CANARY: Thank you. One last question. So there -- I think you heard from the prior panel, there was some discussion of the education provision and the limitations on using specific investments and asset allocation model.

Think the panel before you was suggesting that we should loosen that up as it applies to a plan portfolio where there's a fiduciary that's made a decision about the investment options that are available, but I think they were saying not so much in the IRA space. Can you offer your thoughts --

MR. BENTSEN: We would disagree. I think, again, we lay that out in our comment letter. That we think that the education definition is, is too narrow.

You know, only being able to -- when clearly, in our view, you're not trying to give investment advice or personalized investment advice, you're trying to give education over -- you know, it's got to be more that you should, you know, do 20 percent large cap, 20 percent small cap, 10 percent international, whatever it may be. There's got to be some more context to it.

So we think that should be broad and it should apply, and it should be broadened for IRAs in addition.

MR. CANARY: So one last question on that. I think, as you connected the two, there's a connection between the seller's carve out and education. If you start putting a seller's carve out together with education that includes specific investment products, at least it seems in my mind hard to distinguish that from investment advice. Could you explain how you think it can be distinguished.

MR. BENTSEN: I think -- you know, frankly, I think I would come back and say that's what makes this all so difficult, because on the one hand you're trying to sanitize the conversation to such a point that you really, you can't sell when you are, when it's obvious that you're marketing or selling, and on the other hand you're defining education so narrowly that you really can't tell anybody anything unless they're willing to enter into a contract with you, and so you're really kind of leaving people to their own devices in this.

Again, it's not that I think there's any bad intentions on the part of the Department here, it's just that this is, this gets to, you know, a very difficult thing to define.

MR. CANARY: Yeah. I guess I would take issue with you can't do either one. I mean the line that's being drawn here is when you're a fiduciary you can provide investment advice and be a fiduciary and there's an exemption to allow you to do that so you're not precluded from providing education, nor are you precluded from discussing openly with customers recommendations. The question is whether you're acting as a fiduciary --

MR. BENTSEN: Right, but there's also an issue where there's mutual understanding that you're a fiduciary. And again, it's not without -- and that's -- in itself is not without conflicts.

MR. KEENEY: If I could a little I think dose of reality here. What I see in Sarasota is every week every retiree I know gets an invitation to go to a free lunch seminar and an education opportunity, supposedly. They're advertised with things like should you invest in gold? They're crazy things. The idea is to get these people right through that free lunch and into the broker's office. That's all he cares about.

So whatever you tell them they can say at an education seminar really isn't going to matter very much. The point is what can they say when they get them into the office. That is going to be hard to enforce because there's no, there's just the broker and the customer in that office. I think these seminars need a lot more regulation of some kind to limit the amount of craziness that goes on in those events.

MR. HAUSER: So, Mr. Bentsen, can I -- so if -- assuming we, you know, made clear that when we talk about a covered recommendation or covered investment advice we're talking about a recommendation in the SIFMA sort of sense, a call to action to invest in a particular product, pursue a particular investment strategy, if that's the rule and if there has to be a fee, direct or indirect, associated with that, why do you need a seller's carve out layered on top of that?

When you have a customer going to somebody who's getting compensated, you know, and making a specific recommendation, and that person by and large, whether they're a registered rep or not, is calling themselves an investment advisor, an investment professional, an investment consultant, and, part and parcel of that communication is not just a sale, it's advice.

It's looking at the person's individual circumstances. It's giving them a measure of professional judgment about what the person should be invested in. So if you have that, why should you ever be able to disclaim the obligation to make sure that the advice is prudent and in the best interest as we define it?

MR. BENTSEN: Well I think if you're saying that that's where your, if that's where your proposal ends up?

MR. HAUSER: Well, so assume -- I think that's kind of where our proposal is. I mean our -- we define a -- you don't have investment advice under a proposal unless you have a recommendation. These are -- and necessarily in this marketplace, in order to get a recommendation you're going to, you know, you're talking to an investment professional who's suggesting a particular course of action.

MR. BENTSEN: Right. I think our concern, and again, I'll rest on our comment letter, but I think our concern, again, is when is it advice, when is it a recommendation, when is it education, and when does that cross over.

MR. HAUSER: So if we defined that -- I mean if -- so I guess going back to it, so if we stuck pretty closely, or maybe even identically, to where FINRA drew the line on what counts as a recommendation, does that take care of this issue as far as the need for a seller's carve out goes?

MR. BENTSEN: Again, as much as I appreciate the fact that you're in, leaning towards FINRA, I mean let us think about that and then respond to you on the record. Yeah.

MR. HAUSER: Okay. Thank you.

MS. LLOYD: Mr. Keeney, can I just go back to you for one quick minute?

MR. KEENEY: Uh-huh.

MS. LLOYD: Our proposal includes a requirement that the fiduciary acknowledge fiduciary status in writing and I was wondering if that has any impact on the likelihood of a claim in arbitration.

MR. KEENEY: It might have some. Certainly the allegation in the claim would allege that that standard has been broken, but the reality is once you get into an arbitration setting with three individuals up there who have usually industry bias, they are not going to care very much about the niceties.

They're going to want to know what did he sell her, how much money did she have, how bad, how much did she lose, things like that, and the law gets lost. Even something like fiduciary standard. You don't hear suitability discussed much in FINRA arbitrations, you hear the actual facts of the case.

MS. LLOYD: Thank you.

MR. HAUSER: Thank you all very much.

ALL: Thank you.

MR. HAUSER: So if we could have Panel 3.

(Pause.)

MR. HAUSER: Ms. Roper?

MS. ROPER: Hi, I'm Barbara Roper. I'm director of investor protection for the Consumer Federation of America.

You know, as we move into this next stage of the rulemaking process you all face the unenviable task of reading through thousands of pages of comment that have been submitted in order to find those relatively few valuable nuggets, genuine suggestions to improve the rule, amidst these huge pile of -- verbiage.

The good news is that those nuggets do exist. Concrete proposals have been put forward that would improve the rule by making it easier to implement, by clarifying certain key points, and those suggestions ought to be able to win support from a broad array of stakeholders in this debate.

I'd like to talk today instead about a couple of the arguments that we think you can safely ignore as the last gap efforts of industry to maintain a status quo that has been hugely successful and profitable for them and far less beneficial for American working families and retirees who struggle to afford an independent and secure retirement.

The first is the argument that industry supports a best interest standard, just not the standard that you've proposed here. I'd be willing to make a small wager that virtually every industry representative who testifies here this week will somewhere in their remarks profess their support for a best interest standard, and some of them may even believe it.

When you look at the details of the standard that they actually support I think you'll find that in the majority of cases there is considerably less there than meets the eye. So, for example, they support a best interest standard, as long as it doesn't apply to the full range of services that investors perceive and rely on as objective investment advice.

So they advocate, for example, by an

extension, for an extension of the seller's carve out into the retail market in order to recreate, using different words, precisely the same loopholes that this rule is intended to close, or they support a best interest standard, as long as it doesn't actually require them to seek to do what's best for the investors.

Now I've been doing this for a long time and I have to say I was frankly shocked to see this argument made in the FINRA comment letter where they suggested essentially that best interest advice and suitable advice are two different things for basically the same thing. I can assure you that's not how investors perceive it.

Or, and this is critical, they will support a best interest standard, as long as no one expects them to set aside their own financial interests while they seek to identify the best course of action for the investor, and as long as no one asks them to dismantle the complex web of toxic conflicts that they have embedded in their compensation system in order to incent and reward advisors for advice that is, in fact, not in the best interest of their customers.

So, to be clear, the DOL's best interest standard, which recognizes that best interest is a higher standard than suitability, and which recognizes that that standard must be backed by meaningful mitigation of conflicts, is completely consistent with the reasonable expectations of retirement investors when they seek advice from financial professionals.

So second argument we would argue that you can safely ignore is the argument that you should step aside and let the SEC provide leadership in this area in order to avoid the potential confusion that could arise if we had different standards for retirement accounts and other securities accounts.

Now there are so many holes in that argument that there simply isn't time today here to catalog them all, but I think it's important to note that if you followed that approach and the SEC were eventually to get around to adopting a rule which is far from guaranteed -- we at CFA have been waiting for a little over 15 years now -- it would, by definition, be a standard that applied to securities accounts.

The retirement market is not exclusively a securities market, and so what we'd end up with is a consistent standard for securities accounts, which would make compliance easier for brokers, but different standards for different products sold within retirement accounts, which would be far more confusing for retirement investors and expose them to greater harm.

The irony here is that the Department has gone out of its way to borrow securities law concepts in drafting this rule. So your definition of investment advice is virtually indistinguishable from the definition of investment advice under the securities laws, your best interest standard is borrowed directly from Section 913 of Dodd-Frank, where Congress identified that standard, best interest without regard to the financial or other interests, as the appropriate standard for SEC rulemaking should they develop a harmonized standard for brokers and advisors, and you even deal with issues like ongoing duty of care and sale from a limited menu of proprietary products in a way that are, in ways that are essentially consistent with the 913 language.

So we would argue that the SEC could do far worse if they get around to drafting a rule than to follow the lead of the Department to craft a strong and protective rule for investors.

There's no question the Department's job would have been easier if the SEC had provided leadership in this area, if they had developed a strong fiduciary standard, if they had taken action to reign in the corrosive conflicts of interest that purveyed the broker/dealer business model, if they had even just provided clear disclosures about costs and conflicts.

But they've done, in fact, none of those things despite decades of entreaties from investor advocates, which leads us to wonder whether the real reason industry isn't arguing so hard for the SEC to take the lead is because they think they have a much better chance of getting the watered down best interest standard that they're lobbying for out of the securities regulators than they do out of getting it from DOL.

We don't know at this point where the SEC is going to come down, and we hope for better things, but if you listen to the noise that we've been hearing lately from FINRA and at least one very vocal SEC commissioner, you have to think that they have at least a decent basis for that conclusion.

So I would be remiss if I didn't note the industry's sort of favorite argument against the rule, which is that if you adopt this rule, many members will simply stop serving this marketplace, and that investors will be harmed as a result as they either lose access to advice or forced into more costly fee-based accounts.

Again, there are many arguments against why this doesn't hold up. For example, there's actually no evidence that fee-based accounts are consistently more costly than brokerage accounts when you consider the full cost of the advice plus the investments.

Beyond that, you have to understand this is what they always say when they're faced with a regulation that they don't like. A recent example came when the SEC was considering a rule to regulate all fee-based accounts under the Advisors Act, so fiduciary accounts under the Advisors Act.

Many of the same organizations, and, in fact, some of the same people, made exactly the same arguments that if the SEC took that action they would stop offering fee-based accounts and investors would lose access to these valued services. The SEC backed down, but in a rare win for investors, the Courts actually overturned that ruling. Today, all fee-based accounts are regulated as advisory accounts.

Guess what? The sky didn't fall. Brokers didn't stop offering those accounts. In fact, there's more money in fee-based accounts today than there was ever before.

So while there are very good reasons to, as you seek to finalize the rules, try to identify ways to make the rule as streamlined, as easy to implement as possible, consistent with a strong and effective standard, there's absolutely no reason to believe that the industry is going to voluntarily walk away from a multi-trillion dollar market if you finalize a rule based on this proposal.

So I would just like to close by saying, you know, we have a financial, we have a retirement marketplace today that works really, really well for the broker/dealers, and the insurance companies, and the mutual fund companies who reap billions of dollars in profits providing services to our tax-subsidized retirement accounts.

It works a lot less well for working families and retirees, people with no particular financial sophistication who struggle with complex decisions about how best to save for, and in, retirement, and who bear the full weight of any mistakes if those decisions go wrong.

This rule can help to ensure that when those retirement savers turn to financial professionals for advice what they get is actually objective advice and not just a sales pitch dressed up as advice. That won't solve every problem we have with our retirement system but it is a goal very much worth fighting for, and so we urge you to move ahead and finalize this rule without further delay. Thank you.

MR. HAUSER: Mr. Lane?

MR. LANE: Great. Thank you. Good morning. My name's Nick Lane and I lead AXA's U.S. Life and Retirement business in the U.S., a company with over 150 years of experience and serving three million clients today.

I also served as chairman of the board of IRI, the Insured Retirement Institute, representing over 700 firms across the value chain, insurance companies, broker/dealers, asset managers, and service providers, whose scope includes over 150,000 advisors and are providing 30 million Americans today with insurance-based retirement solutions.

I want to thank the DOL for their hard work and the opportunity to testify. We really do want to be part of the solution. First, let me say we support the DOL's objectives: better serving clients, and providing better client outcomes. We passionately believe Americans deserve dignity in retirement, financial protection for their modern families, and empowerment through financial literacy. Advisors should work in the best interests of their clients.

On a personal level, my grandfather was a teacher in a small town in Tennessee, Columbia, Tennessee, never making more than $15,000 in a year. Through his own hard work and work with financial professionals and those people he considered friends, he was able to provide a dignified life for himself to the age of 96, as well as help support my own educational costs after leaving the Marine Corps. This is a deeply personal issue.

Now, however, while we do support the DOL's objectives, we do have justifiable concerns that there will be significant negative unintended consequences. As you know, IRI has provided a detailed comment letter with constructive feedback. We wanted to focus on three simple solutions to make this rule workable.

The first would be broadening the definition of what is considered education versus what is considered advice. The DOL's definition should not include customary sales, marketing, educational, and service-related activities. We'd point to the DOL's own language in the 2010 proposal around the seller's exception as a good starting point.

The second would be equitably including variable annuities and PTE 84-24. I'm going to spend a little bit more time on this subject. The importance of individual annuity options for lifetime guarantees, given the steady decline of company-supported defined benefit plans, is indisputable.

Both the Obama Administration and the Treasury have publicly stated the importance of annuities for retirees. Just this past week Sen. McCaskill sent a letter to the DOL stating that even as lifetime income products are becoming increasingly more important, the proposed rule would nearly eliminate access to annuity products and seems in conflict with the good work that has been done on lifetime income.

Now let me address the issue of cost and complexity of variable annuities head on. Variable annuities at their core are insurance products that deal with the number one concern of retirees, which is outliving their income.

The fees are higher than mutual funds, but they provide enhanced benefits and services, diversifying a client's portfolio by meeting three needs in one: guaranteed income, access to a portfolio of stocks and bonds, and life insurance.

Compared to immediate annuities that allow consumers to receive an immediate stream of income, variable annuities allow retirees to essentially lock in a stream of income while retaining access to their principal, thus establishing an income floor, but creating the opportunity for a potential pay raise in the future.

For those consumers that purchased variable annuities in 2007, they locked in income streams at six to six and a half percent, almost 400 basis points higher than what can be achieved today investing in a 10 year Treasury hovering at 2.25. Our own research at IRI shows that over 85 percent of consumers that have bought variable annuities are satisfied and happy with their purchase.

While they may be the subject of press articles, FINRA's own statistics point out that less than three percent of arbitrations relate to variable annuities.

Given that they are insurance product, and given the design of the BIC, PT 84-24 is probably the only viable way to continue to make variable annuities available to the vast majority of Americans while ensuring that when consumers and advisors evaluate the benefits and costs of guaranteed income, they do it under the same set of rules.

Third, we would encourage the Department to streamline the BIC and work towards harmonization.

Feedback from our members, our advisors, and our IT staffs is that is its current form it is unworkable, and it would be confusing for consumers and advisors that will have to operate under four different sets of rules. We would encourage the Department to continue to streamline the rule and work towards harmonization with FINRA and the SEC.

Without these changes we do believe there will be significant negative consequences on American savings rates and American jobs. The reality is the only way that firms and advisors can comply with the current proposal in eight months will be to lower their fee -- lower their services and access to certain segments of consumers.

The reality will be a two tier system where affluent Americans receive fee-based financial planning while the average American is left with a website and the daunting task of facing retirement on their own.

The advice gap that this would create is a significant concern. Our research shows that roughly 20 percent of Americans are do-it-yourselfers across all generations and across all demographics. Eighty percent of consumers are looking for help. Given the UK experience it's reasonable to assume that almost 25 percent of advisors could exit the industry in the first year alone.

Now, currently 401(k) plans and robo advisors will not fill this gap. Defined contribution plans are a great form of accumulation but are currently devoid of retirement advice and product features to help retirees live on a fixed income. Robo advisors will certainly play a role, but in their current form are no substitute for the array of personalized investment options available to Americans today.

The key to retirement success is a disciplined approach which includes participation, asset allocation, and fund selection. Many Americans are unable to follow this approach on their own and under the proposed rule may not be able to afford to hire a financial professional to help them create and maintain such an approach.

I'd like to share a real life client story that may not be possible in the future unless changes are made. Robert and Betty Warren from California started their relationship with Kirk Cartwright in 1998 as they approached retirement. Kirk still remembers their conversation almost 15 years ago when he talked about the need for a well-diversified plan, not putting all of one's eggs in the same basket, to which Robert responded, what do you do when you just have one small egg?

Mr. Cartwright worked diligently to create a customized financial plan for the Warrens that included the purchase of a variable annuity with a guaranteed minimum income benefit, allowing him to retire two years later.

Having lived through two market crises or market corrections in 2001 and 2008, Mr. Warren stated that the lifetime guaranteed income that they have is vital to his retirement, representing almost 30 percent of the check he receives monthly, and without which he and Betty would be facing some very difficult decisions today.

The Warrens sent a letter thanking Mr. Cartwright for his foresight and skill he used in planning for their future. As Kirk told me, these are great Americans of modest means, and helping them is one of his proudest achievements.

The American public deserves dignity in retirement, the Warrens deserve dignity in retirement, my grandfather deserved dignity in retirement, and we have the opportunity to collectively get this rule right and ensure that in an effort to provide better advice for all we do not eliminate personalized advice and the access to guaranteed income solutions for many.

We respectfully hope that our comments and constructive feedback are taken seriously so that we have a workable solution. Thank you very much.

MR. HAUSER: Thank you.

Mr. Blass?

MR. BLASS: Thank you very much. Good morning. My name is David Blass. I'm the general counsel of the Investment Company Institute. The regulated funds that ICI represents are especially attuned to the needs of retirement savers. Mutual funds alone account for about half of retired assets in defined contribution plans and in individual retirement accounts.

Fund advisors recognize the trust and confidence that every investor in a fund places in them, and they labor every day to live up to those standards and expectations.

In that vein, we agree with the Department on the underlying principle behind the proposed fiduciary standard, and we do think this is something that, while many will agree is important for you to hear from the industry, financial advisors should act in the best interest of their clients, as Nick described in his opening statement.

As the long history of the Department's efforts make clear, crafting a fiduciary rulemaking is a significant undertaking and it requires a care and a focus on simplicity, whenever possible, and clarity in all matters.

It's all too easy to make that kind of a rulemaking overly complicated and confusing, and, quite regrettably, we believe that that's exactly what happened. The Department has done just that, ending up with a proposal that does not resemble the principle-based and flexible approach that Secretary Perez has described.

In fact, we do believe if the Department adopts the rules as currently crafted and without further refinement, we have grave concerns that retirement savers will be harmed, not helped. Again, the problem we have is not with the standard that is being discussed, but rather, everything that comes on top of that -- the extra obligations placed on financial advisors.

As drafted currently, the proposal risks limiting retirement savers' choice of advice provider and risks restricting savers' access to information they need for retirement planning. It also will increase costs, at least for some retirement savers, and particularly those who can afford it least.

This is because the net effect of the proposed rules if adopted, again, as currently drafted would result in retirement savers having access to less information and guidance than they currently rely on and that they need to make informed investment decisions for their retirement.

Some savers will pay more for advice because they're effectively forced to use fee-based advisors that frequently come with higher cost services. Worst of all, some savers, primarily those with the smallest account balances, risk losing any access to advice at all.

Fortunately there remains the opportunity to correct these problems, and I'd like to describe five of our primary recommendations for doing so, many of which are the types of concrete recommendations I hope Barbara was referring to earlier.

First is on the regulatory impact analysis. We believe the Department must fundamentally revisit what we believe is a deeply flawed justification for the rule proposal described in that regulatory impact analysis.

I know the topic will be addressed at length tomorrow. I'll only mention here that the analysis doesn't consider recent publicly available data that contradict its conclusions and does not analyze the significant harm to retirement savers that will result if the Department adopts the rules as currently drafted.

The results of an impact analysis must inform an agency's, a regulatory agency's policy choices. We believe strongly that if you reassess that impact analysis in light of comments, you'll make policy choices that both meet your goals, while also making the rules simpler and more practical to implement. ICI, for our part, stands ready to assist in that effort.

Second, the Department needs to be more targeted in crafting a fiduciary definition. The proposed definition attaches fiduciary status to many ordinary day-to-day interactions that don't entail a genuine fiduciary relationship. For example, when a retirement saver simply wants to pick up a phone and call somebody to talk about their account, the availability of services or potential investments.

Fiduciary status entails one of the highest obligations known to law. It carries with it, as you know quite well, a host of prohibitions under ERISA. Because of the restrictive nature of these prohibitions, rules governing what activities give rise to a fiduciary relationship must be quite clear, must not overreach, and must provide a meaningful ability for one to market or sell one's services and products to all savers.

The practical consequence of this aspect of the proposal would be quite damaging for many retirement savers. Unless the Department clarifies that these basic day-to-day interactions are not fiduciary activities, many providers will have no choice, because of the prohibitions that come along with ERISA fiduciary status, will have no choice but to stop offering them.

Put more simply, retirement savers would lose the ability to talk to somebody on the phone about their account, or potential investments for their account, and they would lose access to information they rely on today that's provided through the website, newsletters, and other sources. They'd lose even the ability to see examples of investment options that would fit a model portfolio.

The risk I'm talking about is both probable and foreseeable. As you heard on the last panel, and you probably know all too well, the government of the United Kingdom launched a review of an advice gap for small accounts.

We should learn a lesson from the United Kingdom and take steps to promote advice and information being provided to savers with small accounts, not impede the provision of that advice and information as the proposed rules would do, at least as drafted.

At a minimum, the Department must craft the definition more carefully to capture only individualized recommendations that are intended for a retirement saver to rely on to take a specific action. We provided in our comment letters alternative text that would accomplish this goal. I know several other commenters did as well, and we'd commend the collective set of recommendations to you for analysis.

The Department also should provide a meaningful seller's exception that covers all savers and that would apply to true marketing and sales activities.

Third, the Department needs to greatly simplify the rule's exemptions. These exemptions are essential to making the rulemaking workable. They, in turn, must offer clarity and practical conditions.

The most sweeping exemption of course is the best interest contract exemption. As drafted, it's not particularly useful because it imposes a multitude of ambiguous impractical conditions on brokers and others who wish to rely on it.

It clearly requires some refinement, as we've heard from both panels already today. Without that refinement, the result will be that savers who today rely on brokers and other commission-based advisors for investment services won't be able to do so. They'll be forced either to switch to fee advisors, likely increasing their investment expenses, or risk going without advice. That's the most costly course of all.

A better approach is to heed Secretary Perez's call to give sufficient flexibility and discretion to allow fiduciaries to determine how best to satisfy their fiduciary duties in light of the unique attributes of their businesses, and, I'd add, the needs of investors. Here, simplicity and flexibility truly is needed.

The exemption will only work if it's streamlined and many of the impractical conditions are revisited. The Department should start by eliminating the proposed contract and the contractual warranties and representations. They're not needed, only add complexity, and they don't protect investors. They only serve to expose firms to new litigation risks.

The Department also needs to simplify and streamline required policies and procedures requirements for material conflicts of interest. As drafted, the conditions are effectively compliance traps for advice providers.

The best interest contract exemption also would oppose a new set of disclosure requirements that are redundant, granular, and costly. Here, we believe the Department should implement a more useful disclosure model that it already has in hand, the disclosure regime under ERISA Sections 408(a) and 408(b)(2).

Those disclosure requirements were issued only after significant debate about how to best inform retirement investors and plan fiduciaries. They're well-understood by plan and providers and, importantly, they would not overwhelm retirement savers with useless information that's likely to confuse, not inform, them.

Fourth, the Department should avoid retroactive application of the rules if they're adopted. Retroactive application would unnecessarily harm retirement savers by effectively prohibiting ongoing advice on assets acquired prior to the rules' implementation dates.

We recognize that the Department's made initial steps in that regard. We think the route should be completed and additional steps should be taken.

Fifth, the Department should abandon the notion of a potential high quality, low cost exemption. We have grave concerns about this exemption's feasibility and wisdom. The proposal's confusing set of questions on that topic raises a host of conceptual issues that preclude meaningful comment.

The Department does not explain, for example, how such an exemption would work or indicate what investments would, or would not, qualify. We clearly have not been provided sufficient information about this aspect of the proposal to allow for comment in any meaningful way.

Thank you again for the opportunity to present these views. The Institute strongly urges the Department to look at the entire proposal in light of our comments and the many other comments it's received and to draft appropriate revisions using a transparent process.

This would allow it to avoid negative unintended consequences for retirement savers, and after all, it's in the best interest of Americans saving for retirement that the final rule be clear and practical. I'd be happy to answer any questions you might have.

MR. HAUSER: Thank you. So the rule as we wrote it and as we intended it only covers -- and I'll probably be repeating this for the next four days -- recommendations in the FINRA sense, so if you have that kind of recommendation where, you know, an investment professional is telling somebody where they should put their money or what investment strategy to use, I guess my questions, which maybe I'd direct first to you, Mr. Blass, one, what do you think a seller's -- do you still think a seller's exception is necessary, and how would you implement that seller's exception so that it doesn't just become a loophole that essentially makes all advice nonfiduciary advice?

MR. BLASS: Yeah. So first of all, we agree with reference to the term recommendation. It is fairly well-understood in the securities world. We do think there could be a benefit of including in your rule text very explicitly some guidance about what recommendation means just for the, those who are unfamiliar with it.

In terms of the seller's exception, fully understand your point. We think there are, continues to be some ambiguity about when somebody is triggering fiduciary status, especially if you think about a telephone call with somebody at a call center where they're not even getting a commission, they're not getting any additional compensation for a discussion, but they're talking about different types of investment products.

The definition as written. Elements of it continue to be ambiguous. For example, there's a reference to an understanding which I think some commenters have pointed out both is ambiguous on one side and the other but it's an ambiguous term. The element of being, advice being directed to an investor also strikes us as inappropriate because that could be, much is directed to someone, including on a telephone call or by mail.

MR. HAUSER: Sure, much is directed to people, but if what's being directed to them is a specific investment recommendation and ultimately the firm or the individual's getting a fee, why, you know, again, I guess why wouldn't the best course of action to be make that a best interest communication?

MR. BLASS: So the case where there's an individualized recommendation that takes into account that investor's facts and circumstances, we understand your perspective there. We're talking about a different scenario where that has not happened. So it's a conversation where there's some ambiguity about the discussion of different investment product services.

The investor might hear something that he thinks or she thinks is a recommendation. From the advice, the service provider's perspective, they would need to take significant other steps to be sure it's really right and appropriate for that person's specific facts and circumstances, may not intend it to be a recommendation, and therefore be left with a situation after the fact where there, it's been claimed that they were a fiduciary and therefore all the prohibitions were triggered without the service provider really knowing it.

MR. HAUSER: So say that the person on the other end of the phone or in the office is talking to, you know, a 75 year old about how to invest their money and they say, everybody at your age should invest in such and such product, that's it. There's no -- they haven't looked into their circumstances, they haven't done any individualized analysis, but they've quite clearly made a specific recommendation.

Should that really not be treating, treated as fiduciary while we would treat as fiduciary a communication where the broker or the advisor at least made the minimum effort of understanding what the customer needed?

MR. BLASS: Yeah. So I'm not sure how realistic that scenario is but if the question is should investors be confused, the answer absolutely is not. We definitely want investors to know the services they're receiving and what applies. So to the extent there's the ability to tell that investor what, in what capacity they're operating, seems entirely appropriate.

Where there's ambiguity, it's when somebody calls and says, look, I'm looking to invest in large cap funds, what do you have available. There really becomes an ambiguous situation, or there potentially could be, under this rule about whether that discussion where you're identifying different funds that may qualify or may respond to that question trigger or not a recommendation or fiduciary advice.

MR. HAUSER: So perhaps we need to clarify it, but the first prong of our education definition, which is laid out in the text of the rule, is meant to cover just that sort of thing as education.

We fully intend for people to be able to describe the attributes of their investment products, the historical performance, what the terms are of getting into that investment, what the terms are for getting out of that investment, penalties, all the rest. That every bit of that can be described without tripping the fiduciary line. We only propose to cover an actual recommendation.

I guess the question I still have is if you make a recommendation, if you tell somebody you should put your money in this product, do you think there should ever be a circumstance where you can get out of having to make that recommendation from a best interest, you know, in accordance with a best interest standard based on say a disclosure that while our conversation here is a one on one conversation with a professional, you know, you should not rely upon it as a primary basis for your investment decision, or tax planning, decisionmaking? I mean does that seem like a workable standard?

MR. BLASS: So again, we think recommendation is a workable standard. It's one that's well-understood. We agree with that, and did agree with further clarifying it in the rule text. I think the situation comes up where somebody calls and, name your fund shop, they say, look, invest with us, we've got a lot of different products that are good for you. How is that to be handled?

Fund shops, insurance agents, they should be able to sell their services and to market their services.

MS. ROPER: Could I just hop in? I mean that strikes me as you're confusing two very different issues here. We strongly oppose expanding the seller's exemption into the retail market.

There's, you know, extensive evidence that investors do not make this distinction between a recommendation that's a sales recommendation and a recommendation that is advice, and partly because the firms work very hard to convince them that they're in a relationship of trust.

They call themselves financial advisors, they call the service retirement planning, they market it based, you know, they market it as a relationship of trust, and then they want to disclaim fiduciary duty.

A seller's exemption is designed to say, yeah, we're going to do all of that, but then wait, we're going to tell you this is a sales recommendation, we're not acting in your best interest and everything's going to be fine, and it doesn't work. I mean there's a lot of research that shows it doesn't work.

There's a very different issue about saying that firms need to be able to market their services without triggering the definition of investment advice. I don't think that's controversial.

I think, you know, it's -- and to the degree that there is an element of ambiguity in the definition of investment advice with regard to that ability to market your services, as long as that marketing doesn't include a concrete investment recommendation, so as long as it's not, you know, you really ought to roll over, out of your 401(k) so that I can manage your money for you, I don't think you'll find that there's any controversy around providing that clarification that firms need to be able to market their services.

But you don't need to expand the seller's exemption, the seller's carve out into the retail market to achieve that, and we would be adamantly opposed to any proposal to do that.

MR. HAUSER: So what do you -- do you have any thoughts on that?

MR. BLASS: Well we do. I disagree with Barbara to some extent. The seller's exemption, I think, does need to be extended out both to the retirement market and to small plans which currently are excepted from. Both the best interest contract exemption and the seller's exemption need to be extended to small plans.

We do think investors and small plan fiduciaries or providers are able to understand the difference between sales activity and true fiduciary advice.

I do think that an individualized recommendation to someone for their particular circumstances, understand that your rule would attach fiduciary status to that advice.

MR. HAUSER: And I guess the question I have, though, is, I mean is it your view or ICI's view that a simple disclaimer ought to get you out of that fiduciary status? For example, a provision in the contract or in your marketing materials that says that it's, our professional services are educational in nature and not to be relied upon as a basis for investment decisionmaking. Would that push it out of what you would treat as fiduciary investment advice and into a nonfiduciary communication?

MR. BLASS: So maybe this would help. First of all, we do think there's some utility to disclosure to investors and it can take a number of forms. Ultimately, you don't want investors or retirement savers to be confused about the level of service they're getting so disclosure can help in that regard.

Our recommendation is that you look at the totality of the circumstances and if a relationship really is developed of trust and confidence and one where it's clear that there's an intention to have a fiduciary relationship, that would not be then undone by a simple disclaimer.

MR. HAUSER: So if I'm hearing you right -- just correct me if I'm wrong. If we've drawn the line in the right place as between what's advice and education in the first place, you don't really need an additional, you know, seller's carve out. Is that right?

MR. BLASS: There are a number of ways to get there. We do think the seller's carve out provides certainty, so we think that there's utility to that, but certainly revisiting the lines that are drawn on advice versus education would be helpful, too.

MS. ROPER: So I mean I'd just like to point out on this point that there's actually been quite a bit of study about how effectively you can disclose these issues to investors. The process at the SEC started when they tried to develop a disclosure for what were then fee-based brokerage accounts to explain that they were not advisory accounts.

They hired a consulting firm that did a lot of testing of disclosures and went back and redesigned and tested again, and the fact was they weren't able to develop a disclosure that effectively conveyed the necessary information.

The RAND study took that a step further and, you know, shows that investors, as a general rule, don't know whether their own advisor, for example, is a broker or advisor. Then they gave them fact sheets explaining the difference between the two, and guess what, they still didn't know whether their own advisor was a broker or advisor. So even when they're educated about the differences they don't make that distinction.

The notion that you're going to be able to create a disclosure solution -- I mean you're essentially recreating, if you bring the seller's carve out into this market, recreating the problem we've been spending 15 years trying to correct under the securities laws.

So I mean there's -- and again, I would say so in this small plan context, which is not my particular area of expertise, but in putting together our letter we found a lot of statements from the mutual fund industry itself about how small plans is a market that, where plans are sold, not bought, and small company owners don't understand these issues, and they rely heavily on the recommendations they get from these advisors.

In other words, they, themselves, when they're not talking for the regulatory record, make a pretty strong case that this plan market, this small plan market is very similar to the retail market.

Now I would say, again, you know, on this issue for the small participant-directed plans that aren't under either the BIC or the seller's carve out, I mean I think there are probably quite a few advisors who don't get conflicted payments who would be happy to serve that market, but given the noise that's been raised around the, this issue, I doubt you'd get much push back from the investor advocacy community if you bought those small participant-directed plans under the BIC.

A different issue if you try to further expand the seller's carve out, but where there are appropriate protections in place. I don't think you would find that that was a highly controversial proposal.

MR. HAUSER: Thank you.

Mr. Lane, maybe -- and this is probably unfair, but I'm going to ask you a question. I'm going to ask -- I'll read it to you.

MR. LANE: Yeah. You've got unfair questions for everybody, I hope.

MR. HAUSER: I'm going to ask you a question about somebody else's comment letter, which is the National Association of Insurance and Financial Advisors. They described the way their folks essentially come to recommending advising people, selling people annuities and insurance products.

They talk about a long term relationship and they say, for an individual client an advisor commonly holds multiple initial meetings to discuss a client's needs, goals, and concerns in both the short and long term. During the course of the advisor/client relationship the members provide advice during the asset accumulation phase, as well as the distribution phase.

For small business owners our advisors initially encourage them to establish retirement savings plans, and then, following in-depth discussions to ascertain specific needs and concerns, help them implement, essentially.

The question I have is, first off, does -- is this your understanding of how advice works when it comes to insurance products? That it tends to be an extended set of discussions that requires a fair amount of labor and back and forth before you finally get to the specific recommendation.

MR. LANE: So I haven't gone through the details of that, but if the question is do I think that there is an educational process on what the needs are, understanding people's risk tolerance, annuities are designed so people don't run out of income so their risk tolerance is essential as part of that.

I do think it depends on the individual and it depends on the advisor. Certain individuals may want to actually have that course of a conversation over one day, other individuals may have that over 12 months to 18 months.

MR. HAUSER: And these are, I mean -- for example, I mean just going to the variable annuity context, these are -- from an investor's standpoint, an ordinary investor's standpoint, these are fairly complex products, aren't they?

I mean to really understand what you're doing you'd have to, and what you're paying you have to understand how the mortality and expense risk charge works, the administrative fees, the underlying fund expenses, you know, the various fees and charges for other features.

To the extent that you're adding additional riders on you have to get some, you have to have some sense of the circumstances in which those riders are going to kick in and help you and what their value is in relationship to, you know, what you're paying in order to get that rider. Then there's a whole set of issues about where, you know, how they work in the, in a tax advantage context.

So all of those things require a level of investment expertise and assistance, I would think, that aren't typical for the ordinary investor. I mean would you agree with that? That they --

MR. LANE: I would say the need's very simple, and the number one in market research shows the concern of retirees is they will outlive their income. The other concern people have is giving up their principal when confronted with the choice of getting a fixed annuity versus a variable annuity, and how do you lock that in.

MR. HAUSER: But wouldn't --

MR. LANE: So I think the needs themselves are very simple, and then as you talk about the mechanics of the product the question is, once you've decided on a variable annuity, how do you think about the features associated with that.

MR. HAUSER: Well I mean, you know, on an elemental level I mean our needs are always fairly basic: food, shelter, a secure retirement --

MR. LANE: Yes.

MR. HAUSER: -- but these products, you know, have a lot of complexity to them. The question I guess I have is is it really -- isn't it going to just invite abuse to say there could ever be a circumstance in which somebody could recommend that you put your retirement savings into one of these products and not be subject to a standard of prudence and best interest?

MR. LANE: I mean I would point to the Obama Administration and Treasury's own statement of the importance of annuities for retirement income. So I think the value of lifetime income in ensuring that people don't live out and aren't risky with their assets is invaluable.

As you talk through the question of the conversation and that decision, I think that should fall under, as we were discussing, the question of what is education, when are you proposing a recommendation.

The concern we have is when you look at the nature of it being an insurance product, how you think about the fee being paid for the insurance. The guarantee versus the fee being paid for the advice. I think in the own -- and I'll make my own disclaimer. I'm not a securities lawyer, but in my own understanding, that acceptance of why fixed annuities were put in PTE 80-24 dealt with that concern.

MS. ROPER: So I want to just say, so when you're talking about this decision, okay, so the need for, the desire for income that will last throughout your life is pretty straightforward, but the way you get it is a lot less straightforward. It's not like there's just one option that gets you there.

And then -- so it could be a variable annuity, or a fixed indexed annuity, or a deferred annuity, or whatever. So you have to evaluate the various benefits of those different options, and then within each of those categories there's a wide array of products available.

In every category we've ever looked at you can see options that are clearly designed to be good for the investor. They have high quality, low cost options. And in every category you can see products that could not exist if the people selling them had to act in the best interest of their customers.

So you have that first selection of, okay, we're, we need to provide income, what's the best strategy for doing that, and then you have the next decision having decided that this fixed annuity, or variable annuity, or deferred is the best strategy. Among those available, what's the best option for the investor.

The typical investor who doesn't know that when interest rates go up bond prices go down and vice versa will never be able to know whether what you're recommending is the best option for them or not. They will rely exclusively on the recommendation they get. I mean investors today fail basic financial literacy tests. They know nothing about how to evaluate these investments. That's why they turn to brokers and advisors for advice.

The research indicates that when they do turn to brokers and advisors for advice they rely extremely heavily on the recommendation, often without looking at another piece of paper, precisely because they don't feel that they have that expertise.

So there's no way that the typical investor could distinguish between all that, those options and know whether the broker is serving their best interest not, no matter what disclosures you provide them, so you have to create an enforceable regulatory obligation for the broker to do that so that there's at least some regulatory accountability that's likely to hold them in line.

MR. HAUSER: So maybe just one last question. But is it even the right question, in a way, to ask whether the customer understands this to be a sale rather than advice? I mean in virtually all of these circumstances isn't the fact that there's a little bit or a lot of both going on? You know, that there is both an investment professional holding himself out as somebody who can help the person get to a secure retirement, and there's a sale going on.

The question is when you make a specific investment recommendation, what the legal consequences of having made that recommendation are. I guess I just wonder why does anything much turn, in your judgment, on whether it's viewed as primarily sales or advice when, really, it's likely to be both.

Do you honestly think that the customer here is ever going to be in a position, at least without a legal and financial training, to understand all of the subtleties of, you know, what might turn on that?

I mean, you know, the fact that something's a sales pitch, does that disclose to somebody that now it's a suitability standard under securities law say, or under insurance law rather than the ERISA standard? Does it disclose that there's a scienter requirement or not should they try to bring an action? The existence of a private cause of action or not. Does it tell them anything about the investment?

I mean isn't the fact -- we're not really -- whatever function disclosure might serve in this context or the judgment about a sales pitch versus education, it just seems like ultimately the question is once you've made a recommendation, what should be the legal consequence.

I just, I have a hard time understanding why: 1) the question's even relevant whether the customer thinks there's a sales pitch if there's also advice associated with a sales pitch; and 2) why, if there's a recommendation, that there shouldn't be a prudence and a best interest obligation attached to it if the person's getting a fee for that recommendation.

MR. BLASS: So I'll start and others can weigh in I suppose, if they want. Just to back up and think about what we're asking. The fiduciary status carries with it tremendous obligations. You fall within a very prohibitive environment, and it's very important for a service provider, because of that, to know when they're getting into a fiduciary relationship and when they're not.

If they've missed the mark, then they have real problems because they probably weren't, may well not have been complying with the prohibitions that applies to them, especially if you're in a commission-based environment.

So at its core we're asking for clarity, understanding that your intent is to apply fiduciary status to broker/dealers when making recommendations, and not suggesting that we undo that through another exemption that fundamentally makes what you're looking to do meaningless.

So we're looking for clarity. We do think there are circumstances where there really is sales behavior, and the proposal is written in a fashion that creates ambiguity about whether or not fiduciary status attaches.

MR. LANE: I would agree. I think you've highlighted the concern, which is -- and it's difficult and we respect the DOL's efforts -- when do you go from education to advice, when do you go from sales to a specific recommendation.

I think as part of our comment later we wanted to provide those nuggets that were mentioned on how we draw those lines so that there is no ambiguity, and at the same time we don't risk people concern, to really advocate that people take action to take care of theirselves in retirement because they're concerned that in any conversation they'll be deemed to be a fiduciary, given the risk imposed on that. I think that's your objective, also.

MS. ROPER: So could I just add one thing. So I would say -- always, right?

MR. HAUSER: Could we stop you?

(Laughter).

MS. ROPER: Right. You might. For you, Tim. So I would just say that I mean this is a relationship that cries out for fiduciary protection because it is a relationship of trust and it's promoted as a relationship of trust.

Because of the loopholes in the existing definition we withdraw that protection precisely when the conflicts are greatest and the risk to the retirement saver is greatest, and that needs to be fixed. We think you've gotten the definition right. I hope you've noted that you're supposed to make it more principles-based, but also less ambiguous, so good luck with that.

You know, we think that there is room for clarification on certain points but, for the most part, you have gotten the definition right. It's consistent with the securities law definition. If you incorporate the guidance from FINRA with regard to what a recommendation means, I think that's beneficial for clarifying this issue further.

The definition of advice is on the money, as far as we're concerned, and recognizes how investors perceive this relationship.

MR. BLASS: So just to add to the discussion, the definition of investment advice needs to be revisited for the directed to element and some ambiguous terms, including the understanding element, if I recall.

MS. ROPER: Actually, we agree on that.

MR. BLASS: Yeah. The precise definition. So generally, again, agree on the recommendation as a standard, but those two elements really need to be revisited. Barbara's right, there is a bit of a yin and yang with flexibility versus precision of rulemaking.

We do think it's important to have, if one is a fiduciary, a principle-based flexible approach to implementing fiduciary duties or the best interest contract, or the best interest standard rather. That doesn't mean there's a vague, ambiguous term for, definition for when those obligations attach. I didn't do the greatest job there.

But great precision around when one is a fiduciary, followed by some flexible approach to implementing obligations that flow from that.

MR. HAUSER: I guess, David, I mean to the extent that that line, we can bring clarity to that line by making it clearer, we're talking about a recommendation in the FINRA sort of sense, maybe giving additional examples.

You know, I think I understand the point, but when I read a lot of the comment letters what's proposed as the best way for us to bring clarity to where that line is is essentially to let people disclose somewhere, in the contract, in, you know, maybe on the front page, maybe in the boiler, in footnote boilerplate, but wherever, I mean just to say whatever you think, we're not giving this advice in a fiduciary capacity and you should not rely on it.

The concern is if you permit that, doesn't that effectively gut the rule? I mean isn't -- all the rest of the conversation can be this multi-day, multi-consideration conversation that's aimed on getting, an investor getting help from an investment professional, while a clear statement, you know, which may not even been paid attention to in the stack of material given to the investor essentially takes all that away and makes it nonfiduciary.

MR. BLASS: Yeah. So we do think there's some utility to disclosure to investors. Investors can understand that we look to the circumstances surrounding the relationship. We'd suggest that if the relationship really is one of trust and confidence, that fiduciary status, it's appropriate to apply.

MR. HAUSER: Thanks.

MR. CANARY: One question. Is there a seller's carve out on the securities laws that you all are aware of like the one you're suggesting we have?

MR. BLASS: I don't --

MS. ROPER: So there shouldn't be. There effectively sort of is in the sense that the Advisors

Act written after the '34 act governing brokers has a very broad definition of investment advice that any broker/dealer would need.

What they did in the statute is they said that you, the brokers were exempt insofar as they limited themselves to giving advice that was solely incidental to their primary function as broker/dealers and didn't receive any special compensation for that advice.

So it is -- and then it's created all sorts of trouble, which is -- I mean Congress clearly intended, if you read the legislative record, clearly intended a narrow exemption. They were quite aware of problems associated with broker/dealers giving advice.

The SEC has interpreted it in a way -- they've essentially interpreted it out of existence so that solely incidental to is viewed as meaning in connection with and reasonably related to, so anything.

So, yeah, we have, in essence, a broad carve out not in the statute, but in the way it's implemented, that is the reason we're working to try and get a harmonized fiduciary standard for brokers and advisors under the securities laws to fix that problem.

MR. HAUSER: But that's not a distinction between what's advice and what isn't advice. That's a distinction between what's incidental and isn't incidental, isn't it?

MR. BLASS: Yeah. I mean Joe said it. It's a good question. I do think, I mean to go back to the justification for your rule, you do have a different statute, you're administering a different set of regulations, a very fundamentally different regulatory approach which is very prohibitive in nature.

The reason the exemptions are so important for this rulemaking, to make it workable, is just that: the prohibitive nature of what comes along with being a fiduciary. I can't think of a lot of situations under the federal securities laws just off the top of my head that are analogous. Maybe the one Barbara's mentioned is similar, but -- so I think it's just a different, it's a comparison of apples and oranges in that case to the federal securities laws on this particular issue, in my opinion.

MS. ROPER: I mean I agree. It's just -- it's relevant without being directly the same.

MR. BLASS: Well said.

MALE VOICE: Same thing but different.

MS. ROPER: Similar, but different.

MR. CANARY: One other question for Mr. Lane. Are you aware of any, or alternate dispute resolution model in the insurance space that would be similar to, or maybe different from, the FINRA structure for arbitration if you're dealing with an insurance product which is not covered by the FINRA system?

MR. LANE: Personally, I'd have to get back to you on that answer so if, you know, we get a detailed view of what's available.

MR. CANARY: That's -- I appreciate that, because one of the things I think we're hearing is people having different views in terms of the merits of the FINRA arbitration system. I think one thing that is clear is that not everything that would be covered by our rule would be covered by the FINRA system, so to the extent that there are other models, either that exist in the insurance space or maybe in the banking space, where we could look to as a resource, that would be helpful information.

MR. LANE: We'll be happy to get back with you on that.

MR. CANARY: Thank you.

MS. LLOYD: Mr. Lane, also, you mentioned the issue of sort of two different exemptions that might be available for insurance products. You know, it's our intention, definitely, to make the best interest contract exemption workable for insurance products, so I wondered, you mentioned an issue with how we would define reasonable compensation as one of the issues that people were more interested in, 84-24.

Is that the primary concern that people have with the best interest contract exemption or are there other things that we could do to make it more workable?

MR. LANE: No, I think you're hitting on the concern, which is how do you treat the fee for the guaranteed income separate for the fee for the advice. In its current form people will de facto go not encouraging people to get lifetime income solutions, but indexed mutual funds. So pragmatically that's the feedback we've gotten from our members and different firms.

MS. LLOYD: So the language in 84-24 is something that we should be considering when we consider amendments or, you know, changes to the best interest --

MR. LANE: I think you're hitting that issue, the language around that issue in both sides.

MS. LLOYD: Okay. Thank you.

MR. BLASS: And of course there are a number of other issues for the best interest contract exemption beyond just the one on insurance. The disclosure really should be simplified dramatically. We pointed to a model that you've already developed as one way to do that.

Looking at mutual fund, a prospectus, a presentation of expenses would be a good way to go about it, in our view. The current proposal requires some projection of performance, which is both inconsistent with federal securities laws and generally not a great idea, so we think a standardization would really help in that regard with examples.

For example, over a, you know, one, three, five, 10 year period, and examples of dollar amounts. $5,000, $10,000 dollar amounts invested.

MS. ROPER: So I mean I think that's an issue where we agree on standardization of those tables. I will say if I ever get finished working on this issue my next issue is to reform mutual fund cost disclosures so we would not advocate using the model for the mutual fund prospectus for that purpose, but that's another fight for another day.

MR. BLASS: Well it's been through a reform a few times. It serves as a good model. People get it. So it's --

MS. ROPER: No, they don't. People don't have a clue what they're paying for their mutual fund, so in that sense it's really not working very well.

MR. BLASS: Well, you know, it's there for people --

MALE VOICE: So this may be another panel subject.

(Laughter).

MR. BLASS: Exactly.

MS. ROPER: That's right. Yeah.

MALE VOICE: Coming in 2017.

MR. BLASS: Sounds a little early, actually.

MR. HAUSER: We have enough on our plates.

MS. ROPER: It's not your problem.

MR. HAUSER: Just following up on your point of sale, so if instead of, you know, expecting anything in the way of projections we just specified, for example, a particular interest rate, rate of returns over a one, five, and 10 year period, and just had that calculation done, I mean what -- how big do you think the -- how much of a problem is it from an administrative ability perspective to have that kind of calculation done, but have it done on the actual amount of money that the customer's putting in? So they see a dollar amount that actually reflects what they're putting into the account.

MR. BLASS: Well I think it's a linking of the two. I don't think simply going to an assumed rate of return really does it. It's both. An example, hypothetical, would be extremely helpful to implement.

Point of sale disclosure raises a host of issues. Really, a layered disclosure regime that's internet-based is the right way to go about it, with a point, a reference to that disclosure that's available.

You get into situations, and this is really for others to talk more in depth about, you get into situations where there's, you have somebody on the telephone and wants to purchase an investment and there's really no effective way to get a disclosure to that person at that point in time. So it raises a number of issues.

We do think a standardized approach that makes a comparison across the industry or facilitates comparison across investment products really would be helpful and more operational.

MR. HAUSER: So putting aside the question of web versus paper disclosure, whatever, and just the question, though, would it make sense for -- would it be problematic for the disclosure to center on the actual amount of money the person's investing?

So you would give them a dollar figure over one, five, and 10 that would be hypothetical, it would be based on a set of assumptions that essentially our rule gave them, but then it would give the numbers actually reflecting what the deposit amount was.

MR. BLASS: So this is probably for others to answer because they're closer to the issue than I am. My understanding is it's very difficult to operationalize a personalized dollar amount investment, so that's why standardization really is more helpful, and it makes comparison more easy. Easier.

MR. LANE: I think as you go through, if you're going to project going forward, you're going to raise a whole host of issues of what are the scenarios, what does it look like, what do one, three, five, 10 year, and that's going to create more ambiguity with customers, more ambiguity with advisors.

You know, point of sale, did you understand what the consumer wanted, their objectives, but making any type of indication, or as you start to go through those and into deterministic versus stochastic, that is going to create a lot of burden to this rule.

MS. ROPER: So those tools exist now. You know, you can input specific dollar amounts and the name of the fund and get the estimated costs. I mean it's not impossible to do. There is a cost associated with developing those tools.

And as for delivery, I mean in this modern day it may not work in every circumstance, but often you can just send -- if you -- if the information's going to be on the web you can send them a link and it's instantaneous while you're still on the phone. So I think there's a desire to create more difficulty around this issue. It's not -- it doesn't have to be as hard as it's being made.

MR. BLASS: Well I mean Barbara's absolutely right, there are calculator tools that are available for investors to input investment, actual dollar amount investment options, and it will generate for that investor costs and other information about the potential investment. So those tools do exist.

Maybe I misunderstood the question. I thought it was about delivering to investors a point of sale that kind of individualized information, which is very challenging to do operationally, I understand.

MR. HAUSER: Okay. Let's thank -- we're out of time, so thank you very much. Very interesting panel. Panel 4. Okay. I know that one of the consequences of going to 1:15 is that everyone thinks it's lunchtime, but it's actually not.

(Pause.)

MR. HAUSER: Okay. Mr. Bullard, the floor is yours.

MR. BULLARD: Thank you. I'm Mercer Bullard. I'm a, well, professor at the University of Mississippi and I run an advocacy group called Fund Democracy. I work for a certified financial planner. I was formerly an assistant chief counsel in the SEC's division of investment management and started my career advising large broker/dealers and investment management clients about the same kinds of sales practices that are really the subject of your rulemaking.

I also provide consulting, and I should probably disclose that the, I am paid by industry in connection with providing guidance on the effect of the rule, and that's the only compensation that I receive in connection with this rulemaking.

I'm really not wearing an advocacy hat so much in terms of my prepared comments, but rather, using my time to provide what I would call analysis of the rule. So I'm going to provide some examples of how broker compensation models create incentives, and then I'm going to talk about how I think the rule will actually affect the industry.

I want to start with some background about mutual fund compensation. What I've assumed from my analysis, for example, is that -- and this is important for the analysis -- that a high load fund, for example, would charge about a five and three-quarter load, about a three and half percent load, and about a two percent load for an equity fund, bond fund, and short term bond fund.

A low load would be more in the range of three and a half percent, and then two, and maybe one and a half percent. Then also keep in mind that mutual funds typically have break points usually at $25,000 or $50,000 where you would get a discount, or reduction, in that. Much turns on the effect of that commission structure in terms of the conflicts created for brokers.

So let's start first with the fact of commissions. If you look at my Chart No. 1, what you'll see -- and I apologize. We weren't given the opportunity for audio/visuals and my charts are outside but it's probably too late for you to get it. I wanted to provide some really hard analysis. You don't hear a lot from the industry as to how the rule would actually affect them so I wanted to talk about some of those conflicts.

If you look at Chart No. 1 what you see is an example of a retiree's $35,000 rollover from a 401(k) account and the red line is the advisor's pay out which comes out of the commission paid to the broker which I've assumed is 40 percent, and that's a pretty typical pay out for a pay out grid for a broker. The broker's total compensation is in blue.

The bottom row assumes that the rollover's invested in a low load complex and divided 50, 30, 20 among stock, bond, and short term bond funds, in which case the broker will be paid $301 commission.

The next two rows show that recommending a moderate 50/50 allocation or an aggressive 80/20 allocation between stock and bonds funds would increase the pay out by $49 and $63. These increases result from the higher commissions on the sale of the stock fund and the bond fund. Primarily the stock fund.

Now the advisor switches to a high load fund as you move up the chart. That has a low commission breakpoint at $25,000. With the increased commission the advisor's compensation would go up to, go up another $140.

Now the advisor switches to a high load complex with a higher $50,000 breakpoint and under the same commission structure but now with the higher breakpoint the advisor would be paid up to another $111. Then after that I finish with what would be a very aggressive allocation, 100 percent equity, in which case the advisor would top out at a $700 commission.

So what this shows is the advisor has a financial incentive to recommend more aggressive allocations over less aggressive allocations, high load fund complexes over low load complexes, and high breakpoint fund complexes over low breakpoint complexes. An advisor can more than double their commission by choosing the right combination. In this case, the advisor doubles their compensation from $301 to $700.

The advisor could increase the commission to about $1,000 by selling a variable annuity or a fixed indexed annuity, and to more than $2,000 by selling a nontraded REIT.

If you look at Charts 2 and 3, these are designed to illustrate the advisor's financial incentive to chase hot funds. The columns of the table under Header 2 switches. Shows an investor's $20,000 rollover into an IRA split between a mid cap growth fund and a mid cap value fund at the start of 2002. The advisor is paid a $460 commission on the initial sale.

During 2002 mid cap growth funds underperformed mid cap value funds by 21 percentage points, so at the end of 2002 the advisor switches the growth fund balance to the value fund. Growth then outperforms value, so after outperforming by 18 percentage points in 2007, the advisor switches the investor back to the growth fund in 2008. The columns under the heading "no switches" assume that no switches occurred during the period.

If you turn to Chart 3 you can see the effect of switching on the advisor and on the investor. The advisor earns a $200 commission on the second, on the first switch, and a $683 commission on the second switch, which brings the advisor's six year commissions to $1,343. This is almost three times more than the $460 that the advisor would have earned by simply staying the course.

While the advisor increases his compensation by more than $800, the investor loses more than $5,000. There's a substantial literature that shows that this kind of market timing causes mutual fund investors to routinely underperform the funds in which they invest. Some of this is due to what you see in this chart: financial advisors increasing their compensation by chasing performance.

Charts 4, 5, and 6 illustrate the incentives created by financial advisor pay out grids. Chart 4 is a pay out schedule for Janney Montgomery Scott. You can see the pay out jumps from 32 percent to up to 42 percent once the financial advisor has hit $300,000 in commissions.

The higher rate is generally retroactive, so when the advisor's compensation production goes from $299,000 to $300,000 the advisor receives an extra 10 percent of all commissions during the 12 month period. If you'll turn to Chart 5 you'll see how this kind of pay out grid creates distorted incentives.

As explained in the narrative that you see, it's the last day of the year. The advisor's stuck at $299,000 in commissions over the last 12 months. The broker is switching to a new firm the following week so this is his last chance to hit the 42 percent pay out.

A retiree with a $20,000 rollover walks in the door. The advisor could recommend a 50/50 split between a stock and a bond fund, but that would generate a commission to the broker of only $800 and leave him short of $300,000 in commissions. Only a 100 percent equity allocation will get him to $300,000 in commissions and the 42 percent pay out.

If you turn now to Chart 6 you see the financial advisor's incentives. He can recommend a 50/50 allocation and earn $256 on the transaction, or he can recommend a 100 percent equity allocation and earn $30,320. The broker's commission would be $1,000 which would get the advisor to the $300,000 level of 12 month commissions and trigger the 42 percent pay out.

Recommending the 100 percent stock allocation earns him $420 on the actual rollover and $29,900 on the first $299,000 in commissions. His effective commission rate on the $20,000 investment is 152 percent.

My assessment of the actual effect of the Department's proposal is as follows. Broker's selling compensation generally plays out at three levels: the firm level, branch level, and the financial advisor level. As a general matter, given the choices the brokers will make to comply, the rulemaking will have no effect on the broker level. That is, the firm level.

The proposal will likely have very little effect on the compensation differentials at the branch level. While compensating financial advisors based on the branch's profitability will not be permitted, other branch level selling incentives will likely be unaffected. Branch level compensation is important because it is a primary vehicle through which financial advisors are incentivized to sell high revenue sharing fund complexes.

The proposal will also have limited effect on selling incentives at the financial advisor level. Financial advisors' selling compensation varies across different compensation groupings. That means proprietary funds pay more than nonproprietary funds and nonproprietary platform funds pay more than nonplatform funds.

The rulemaking will generally have no effect on financial advisors' incentives to recommend a product in one compensation group over a product in another. Selling compensation also varies based on the different types of investment products. Variable and fixed index annuities pay more than mutual funds, nontraded REITs pay more than annuities.

The proposal will eliminate advisors' incentives to sell band product types such as nontraded REITs, but it will otherwise have no effect on the incentives for one product type over another. This is important because the proposal will have no effect on the improper sales of variable annuities and fixed indexed annuities in IRAs.

Selling compensation -- I'm almost done. Selling compensation varies according to investor's asset class, as illustrated in my Chart 1. Advisors have incentives to recommend more aggressive asset allocations, but the proposal will have very little effect on that outside of very narrowly defined asset classes.

The advisors' incentive also is based on the frequency of transactions. This shows on my Chart 2 and 3. The proposal will have no effect on those incentives either. They also vary based on commissions' break points, as illustrated in Chart 1. The proposal will have no effect on that incentive either.

So the summary of my assessment of the proposal is in Chart 7, which essentially shows in the top left corner that the only effect will be compensation paid to the advisor. It will not be affecting compensation paid to branch managers or the firm.

It will generally only affect commissions and 12b-1 fees, with the exception that revenue sharing will be affected if it's -- continues to be paid through the branch's profitability, and that higher compensation will be permitted as provided in the box, with the exception of banned document, banned products.

So essentially what you see here is that you can make a recommendation from a platform of an international small cap, actively-managed growth stock variable annuity and the only limit that your rule as currently proposed and explained will impose will be if you are recommending another fund from the same platform that is also international small cap, actively-managed growth stock fund and a variable annuity. The compensation will have to be level, and that will require changes to pay out grids. Otherwise, it will have -- it will not have an effect.

Then finally, it's not even clear that that limited effect will matter because, in my assessment of arbitration and claims that will be brought, the

BIC is not going to be enforceable in arbitration.

In fact, I think the most important effect of the proposal as currently presented is going to be that in arbitration lawyers will be able to now show that the person was acting as a fiduciary in the context of ERISA assets, and therefore will be more easily able to prove a common law fiduciary claim, but not a BIC claim. Thank you.

MR. FINKE: Okay. I'm Michael Finke and I'm a professor of retirement planning and living and personal financial planning in the Department of personal financial planning at Texas Tech University. I've done a number of studies on the impact of a fiduciary standard on financial decisionmaking in the financial services industry.

American taxpayers invest nearly $200 billion each year in foregone taxes on 401(k)s and IRAs in order to provide security for workers who must now fund their own income in retirement. The bulk of these assets are invested in employer plans, where the sponsor serves as a fiduciary when selecting investments.

In previous generations retirees would spend down their savings from pensions that were also managed by administrators who had a fiduciary responsibility to participants.

It's reasonable to suggest that advisors recommending products and strategies for a tax-sheltered retirement plan should also be fiduciaries and must also avoid self-dealing and make recommendations that are in the best interest of workers. Practically, the industry that caters to this market has developed a system of compensation and proprietary products that will need to be revised in order to make the proposed rules.

The primary consideration of the proposed rulemaking should be whether the outcomes of the rulemaking will move us closer to the ultimate goal of providing greater retirement income security for workers.

My comments will focus on the common transition that workers make from saving in an employer-sponsored plan to rolling over assets into an IRA at retirement. Since the account balance of workers is largest during this transition, marginal improvements in the quality of their investments can have the greatest impact on the welfare of the worker.

The average American often knows little about how to invest and withdraw their retirement savings. It is no more practical to teach millions of retirees complex investment theory than it would be to teach them medical science or estate law. It is far more efficient to allow them to either rely on the help of a professional advisor or to give them the tools they need to make effective choices on their own.

Rather than focus on the cost and benefits of imposing a fiduciary standard on those who provide much needed advice to workers, it may be helpful to begin by deciding what we want financial advice to look like.

In an ideal marketplace financial service providers would compete to deliver the highest quality products at the lowest price. Advisors would have an incentive to invest in training in order to improve the quality of their advice and their employers would have an incentive to reward advisors who made recommendations that improved the retirement security of their clients.

Workers would be able to trust the recommendations given by their advisor and would be able to make reasonable investment choices if they decided to manage an IRA on their own.

Workers seek an advisor because they need help making financial decisions. The advisor draws from his or her knowledge to help the worker select investment products and strategies. Since the advisor has greater knowledge there is an informational imbalance.

Simply put, the worker would not seek out an advisor if the advisor wasn't more knowledgeable. This imbalance of information underlies any profession in which we hire someone to provide expert advice.

Historically, the assumption of a fiduciary standard of care exists within advice professions and these professions have thrived and continue to offer services to moderate income consumers. Examples include doctors, lawyers, real estate brokers, accountants, and even registered investment advisors.

My research suggests that a fiduciary standard of care, if carefully constructed, would not prevent advisors from working with average Americans. In fact, given low levels of public trust many have in the financial industry, the improvement in trust by having a fiduciary requirement would likely increase demand for professional financial advice as it has strengthened demand for other advice professions.

In fact, the growth in assets managed by fiduciary advisors in recent years reflects this potential for expanding the industry rather than harming it, as some have suggested.

Some who sell financial products, however, are not fiduciaries. These advisors who recommend products to workers for investments within qualified accounts are often knowledgeable and provide much needed financial guidance. Research shows that those who use a financial advisor are generally very satisfied with the services they received.

Many of these advisors operate within a suitability standard of care which prescribes specific conditions that govern the sale of products. This suitability standard creates slightly different incentives than a fiduciary standard. With a suitability standard, inappropriate practices are clearly defined by rules. With a fiduciary standard, practices become defined through lawsuits and enforcement.

The limits of suitability are often tested by advisors and the arbitration process for determining these limits reduces legal cost to the industry, but may result in inconsistency from a lack of legal precedent.

The most significant consumer problem is that an advisor who knows more than their client may be tempted to recommend products that provide greater compensation within the limits of suitability but are not the best choice for a client. To use a baseball analogy, Ted Williams mapped out his batting average in each area of a strike zone. His average was highest in the middle of the plate but the pitcher has a strong incentive to throw the ball where his average was the lowest, low and outside.

If an advisor gets paid more by recommending a product that falls on the low and outside corner of the strike zone, then advisors may be tempted not to recommend products in the middle of the plate. This temptation may be particularly strong when selling financial products to less sophisticated consumers who are unable to detect when the recommendation is less than ideal.

There is evidence that some advisors who are not governed by a fiduciary standard of care recommend financial products that are less efficient after a rollover than the investments that were originally invested in the employer's, in the employee's 401(k).

Estimating the loss to workers as the difference between investment performance in the middle of the plate, for example, the performance on low expense ratio mutual funds versus investment performance at the corner, for example, a commission fund with higher fees, is a reasonable way to calculate the potential gain from imposing a fiduciary standard on advisors.

It is also reasonable, however, to study what a worker would have invested in without the guidance of an advisor. Without this incentive to recommend a fund with an appropriate asset allocation, it is possible that the outcome of no advice would be completely outside the strike zone.

Just as the use of life cycle-appropriate asset allocation defaults has had a remarkable impact on moving workers away from less efficient default investments, more thought needs to be given to how unadvised retirees are going to invest on their own.

One possible solution to poor outcomes among unadvised retirees is to provide incentives to plan sponsors and employees to remain in their employer-sponsored plan and to develop efficient defaults that focus on providing retirement income security rather than accumulation.

To the extent that employers view the adoption of a default retirement income alternative that involves annuitization as an added fiduciary risk with no benefit, the retirement security of unadvised workers will likely be worse than even conflicted recommendations by advisors who are not fiduciaries.

An important problem related to defaults is that post-retirement IRA product solutions may not require ongoing investment advice. There is some concern that the conflict of interest rulemaking will favor fee-based advisory services over commission compensation and that propriety products sold by a financial services company whose advisors are trained to understand them may be discouraged.

This is a legitimate concern, particularly in a marketplace where default investment products include automated features that do not require regular maintenance by the consumer.

Americans in particular tend to avoid annuitization and academics have estimated that annuitization can improve retirement welfare by as much as 50 percent over a conventional investment only strategy. Since the ultimate goal of the regulated pension system is to improve retirement income security to workers, this goal will not be realized if annuitization strategies are discouraged.

Advisors and companies they work for should, however, have more incentives to provide higher quality products that consumers understand. If I buy a car I may not know how much commission my salesman is earning, but if I have a clear information about the cost of the car, and if the government is able to work with industry to standardize product characteristics and provide clear information about quality similar to providing fuel economy and safety ratings, then the consumer has the tools they need to make better choices and manufacturers have an incentive to build safer and more efficient cars.

My own preference is that the industry work toward creating standardized retirement income products in which a few basic features such as guaranteed income, credit quality, and expenses can be easily compared by consumers.

Although disclosure of complex product characteristics is often ineffective and counterproductive, simplified disclosure and standardization can result in better and cheaper products through competition.

Finally, my research shows that the ability to make complex financial decisions declines in old age. Many who reach their 80s and 90s experience some form of cognitive impairment that reduces their ability to make effective investment decisions.

Since many future retirees will reach old age with significant retirement savings rather than a guaranteed income from a pension, the financial choices they make will have an important impact on whether Americans rely on public assistance for later life, housing, and medical care.

MS. SMITH: Good afternoon. My name is Felicia Smith. I'm a vice president and senior counsel for regulatory affairs at the Financial Services Roundtable, on whose behalf I am testifying here.

Thank you for inviting us to present our views on the new proposed rules concerning a revised definition of investment advice fiduciary and related exemptions which were proposed on April 20, 2015. We appreciate the opportunity to provide views on a matter of high importance to Americans who are saving to meet their unique needs in retirement.

FSR believes that providing these opportunities for all Americans to plan and save for their retirement is important because savings increase domestic investment, encourage economic growth, and result in higher wages, financial freedom, and a better standard of living.

We believe that most Americans should approach retirement with a comprehensive strategy that incorporates a number of retirement vehicles.

Consumer education about retirement savings products can help them make sound investment decisions and provide opportunities to maximize their retirement savings.

Further gains can be achieved through better use of investment advice and by promoting policies that provide for more diversified, dynamic asset allocation and exploration of new and innovative methods to help individuals make investment decisions.

FSR supports a best interest standard that would be applicable to investment products and services and administered in a coordinated manner by federal agencies and self-regulatory organizations that serve as front line regulators of the financial services industry.

Our position is consistent with our long-held support of a uniform standard of care applicable to broker/dealers and investment advisors providing personalized investment advice to retail customers which predates the Department's October 2010 publication of its original proposals to revise its investment advice fiduciary rule.

The proposal is extremely complicated and impractical and would adversely impact retirement savings, particularly for low and moderate income

Americans. FSR strongly disagrees with key aspects of the proposal, as well as certain premises and presumptions underlying the proposal. FSR also believes assumptions relating to the likely economic impact of the proposal such as cost of legal and other services required to implement fully the proposal are flawed.

Indeed, the Litan-Singer study finds that, "the cost of depriving clients of human advice during a future market correction, just one of the costs not considered by the Department, could be as much as $80 billion, or twice the claimed tenure benefits that DOL claims for the rule".

As more fully described in our July 21st comment letter, the proposal could have unintended adverse effects of limiting retirement services and guidance, limiting the types of retirement investment products commonly available today, requiring consumers to review large volumes of disclosures relating, regarding all potential investments, requiring a signed contract with a financial professional before even general discussions regarding retirement goals could take place, and limiting employee access to financial education and guidance through workplace savings plans.

FSR believes these adverse impacts could deter a retirement savings at a time when more saving for retirement is urgently needed. While well-intentioned, the proposal is too long, extremely complicated, and impractical.

FSR's simple solution preserves retirement savers' access to financial advice and guidance and flexibility to work with their preferred financial professional or institution and pay for products and services as they choose.

We urge the Department to adopt FSR's simple investment management principles and expectations prohibiting transaction class exemption, which would achieve the Department's articulated policy goals of a best interest standard, coupled with a reasonable compensation standard for services provided, but without the burdensome and extremely complicated requirements set forth in the proposal.

This approach would allow transaction-based compensation as opposed to fee-based compensation, where it would make more sense for both the retirement saver and the financial professional or firm. FSR's simple PTE focuses on ensuring that financial professionals and firms manage conflicts of interest so that any potential conflict would not impact the advice provided to retirement savers.

The reasonable compensation standard would reflect the prevailing market rates or practices for that specific product or service and recognize that fees and expenses of various investment products and services vary based on the particular type of product or service.

We note that recent amendments to ERISA reflect Congress' policy preference to ensure that advice is broadly available by emphasizing management of conflicts rather than outright prohibitions. FSR's simple PTE is consistent with this policy preference.

The principal elements of FSR's simple PTE are codified in the best interest standard, requiring that the customer's interest be placed first. A reasonable compensation standard that allows the financial professional or institution to receive reasonable compensation for their services.

Clear, concise, and understandable disclosures, in plain English, are material conflicts of interest and compensation to customers. Reasonably designed internal controls and compliance procedures adopted by a firm and tailored to that particular business and operations of that firm that would reasonably enable them to comply with the requirements of the simple PTE and remediate properly failures to comply.

Prompt resolution of complaints and inadvertent violations, allowing, if there is a problem, that the firm has to remediate the problem with the customer. If the customer is not satisfied, the customer may proceed to whatever other dispute resolution forum is available.

Hold people and firms accountable. This is a job that we believe regulators are fully empowered to accomplish. FSR's simple PTE would easily harmonize with any broader efforts to establish a single fiduciary standard for all investment products and services.

FSR's simple PTE also harmonizes with the currently existing regulatory framework of federal capital markets and prudential regulators, securities, options, futures, commodities, and banking, and state banking insurance and securities authorities.

For example, under the substituted compliance approach of FSR's simple PTE, financial professionals and institutions that are subject to a regulatory regime administered by the authorities such as the Securities and Exchange Commission, FINRA, or state insurance commissioners, could satisfy the simple PTE requirements through compliance with regulations governing compensation standards and disclosures of material conflicts or compensation as administered by the relevant federal or state authority.

There are many federal, state, and industry regulations to hold financial professionals and institutions accountable. Federal, state, and industry regulators have many tools they can use to punish those who violate the law, including civil and administrative suits, suspensions or bars from the industry, criminal penalties, and, when appropriate, jail time.

Let's fully enforce existing laws and remove bad actors from the industry and further insure all customers receive investment advice that is in their best interest. We urge the Department to adopt the simple PTE as a final rule. Under the Administrative Procedure Act, agencies solicit comments on proposed rules for members of the public, including persons affected by potential agency action.

Given our view that the simple PTE fully addresses the Department's articulated policy goals as communicated in person to us, but without the extremely complicated and burdensome huddles, puddles of the proposed BIC exemption, we urge the Department to solicit public comment on the simple PTE.

The simple PTE incorporates a 60 day comment period which would expire by October 12, 2015 if it were published by the Department in the *Federal Register* on August 14, 2015.

We laud the Department for its efforts to improve the investment advice options available to Americans generally. We look forward to working with you further to make sure that this rule can be implemented in a way that does not disrupt markets, but that helps investors achieve their goals. Thank you very much.

MR. HAUSER: Ms. Smith, so I'd just like to go over some of the features of this simple PTE, and if you could tell me whether I've got them right or wrong, that would be helpful. I don't see in the simple PTE anything that's analogous to a duty of loyalty.

I didn't see any language in there that says that, for example, in the example that Mr. Bullard gave at the start of his presentation, anything that would preclude an advisor from putting his financial interests before the interests of the customer based on that pay out that he stood to gain. Is there something like that in the simple PTE?

There's a prudence obligation but there doesn't seem to be any loyalty or, you know, obligation or requirement to act without regard to one's own financial interests.

MS. SMITH: There is a prudence obligation because that's part of being a fiduciary under common law standards. To the extent that you are required to place the customer's interest first and primary, it seems to me that that is where your, the concept of the duty of loyalty comes in.

MR. HAUSER: Right, but that isn't -- I didn't see that language anywhere in the simple exemption. Would you just assume that within the duty of prudence?

MS. SMITH: I think it's part and parcel of the duty of prudence. If that's a language adjustment that needs to be highlighted front and center, we don't have any objections to doing that.

MR. HAUSER: So I mean just in your words, the idea would be you intend for there to be some kind of put the customer's interest first obligation as part of this proposal?

MS. SMITH: That is part of the proposal. The customer's interest has to come first. In deciding what the customer's interests are you have to consider all of the facts and circumstances about that customer's financial condition, goals, risk tolerance, and other information the customer makes available to you, the financial professional.

MR. HAUSER: I also didn't see any requirement in the exemption that the financial incentives provided to the advisor actually line up with the customer's financial interest. Is that correct?

MS. SMITH: We don't approach it in using that type of language. We approach it from the compliance perspective. That the fund would be required to put in place internal controls that would allow it to understand what are the material conflicts that the firm has, what are the material conflicts associated with each of the products and services that it offers, and how does it mitigate those conflicts, and how does it then monitor on an ongoing basis to ensure that its requirements are being met by its personnel.

It also requires training for branch personnel, branch managers. For the employees at all stages who have any contact whatsoever with customers.

MR. HAUSER: Under the proposal could the firm incentivize its advisors to make recommendations based on what's, precisely on what's most lucrative to the firm as opposed to what's in the customer's interest?

MS. SMITH: I think that would be counter to the requirement that the firm's internal policies and procedures ferret out where the material conflicts are and ensure that the conflicts are mitigated or managed. So the, a simple answer to that is no, you are not going to be permitted to do that.

MR. HAUSER: Right, but mitigated or managed can mean just reduced a bit, or it can mean reduced a lot, or eliminated. What is the standard by which FSI would propose to measure whether or not a policy and procedure adequately mitigated a conflict?

MS. SMITH: I think that's going to be a facts and circumstance determination because each situation, each company has different factors that impact its business. The regulators will be holding the companies accountable in terms of reviewing their particular internal controls.

For example, if you are a securities broker/dealer, I highly anticipate that FINRA will be right there at your elbow to take a look at your particular conflicts and see, do you have proper procedures in place. Are you seeing these things before they become endemic throughout your organization.

And when you find them, what are you doing about them? Are you making sure that if someone decided to close their eyes, that they have a greater incentive to open their eyes going forward? And to put in, put disincentives that can be very painful to the broker involved or to the branch manager if they try to skirt around the rules.

MR. HAUSER: And as I read, just going on, you know, there's the definition of reasonable compensation. At least as I read it it's anything that's currently legally permissible under the securities law or insurance laws is defined as necessarily reasonable compensation. Is that right?

MS. SMITH: That is correct. And it's based on the fact that you're looking at compensation that is arm's-length transactions in the marketplace. Because we think the marketplace is the best arbiter of what's a reasonable compensation level, as opposed to trying to artificially construct a reasonable compensation from a regulatory perspective.

MR. HAUSER: There's no additional enforcement mechanism attached to this proposal other than a right to complain to the firm that gave the advice, is that right?

MS. SMITH: You have the right to complain and if the company, in looking at the circumstances that you bring to its attention, concurs that they, that there has been an injury, then they are supposed to make you whole. If you are dissatisfied, then you can move on to arbitration, if arbitration is available, or to some other forum if arbitration is not available.

MR. HAUSER: But just to the extent it's provided already under other law. There's no --

MS. SMITH: That's correct. There's no other attempt to superimpose on current regulatory structures additional dispute resolution mechanisms. We would also anticipate that to the extent that you do have these problems, because at least on the securities brokerage side you are required to report these types of things to your regulators, that there will be a heightened interest in how are you managing customer complaints and what's going on with your firm when there are a number of complaints that are justified about certain practices that you have that run counter to the requirements.

MR. HAUSER: So one last, maybe. Well one last question or two. I understand the desire and I -- we certainly agree it's important that we not have a detrimental impact on retirement savings through this project, and we're trying to craft a rule that we don't think will have that impact.

It strikes me when you're thinking about the policy levers that might promote savings, probably the best policy level, you know, isn't that the way we're going to promote savings is by giving people financial incentives that run counter to their customers and trust.

I mean wouldn't you agree there must be other better policy ways to promote savings than to incentivize people to make, you know, biased investment recommendations.

MS. SMITH: And we would agree with that. Our simple PTE has that as its foundation as well. I would hasten to say that among our membership there's no groundswell of support for people who take advantage of their customers.

MR. HAUSER: Okay. Appreciate that.

Mr. Finke, you made a suggestion that I thought was kind of interesting about maybe trying to promote -- I mean first off you can tell me whether you think the best way to promote savings from a policy perspective is to rely upon conflicted advice, but second, you had a proposal about coming up with something to encourage annuitization.

We had a proposal or a set of questions about a low fee kind of high quality safe harbor in here. You know, certain investment products maybe pose so little risk that conflicts are what's driving the recommendation that we should create a simple, easy, streamlined exemption to promote those. We found that very difficult to operationalize.

I'm wondering if you're thinking that maybe something like that might work for a certain limited class of annuities, and if you think so, if you have any ideas on how we might structure that.

MR. FINKE: So first of all, I think that creating some sort of standards has worked pretty well in the QDIA legislation. I think that what we've seen is there is a lot of competition to fit products within that specified structure and it's led to improved outcomes.

I would love to see us do a similar type of thing in decumulation. So in other words, begin with some type of a general structure and then allow companies to compete to provide the best characteristics within that specified structure.

I think most of us will agree that we have a difficult time understanding what we're paying for and how much we're paying in the market for variable annuity type products, but I think most economists will agree that variable annuities are pretty clearly near the most optimal type of decumulation product if properly structured.

So if we can come up with some sort of a -- especially if the industry would get together. Because I think there's so much potential for growth in this industry on the rollover market, if we could get together and decide what these characteristics are going to be and then open ourselves up to competition for those specific characteristics, we would all be better off.

MR. HAUSER: So if you were me would you ask the industry, hey, as part of your comments why don't you propose something like that in this next round?

MR. FINKE: You know, I proposed that and I've been told that it's a nonstarter.

MR. HAUSER: And why is that?

MR. FINKE: I think you'll probably be told that as well because I think that, you know, it's easier to have fewer high margin products sold. It's also -- it's the way the industry has worked so far.

But I think that the, you know, that there is -- we've gone from $50 billion in target date funds to over $700 billion right now, so the potential for growth in something that is a standardized type of product, especially if it's the type of -- I mean everybody knew that life cycle funds was the right type of investment for most workers before retirement but it took that, the rulemaking to actually get it to happen.

It wasn't even forcing anybody to do anything. It was just safe harbor. So if we could come up with some sort of a safe harbor rule for post-retirement outcomes, I think that would be a home run.

MR. HAUSER: Okay. Well I invite you to submit that comment.

(Laughter).

MR. HAUSER: Mr. Bullard, so the first 90 percent of your presentation it struck me was here's an example of something that would be prohibited under our proposal that perhaps is not prohibited under current law. It would be hard to say that this, the advisor in this circumstance was acting without regard to, you know, his own financial interests in making the particular recommendation.

It would probably be pretty hard to defend a compensation structure that made a fairly small, you know, that triggered such a large commission impact based on a single investment recommendation that gave such a large incentive to that.

Having gone through that example and made that point, you kind of finished up saying, but I don't think your rule's going to do that much to protect anybody, if I understood what you were saying.

So the question I guess I would have is I mean it seems to me that that view: 1) probably expresses or reflects a considerable degree of skepticism about whether broad fiduciary standards make much of a difference in terms of people's impact, and maybe a set of assumptions or, about other aspects of the -- or review -- views about other aspects of the law that you, of the proposal that you don't agree with.

It would just be helpful to know what you think those -- you know, what does that reflect? What are the aspects of the rule you would -- and are there things you would have us change to have a greater impact.

MR. BULLARD: Yeah. I'd say we're in Jon Stewart skepticism territory. The principal issue is that when you are advising clients regarding compliance, in the bare knuckle worlds of brokerages you look at your litigation risk, and a litigation risk is going to be public and private.

So if you start with the private you are limited to arbitration, and although I don't support banning arbitration for all claims -- I disagree with Mr. Keeney -- in this case it will not be possible to get a fair hearing on your contract in arbitration.

One of the problems is that arbitration is just not set up to bring ERISA claims, it's not set up to bring contract claims. Arbitrators are not paid for any of the work they do outside of a hearing, which, as Mr. Keeney correctly pointed out, very fact-based inquiry is just not going to happen where they're reading the contract and studying your legal requirements.

They're not lawyers, although usually the chair of the panel is a lawyer. The lawyers who bring these claims are not familiar with ERISA. If I were advising a client as to whether someone who already had a fiduciary claim -- which is already the most common claim brought in arbitration, and arbitration are often, is often decided in favor of investors on the basis of fiduciary breach because the broker has a relationship of trust and confidence -- I would probably advise them do not blow a good thing by bringing in the BIC.

However, I would have them bring in the fact that you have very clearly made that person a fiduciary, and that's the biggest hump to get over. Establishing that trust and confidence relationship will be helped by being able to say the DOL says that they're a fiduciary.

Now in contrast with that, if you allow the exemption as far as the, basically the out where you can go to the client and say, look, I'm acting as a salesman, the effect of that will actually make it a lot harder to win arbitration claims because you can imagine that if I were a defense lawyer I would come in and say, look, the DOL says that if this language is in the contract they've anointed this as a nonfiduciary relationship.

Good luck trying to show that person is a fiduciary once DOL has said that they're not, and you will now lose claims that you would have otherwise won under common law duty. So as a practical matter, that's the way arbitration works generically.

On top of that you have both FINRA's chairman and CEO in a speech and FINRA, the institution, in a comment letter deriding the DOL's competence to do rulemaking, saying that the rule is virtually unenforceable because it cannot be understood.

Mr. Ketchum (phonetic) referred specifically to judicial arbiters -- using those words -- not being able to understand the rule, and to those required to comply with it, not being able to do so, which is as good as giving a defense lawyer a perfect defense where in a FINRA arbitration he could say the FINRA CEO says this is not able to be complied with.

Not to mention that in the letter they specifically said, as you heard Mr. Bentsen say, that there should not be a double standard for IRAs and ERISA assets and not ERISA assets, even though not only that is exactly what ERISA does, which is to apply a higher standard to those assets, you are legally mandated to apply that higher standard, and you have the so-called regulator FINRA saying we don't even agree with what the law already is.

So although I think arbitration works in securities claims, it is not going to work in this case. And we haven't even gotten to the details of the BIC, which in arbitration is not going to be able, something you're going to be even willing to try to argue, much less be able to show, because every one of your standards is open to what you used as the non-neutral time and analysis safe harbor.

The reason my chart is set up the way it is is I could write you compliance procedures that would make it clear that every time I chose international as opposed to U.S., extra time and analysis. Every time I chose active versus passive, every time I chose stock versus bond time and analysis justifies the differential. The only close call in that chart is growth versus value.

I would be completely comfortable for what I can tell you are very aggressive clients in this business. We're not in the investment management world, right? We're in the broker/dealer world where it is bare knuckles compliance, and that is exactly what the aggressive firms are going to do. They will not hesitate to allow you to distinguish because that is already the culture.

I mean we have a standardized world in which both FINRA and the SEC have no problem with my recommending a product that pays me five percent that's a stock fund and a short term bond fund that pays me one, and this is for a retiree who's 65 years old. You get paid three times as much. This is what securities regulators think is permissible.

And you want an arbitration panel that's been living with this world for decades to all of a sudden think that DOL, which FINRA says doesn't know anything about what it's doing, to change the rules? That is not going to happen in arbitration.

MR. HAUSER: I don't think they were quite that.

MR. BULLARD: Well, look, you know, I know you can't say that, but I don't think you've asked a question yet that you didn't know the answer to, if you know what I mean.

MR. HAUSER: So can I ask you one more? And were we to get rid of the arbitration requirement, then what? What do you think the impact would be?

MR. BULLARD: I'm not sure that you can undo what FINRA has done. That has poisoned the well. But I think the better approach would be practical decision that there are some conflicts you're going to allow. I think you should allow proprietary, nonproprietary, and nonplatform conflicts. I think you're going to have to allow mutual fund versus variable annuity, and that is a very costly conflict but I don't see how you can get around it.

What you should make clear, and you're departing from the principles-based approach, is that you implement an asset allocation, you've got to get paid, the financial advisor, the same no matter what. So if it's international, U.S., doesn't matter. Stock, bond, doesn't matter. Once you've got that 50, 30, 20, or whatever it is, the financial advisor gets paid exactly the same.

You've got to be explicit about their not being able to participate in branch manager profits. You've got to talk about branch manager incentives. Branch managers control lots of aspects of the life of a financial advisor. It's not just the interoffice pressure they bring to bear. They control who gets inherited accounts, they control their performance evaluations, they control their compliance evaluations, they control the travel and entertainment benefits they get.

They have a long list of abuses that started after the Tully report came out in the late '90s, for those of you who remember the real history of this, that they used to circumvent the limited attempts that FINRA has made to stop this. This is an old issue that has been around for a while. If you don't talk branch manager, you're not talking conflicts.

The good news is that as far as I can read from compensation structures, revenue sharing is pretty much removed from the pay out grids. But as far as the pay out grid's ratcheting effect goes, you're going to have to expressly prohibit retroactive pay out grids because you have been permitting them for fiduciaries that are fiduciaries under current law for decades.

If DOL has never brought, or rather, Treasury has never brought a case with respect to retroactive pay out grids, how can you possibly argue there's a problem with them now? You would lose that case. So you're going to have to change that position, which is an implicit position you've already taken.

On the other hand, I think time and volume-based pay out grids are fine. Pay out grids reflect the fact that their efficiencies -- if within a 12 month period somebody generates more volume because there's a fixed set of costs that you've got to cover, I'd leave those alone.

You've got to make some of those practical cuts as what do you want to stop and what do you not want to stop, and you're not going to be able to do it with a principles-based tool, especially one that has been enforced or not enforced in arbitration for a very long time.

MR. HAUSER: Anyone else?

MR. BULLARD: You want to know what I really think? No.

(Laughter).

MR. HAUSER: I have some follow up, but --

MR. PIACENTINI: I guess if I could for Ms. Smith ask one question about monitoring. When you talked about your simpler prohibited transaction exemption alternative I think one of the things you talked about was that based on facts and circumstances, different firms can monitor and mitigate conflicts in different ways.

Could you comment a little bit more about monitoring. Let me just mention what's part of the context of the question for me. We've had this conversation with the industry about data. What kinds of data do they have, what kinds of data can be used for analysis to look at -- you know, can you detect instances -- could you detect, if they were happening, instances where the compensation structure is directly influencing recommendations that are being made.

So I guess my question is is there data in the industry for firms to find the way for each of their practices to really look and just be able to see in real time whether that's happening, and, if so, do they do it now?

MS. SMITH: Okay. I have been away from supporting a compliance function for a number of years but I will say based on prior experience that firms use their compliance Departments to create exception reports. They base those exception reports and how they're designed on particular policies related to each one of the types of products and services that they offer.

Then you begin to do, in some respects it looks like it's a back testing because every day there will be certain kinds of activity that pop up on the radar screen.

Someone in the compliance shop who's associated with that particular area will go down through each line and evaluate what happened here and does it mean you have to call the branch manager and say, well why are you doing this, and, you know, what basis did you have for the FA to recommend this particular product to that particular retirement saver. So there is a internal conversation, if you will, and that's a daily thing.

If you have too many of the wrong types of red flags popping it then begins to be more elevated within the firm itself. You know, so that's the kind of active monitoring that's required on a day-to-day basis. It's not so much gathering quantitative data that you can then go back and query the data.

I'm not in Congress, so, you know, I didn't stay at Holiday Inn Express last night either, you know, so I'm going to yield to those who know better on that aspect. It's an active use of tools that involve direct conversations with people in the branch. Gathering information to understand why a particular security was recommended to a particular client.

MR. PIACENTINI: So I think what I'm hearing is there's generally not, you know, an ability to sort of scan the data and see what are the sales practices and how do they relate to the incentives, and that not even sort of within the corners of a particular firm, but that instead you're relying on -- I guess my question is sort of what.

So these things that pop up and then get addressed, are they based on whistle blowers? Are they based on --

MS. SMITH: No, no. It's based on --

MR. PIACENTINI: -- complaints?

MS. SMITH: No, no. It's based on trade activity that occurs within a firm. So, for example, if in Branch X there are -- I mean and the accounts will be coded so you'll know that a certain account is a retirement saver account or an IRA account. It will have a unique account number that can only be assigned to an IRA.

So within that account if there are, for example, you see large purchases of securities for that account or large sales of securities for that account, maybe some of it looks atypical for what usually happens in that account. All of that comes up on the daily run the next day.

People begin to call and ask questions, and get information, and make assessments as to who authorized what, on what basis were these decisions made, is this a trade that's going to have to be bought in -- because you can't reverse a trade but you can do a buy in -- will there have to be some kind of sanction or discipline to the branch whether at the manager level or the broker level for the activity if people in the compliance group clearly believe that that was done outside of the rules and the people knew it was outside of the rules.

So it's that kind of active engagement on a, what I like to think of as a real time basis on what's happening with that, within those accounts.

MR. BULLARD: May I add to that? On that, I mean I think that's a right on description of current practices. I would add that variable annuity switches invariably have what's called a 1032 exchange form and that will always go up the chain, usually to a firm level review. That's the compliance structure.

Clearly they have the data and they could do it, but in a way what you're asking is would the broker create a document that not only would create liability by showing that there are biases that wouldn't otherwise be able to be proved, are they going to do it in a way that would actually create the basis for a class-action, which would be very hard to do with respect to broker sales practices.

But what you described just might be able to get over the commonality requirement for class-actions.

MR. CANARY: So just one question -- I know we've got less than a minute at this point -- for Prof. Bullard and Prof. Finke. We've had a certain amount of comment about the private litigation risk expanding if this rule and the exemption went into place. Do you have thoughts on that?

MR. BULLARD: Do you want to go ahead?

MR. FINKE: You go first.

MR. BULLARD: Well as I said, I think the biggest impact is going to be a private litigation impact because you will now be able to use what's a very clear statement about the fiduciary status of somebody where ERISA assets are involved: being a fiduciary.

So if you eliminated one of the two things you need to show, and that is whether they're a fiduciary, that doesn't begin to address what the duties are that are required.

Now arbitration, FINRA makes a point of not establishing substantive law, okay, so they are on their own to do whatever they think is equitable. The answer there is when you are a plaintiff's lawyer you're looking at various sources of law that you're going to present to the panel, and you can't give them too much because this is force feeding them in an oral presentation and you've got to decide which of those sources of law you're going to choose.

I can tell you if BIC makes the list, it's going to be way down at the end, okay? What they make -- what they claim are breach of fiduciary, breach of state securities law, breach of federal securities law, always suitability violation, and if you can show fiduciary, the general view amongst plaintiffs' lawyers is you don't have to show intent and you don't have to show actual reliance, so that makes a difference in the outcome.

Now because arbitration is a black box no one knows how they make decisions, but that's -- talking to arbitration lawyers, there's a general sense of, on a kind of subjective level, it does make a difference. So you'll be able to show their fiduciary and I think that is going to have an effect. Otherwise, most plaintiffs' lawyers aren't going to touch the BIC with a 10 foot pole.

MR. CANARY: Sorry. Prof. Finke?

MR. FINKE: Well I think that when you're thinking in terms of the benefit of having your fiduciary standard of care, litigation risk is that pressure that provides people to change their ways.

So if we look at plan sponsors, nobody likes to have litigation risk but it moves plan sponsors towards selecting more efficient type of providers and provides the kind of incentives that we want to see especially happen in the financial advice industry that would give producers more of an incentive to train advisors and to provide products that they could defend as being in the best interest of clients.

Both of those pressures are good, I think.

They're moving things in the right direction.

MR. CANARY: Thank you.

MR. HAUSER: Okay. That's it. We're back at 2:15. Enjoy lunch.

(Whereupon, at 1:16 p.m., the meeting in the above-entitled matter was recessed, to reconvene at 2:15 p.m. this same day, Monday, August 10, 2015.)

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

(2:18 p.m.)

MR. HAUSER: So who would like to go first?

MR. BREYFOGLE: I'm prepared.

MR. HAUSER: Okay.

MR. BREYFOGLE: Okay. Well, thank you. My name is Jon Breyfogle and I've supplied a copy of the statement that I'm going to summarize to each of you and have a electronic version that's been submitted. I'm a partner with Groom Law Group here, in Washington, D.C., and I specialize in ERISA and healthcare law. I'm testifying today on behalf of American's Health Insurance Plans and the Blue Cross and Blue Shield Association.

We appreciate the opportunity to testify at this hearing. We look forward to working with the Department to hopefully clarify and narrow the application of the fiduciary proposal to insured health and welfare plans, as well as HSAs. We filed detailed comments. Those are obviously in the record.

Just a brief mention, AHIP is the national association, trade association representing health plans. They cover over 200 million Americans in terms of insureds. Blue Cross is the association representing the 36 independent Blue Cross plans that represents and covers over 100 million Americans in every zip code.

Over the last five years the health insurance industry has worked diligently on the implementation of the Affordable Care Act. AHIP, Blue Cross and all of their companies have devoted significant time to Affordable Care Act regulatory implementation.

It's clear to us, or the industry, that the goal of the Department's proposed rule is retirement plans and retirement plan investing and advising. We do think that the proposal, though, has a potentially unintended consequence and spillover effect to the sale of insured health and welfare plan contracts in particular and maybe an intended, or at least subject to discussion, impact on HSAs.

We're hoping that through the rulemaking process the Department will clarify and narrow the impact on insured health and welfare plans and also exempt HRAs as I'll mention.

The basic points that we would like to mention that are summarized in our testimony is, again, we think there is a carve-out that's required for health and welfare plans and merited. Fundamentally, health and welfare plans are different than retirement plans, and retirement plans, particularly defined contribution and IRAs.

So obviously, as the proposal makes clear, participants are in control to a large degree of the investing of their defined contribution plans, the investing of their IRAs. The retirement benefits themselves are a function of the effectiveness of their investing, obviously the contribution amounts, fees, and the like, but the participants in those arrangements bear the risk.

It's a fundamentally different world for health and welfare plans, and we think that is an important distinction that would merit a carve-out for health and welfare plans, which is health and welfare plans have a defined set of benefits, it's set forth in a plan document, defined premiums, and so there's really no risk of loss from the individual participant associated with the cost or the fees associated with the health and welfare plan itself. So they're very, very different.

On the other hand, the proposed regulation does not provide any clear carve out even though you would think just sort of contextually investment advice wouldn't cover a recommendation to purchase an insurance contract. The regulation as drafted could be read more broadly because it covers any recommendation basically to purchase a security or other property, and I think "or other property" picks up insurance contracts pretty clearly.

And then "recommendation" is broadly defined, as of course you know, and so there's at least a reasonable chance that a recommendation to purchase one particular health insurance contract or one particular disability contract relative to another could be investment advice under the rule, particularly since plan assets are typically involved in the purchase through, at a minimum, employee contributions.

If that's the cast of the net, then a lot of concerns would arise, from our perspective. In particular, the provision of information, really, to consumers and groups, employer groups could be chilled.

We're concerned that the expertise that agents, brokers, consultants, and insurance companies themselves that is provided through the marketing sales and educational process could become fiduciary activity, could create liability.

It has a special issue for captive agents. Many Blue Cross plans have their own sales force that would then impose special liability on them as the employer of the employees who are, in fact, in a selling role. It could also chill information that's been provided in a variety of other contexts.

And so that's the basic worry. Right now, obviously it's a very dynamic time in the insurance market and anything that would sort of chill or discourage the provision of information on plan selection, plan choice, could be problematic.

As a result, we would like to see a carve out of health and welfare plans generally from the rule that would mirror the policy choice the Department made in the 408(B)(2) rule. In the absence of a carve out of that nature, then a carve out that would carve out recommendations to purchase insurance contracts that fund health and welfare plans. A carve out without requiring a particular disclosure or consent to the consumer would be appropriate, we would think.

HSAs is a slightly different issue, as you all know. HSAs you can really only contribute to and you can participate, but you can only contribute to them if you are enrolled in a high deductible health plan. So they're an ancillary device typically to fund the uncovered costs of a high deductible health plan.

They are typically invested in short-term bank deposit accounts, and the vast majority of instances they, relatively speaking, have low balances that are largely consumed on paying uncovered healthcare costs from year to year. They are, though, technically within the definition of the proposal. Obviously you sought comments on this point.

We don't think they're IRAs. We don't think they should be treated as IRAs. The account balances are a fraction of IRAs. They are not retirement savings vehicles in the same sense. They are vehicles designed to fund current and near term healthcare costs.

We think the Department appropriately recognized the special nature of HR, HSAs when it largely exempted them from ERISA through the field assistance bulletins issued in 2004 and '06. This is not the same thing exactly, but it's analogous. And so what we would like to see is a carve-out for HSAs and Archer MSAs more generally.

In the absence of a broad carve-out, then we would suggest some sort of carve-out that would really recognize that the vast majority of these are small balance accounts and also seek some protection from the platform carve-out for the HSA custodians and vendors.

You could easily see a situation where custodians would stop offering investment funds in connection with their HSA offerings because they're not utilized that much anyway and that would create liability for them, where a simple bank deposit vehicle would not.

So with that, I think I've quickly summarized it. I am going to hand it off to Steve and Tom. I do appreciate that you put me on the panel with my two colleagues here to make me feel comfortable. So with that, I'm going to pass it to Steve and Tom.

MR. SAXON: The Groom Group. Yes. I'm sitting between two partners at Groom. Good afternoon. My name is Steve Saxon. I'm currently the chairman of Groom until he takes over, probably shortly. Maybe right after this testimony. My colleague Tom Roberts is with me today, and Tom is going to share the testimony with me.

We're testifying on behalf of several life insurance companies that are major providers of group and individual annuity products and related services, to ERISA-covered plans, plan participants, and IRA holders. We appreciate this opportunity to comment.

In particular, I wanted to thank the members of the panel and your colleagues for making yourselves available over the last several months. It was extraordinary, what you did, and we really appreciate it. Chelsea McHugh (phonetic) is here somewhere. She organized all those meetings. A special thanks to you because without your help I don't think we would have gotten in to see you guys and we really appreciate that. It made a big difference.

Our comments today focus on the need to preserve free and ready access by individuals to a competitive, well-regulated marketplace for guaranteed lifetime income products, and by small employers to the group annuity products and related services that support small plan formation and growth.

Many, including the Department, have observed that the long and continuing migration away from defined benefit plans in favor of defined contribution plans has effectively shifted responsibility for achieving adequate retirement savings and managing the spend down of those assets to individual workers. This secular event has triggered a new recognition of, and appreciation for, the retirement income needs that annuity products are uniquely capable of fulfilling.

The 2010 joint initiative between DOL and the Treasury Department to solicit information and ideas on how defined contribution plan participants' access to, and utilization of, guaranteed lifetime income products might be increased was an indicator of the growing public policy concern that individual retirement savers may be ill-equipped to protect themselves against the risk that they might outlive their retirement savings.

The 2010 initiative is now beginning to bear fruit. In addition, the Department's recent benefit plans statement rulemaking effort, which is aimed at encouraging plan participants to measure their defined contribution savings adequacy not merely as a lump sum, but in terms of its adequacy to purchase and annuitize income stream at retirement, is a primary example. Our clients enthusiastically support this effort by the Department.

Our life insurance company clients and their professional distribution partners make available a wide variety of annuity products to allow individual retirement savers the opportunity to offload the risk that they might outlive their retirement savings. The products that our clients, as well as other major insurers, make available range from fixed immediate annuities to variable products that also include a guaranteed income stream for life.

The breadth of life insurers' on the ground distribution capability is also an ideal match to support the development of plans offered by small employers through group annuity products and other ready-to-use solutions.

We are deeply concerned that this proposal, if adopted without change, would effectively shut down individual retirement savers' access to information about, and utilization of, guaranteed lifetime income products.

Such a result would leave participants unable to protect themselves from the risk that they might outlive their retirement savings. It would also undermine the Department's efforts to stimulate plan participant thinking about retirement savings adequacy.

At the end of the day, what good is achieved if plan participants come to appreciate the risk that they might outlive their retirement savings, but are effectively unable to address those risks by purchasing one or more guaranteed lifetime income products.

Similar, we are concerned that small employers will be deprived of access to the insurance products and services that foster small plan growth and development. Group and individual annuity products are readily available today through well-trained, licensed, and carefully supervised financial professionals who are knowledgeable about the features of the products and providers they represent.

These are products that are sold. These are products that are purchased for the long-term and that generate a sales commission for the financial professionals who successfully match them with their customer needs. The financial professionals who sell these products typically concentrate their sales efforts on a select number of products and issuers that they are familiar with and comfortable representing.

Unfortunately, the proposal ignores the fundamental marketplace reality. First, it recharacterizes all product marketing and selling activity involving small defined contribution plans, plan participants, and IRA holders as fiduciary in nature. Second, the proposal withholds any workable prohibited transaction exemption relief by disallowing as a condition of the proposed exemption virtually all of the financial incentives that promote responsible product sales activity.

We urge the Department to preserve the freedom of defined contribution plan participants to small plan sponsors to choose from among competing insurance products and providers by making three key revisions to the current proposal that Tom will now describe. Tom?

MR. ROBERTS: Thank you, Steve. Our first suggestion is that the Department should either revise the proposed fiduciary definition itself or provide an appropriate carve-out to avoid giving rise to fiduciary status on the part of annuity providers and distributors in situations where a plan sponsor or a retirement saver would not reasonably expect the person offering a product to serve as an impartial and unbiased advice resource.

Under the proposal, fiduciary status arises virtually any time any communication is made that is in any way suggestive of an annuity product purchase if it is either individualized for or specifically directed to a retirement saver for consideration. The proposal would have fiduciary status attach contemporaneously with the delivery of the suggestion even in circumstances where no business relationship yet exists.

Our problem with this approach is that virtually all annuity marketing and selling activity involves the delivery of suggestions to individuals or employers about products that may merit consideration through specifically directed communications of one sort or another.

Special responsibilities clearly should, and do, attach to annuity product marketing and sales activity. Consumers clearly should be able to rely on annuity providers and distributors for clear and complete explanations of the benefits, features, and costs associated with the products offered for consideration, but conferring fiduciary status on all persons who market and sell annuity products to individuals and small employers is inappropriate and it is unworkable.

As noted earlier, annuity products are distributed by professionals who typically concentrate their marketing and sales efforts on a select number of service, of products and providers. Consumers who may be interested in considering a guaranteed lifetime income product purchase know that the financial professional offering the product is not a disinterested fiduciary.

Individuals considering future retirement situations are frequently interested in shopping the guaranteed lifetime income product marketplace by speaking with several competing providers.

These shoppers are interested in obtaining information about one or more particular products and they are entitled to rely on the accuracy of the information provided to them, but they have no justifiable basis for believing that the person they are interacting with is impartial or unbiased. The same is true for fiduciaries of small plans engaged in the consideration of products and services to support the needs of their plans.

The proposal's counter party, or seller's carve-out, is generally available only to fiduciaries responsible for managing large plans. It does not cover selling activity involving small defined contribution plans, or individual participants and IRA holders.

The Department explains the basis for this result springs from its view that as a rule fiduciaries of small plans, plan participants and beneficiaries are incapable of entering into an arm's-length arrangement with a financial services professional. We disagree with that view.

The marketplace for annuity products is extremely competitive, and it is that competition that provides consumers with real power and leverage to shop the marketplace, to assess the information and products that today are readily available, and to make a decision about which product is the best fit for their needs.

Second, the BIC exemption, which is proposed as a source of exemptive relief for virtually all investment and annuity product sales to individual IRA holders, is an exceedingly poor fit for guaranteed lifetime income products.

The extensive cost and compensation comparisons required under the BIC exemption would lump together pure investment products and annuities and then suggest that all product costs should be assessed through a value of services lens.

MR. HAUSER: If you could try to --

MR. ROBERTS: That framework assigns no value to the cost of the nonservice-related guarantees that differentiate annuities from investment only products.

Third, and last, it is absolutely vital that the Department consider, reconsider the changes it has proposed with respect to the relief afforded to annuity products under PTE 84-24, which has served for decades as the primary source of prohibited transaction exemptive relief for sales of insurance products of all types without regard to their fixed or variable nature.

We urge the Department to preserve a level playing field for the marketing and sale of variable and fixed products by removing its proposed exclusion of variable products sold to individual IRAs from PTE 84-24 coverage.

We would also urge the Department to expand the proposed definition of "insurance commission" to more broadly cover all types of compensations paid to insurance agents, brokers, or pension consultants. We are particularly concerned that the narrow scope of the definition would not cover the retirement and welfare benefits that many insurance providers make available to their career agent sales forces.

We appreciate the opportunity to appear here today, and we look forward to taking your questions. Thank you.

MR. RHOADES: Good afternoon. I'm Ron Rhoades, Chair of the financial planning program at Western Kentucky University, and a professor of finance. I'm also an estate planning and tax attorney, a fee only investment advisor, and a certified financial planner. Thank you for the opportunity to speak today.

Like other members of the Committee for the Fiduciary Standard, a group of volunteer leaders of the financial planning profession who donate their personal time and treasure to advocate on these issues, I'm here on behalf of my fellow Americans, the consumers of investment advice.

For many years we have been dismayed by the huge extraction of rents by Wall Street and the insurance companies. We have seen the harm it caused to our friends and neighbors. I'm here today to pronounce for all to hear that the substantial diversion of the returns of the capital markets away from individual investors and into the pockets of the broker/dealer firms and the insurance companies must stop.

Please permit me to summarize some of the contents of my comment letter. First, overwhelming academic research demonstrates that high fees and costs result in lower returns for investors. Despite this, most individual investors today when receiving advice from nonfiduciary advisors are sold high-cost products.

Economic incentives matter. When a person or a firm providing investment advice has the opportunity to receive much higher compensation from the sale of one product compared to the sale of another, the allure of the higher compensation nearly always wins, to the detriment of the consumer.

As a result of this high extraction of rents, individual investors accumulate far less for their own retirement and other needs. Hence, I applaud the Department of Labor's proposed rule which will substantially reduce the conflicts of interest existing in financial services today.

The huge extraction of Wall Street, of rents by Wall Street and the insurance companies must stop. The size of the financial services sector relative to the size of the overall U.S. economy has grown from a mere three percent in 1950 to well over 30 percent, and perhaps as high as 40 percent, today.

Wall Street is no longer the grease that fuels the modern economy. Rather, it has become the sludge that clogs the engine of U.S. economic growth. Not only did Wall Street's conflict of interest cause, in large part, the economic crisis of 2008, 2009, but also, the International Monetary Fund now estimates that the excessive financialization of the U.S.

economy reduces U.S. economic growth by two percent a year. In essence, Wall Street not only led us into the Great Recession, but it is also responsible, in large part, for our very slow recovery from it.

The detrimental effect of conflicts of interest resulting in sales of high-cost products is likely to compound. The diversion of the returns of the capital markets away from individual investors leads to substantially less accumulated capital. This, in turn, results in the higher cost of capital for firms.

Due to conflicts of interests many individual investors have not accumulated enough for retirement. As a result, the burden upon federal, state, and local governments to provide for our retired citizens increases year after year. This results in higher taxes on all of us.

The fiduciary standard is a much needed correction to the current unworkable system for the provision of retirement advice. The suitability standard, on the other hand, is not the answer. The suitability doctrine emerged as the way to protect brokers from being sued for broker stock and bond recommendations at a time when broker services mainly related to the execution of trades.

This inherently weak suitability standard was erroneously extended by FINRA and the SEC decades ago so that it now applies to the selection of investment managers. In other words, mutual funds. As such, suitability has served as a shield to protect brokers and insurance agents from adherence to the duty of care so many other service providers in our society possess.

FINRA recently proposed a best interest standard following on comments by SIMFA, SIFMA that is just nonsensical. Closely examined, it is just suitability with very minor changes. It falls far short of any fiduciary standard. Worse, by using the term "best interest" to describe its standard when it is clear from a close examination of FINRA's proposal that brokers possess very little in the way of any duty of loyalty to their customer, FINRA has been misleading.

As Professors Angel and McCabe observed in a white paper five years ago, to give biased advice with the aura of advice in the customer's best interest is fraud. Simply put, FINRA's proposal permits brokers to act as supply side merchandisers instead of trusted purchasers' representatives under their definition of a best interest standard, and I encourage you to question representatives of the broker-dealer industry as to what they mean when they say best interest.

FINRA tries to blur the line between representing the seller and representing the buyer, but as an eloquent Tennessee jurist opined more than 160 years ago, "It is an infallible truth that a man cannot serve two masters."

Into the void created by the SEC and FINRA, the Department of Labor has ventured with courage. I applaud the Department of Labor's efforts to protect our fellow Americans, and I applaud their leadership on this important issue.

In my comment letter I have set forth that broker-dealer firms and insurance companies can easily adhere to the Department of Labor's fiduciary requirements simply by abandoning the conflicts of interest that differential compensation to both the firm and the individual broker or insurance agent create.

I have also set forth the inevitable conclusion that commissions on products, if not substantially lowered as larger purchases are made, such as by the use of breakpoint discounts, can easily amount to unreasonable compensation.

Additionally, I set forth a listing of the characteristics of variable annuities, equity indexed annuities, and fixed annuities which advisors recommending these products should fully master before they make a recommendation.

Despite comment letters from insurance agents stating that they have devoted a large amount of training relating to these insurance and annuity products, in my conversations with them I have discerned that they have been trained to sell these products, not to discern all of the characteristics and really understand them.

The fiduciary standard requires that those who provide investment advice are experts. Extensive due diligence must be undertaken. This scrutiny levels the playing field for all products. It is altogether certain that most of the variable annuities and equity indexed annuities that are on the market today would not survive due diligence if undertaken by an expert and trusted advisor.

I have heard from opponents of the Department of Labor's proposal that it is difficult to adhere to different fiduciary standards or different standards of conduct. Yet it has long been understood by providers of services under two different standards of conduct that the easiest path to ensure compliance is simply to apply the higher standard to the entirety of the relationship.

I have also heard from opponents of the Department of Labor's proposal that they fear unlimited liability. However, I have practiced as an attorney under a fiduciary standard, and then as an investment advisor for over 30 years. I have no such fears.

All you have to do is be an expert, charge reasonable compensation, act as the representative of the client, not as a representative of a product manufacturer, and avoid conflicts of interest. Advise the client with candor and honesty. If you do this you look forward to going to work every day and you don't have any concerns about liability.

The Department of Labor, while accommodating to a degree the concerns of the industry, should act to preserve over the long-term ERISA's tough sole interest fiduciary standard. The BIC exemption, by not mandating level compensation at the firm level, does not meet this tough sole interest standard, and, as Mercer Bullard suggested, may only be a modest improvement for retirement investors.

Hence, I have suggested that the BIC exemption be strengthened and that it be time-limited.

In other words, sunset after a period of years. Let us move forward in a manner in which particular exceptions to the fiduciary standard, to paraphrase Justice Benjamin Cardozo, are not permitted to exist indefinitely.

Let us conform the securities industry to the fiduciary standard. Let us not change the fiduciary standard just to preserve the conflict-ridden practices of Wall Street and the insurance companies.

The Department of Labor should move forward to quickly implement this proposal. In so doing, the Department of Labor will empower a new era of economic growth and prosperity for us all. Thank you.

MR. HAUSER: Thank you. Mr. Breyfogle, maybe I'll just start this way and go that way.

MR. BREYFOGLE: Okay.

MR. HAUSER: As we've said before, and I'll say again, the proposal doesn't cover the, you know, encompasses advice, advice as covered investment advice, advice to buy a health insurance policy or a disability policy, to fund benefits under a plan or to provide individual health or disability benefits, because we don't view those as investments in the first place. The same would be true of a life insurance policy that doesn't have an investment component.

You know, a number of times I've heard this phrasing about maybe it was something inadvertent in the rule that led people to make this argument. I got to say I don't really buy that. It seems to me this is a little bit of a manufactured issue.

I mean the argument is that because the rule references advice with respect to monies or other property, that it would pick up a policy because a policy is a species of property, but of course the same thing is true of the statutory language which talks about monies or other property, and it's similarly true of the 1975 regulation.

We didn't change anything relevant to this analysis, nor did we intend to change anything when it comes to the purchase of a health insurance policy or a disability policy. So on that point, you know, I hope everybody can just rest easy. At least maybe one issue is off the table, I'd like to believe.

With respect to welfare plans, though, I mean health plans -- when a health plan, for example, is funded by an ongoing trust and that money is being invested to make sure that the plan is going to have the resources necessary to fulfill the promises, to the extent the plan's getting advice on the management of those assets, why wouldn't that comfortably fit within the fiduciary definition, and why would we think that the plans in that circumstance are any less in need of protection from conflicts of interests than in any other context?

MR. BREYFOGLE: Well I mean a couple of points. First, we will look forward to the very clear carve-out you just promised. So that's nice to know. I'll be one for one, at least on that. We didn't find a lot of comfort --

MR. HAUSER: I'd let you take credit, but I'd already announced that multiple times.

MR. BREYFOGLE: Yeah. And that's what we'd heard. You know, there -- the rule applies to all employee benefit plans. If you read the lawsuits that are filed every single week against health plans alleging far-flung ERISA theories leveraged with all kinds of other laws, it doesn't give us a great deal of comfort that we would look forward to clarity in the judicial process as opposed to the regulatory process. So we are grateful that we will see the clarity that you've mentioned.

It's not our top issue if you're talking about funded VEBAs. They're still funding a plan where the participant is not bearing the risk. And I do think that the driver of this rule is defined contribution marketplace, I think it's the IRA marketplace, where, in fact, the investing of professionals or the investment advice of professionals could affect the actual benefit delivered.

Defined benefit plans and VEBAs are not that different in the funded and risk sense that you're making, but just like a DB plan, a participant in a health plan that's a funded health plan does not bear the risk of loss. I think that's an important distinction. I also think that the --

MR. HAUSER: But can I ask on that point?

MR. BREYFOGLE: If I could just --

MR. HAUSER: I'm sorry. Sure. Go ahead.

MR. BREYFOGLE: You know, depending on how the line drawing is done, then it could create uncertainty, so obviously we had thought that a broad carve-out more along the lines of 408(b)(2) that recognizes -- because you can make the same argument on 408(b)(2) that there are certain healthcare arrangements, but they were exempt more broadly because of the potential ancillary effects on that marketplace.

So, but, you know, to be sure we would, and as we mentioned in my statement, a fallback position for us is the clear carve-out for insurance contract recommendations. Yeah.

MR. HAUSER: Okay. Yeah. I would just observe, and you can tell me if you disagree with this observation, but at least in our experience, it isn't the case that the employer necessarily stands behind those assets in a VEBA.

I mean, for example, you have the large auto manufacturer VEBAs that essentially have a finite pool of assets, and to better manage that money is, the longer and better able they are going to be able to fund any given level of benefits, and similarly, employers and plan sponsors typically argue that their health plans are terminable at will.

So in many ways there's an even more direct connection between the investment performance of those assets and the ultimate outcome for participants than there is in a defined benefit plan where you have determinate funding rules and obligations that can't be walked away from.

Then just one more question on, with respect to HSAs and the like. I hear what you're saying and I'm just wondering, I mean do you have any sense of how often people even get investment advice for a fee with respect to the money being managed in those accounts?

MR. BREYFOGLE: I don't believe that a lot of advisory programs are even available to HSAs, to be honest with you, if you look at what's out there, but we do think they're pretty distinct arrangements from IRAs.

MR. HAUSER: Thank you. Tom, you suggested that we should revise the fiduciary definition -- assuming we didn't just give a carve-out to welfare plans all together, that we should revise the fiduciary definition to provide that a person isn't covered where they would not reasonably expect -- maybe you can give me your phrasing again, but was it where they couldn't reasonably be expected --

MR. ROBERTS: Would not reasonably expect impartial or unbiased advice from the provider.

MR. HAUSER: Right. And so my question is how far does that go? So if somebody puts in their contract or in their ad somewhere that, you know, although I'm giving, although this is one-on-one professional assistance, it should not be relied upon as unbiased professional advice, are they good to go at that point and have no fiduciary obligation?

MR. ROBERTS: You know, I think it's very, very much a facts and circumstances determination. I would say -- and I take your point that the use of blanket disclaimers ought not to be available as a device to escape fiduciary status where it is properly assigned.

Having said that, our concern with the rule as proposed is that it errs in the other direction by assigning fiduciary status in all manner of circumstances where there is no reasonable expectation on the part of the advice recipient that they will be receiving impartial or unbiased advice.

So my answer would be, you know, if the reasonable expectation of the participant would be that the advice provider is impartial and unbiased but the advisor slips in a disclaimer, the disclaimer ought not to be effective.

On the other hand, I'm concerned that the Department's rule has gone totally in the opposite direction by uniformly assigning fiduciary status where it is inappropriate.

MR. SAXON: Let me give you an example. Let's say I'm an IRA holder and I want advice, so I invite you, Tim, to come in, you're an advisor, to come in and talk to me and you make all sorts of recommendations, you talk to me about how much you're going to get paid, but the thing that you might not know that I know or maybe you do know it, is that Joe, Karen, and Joe are sitting behind you and I'm going to interview four people that very same day with respect to the advice on my IRA account.

I don't think that the, I don't think the, objectively looking at that that you're coming in to me -- you may be talk -- you may look at my portfolio, you may make suggestions, very firm suggestions about, you know, you shouldn't be all in one particular stock, for example -- obvious -- but the fact is that I'm really doing a mini-RFP and I'm looking at four different people and I don't think that any of those four people should be deemed to be a fiduciary.

So that's -- I think that's what Tom meant by -- what we're worried about is if you don't apply the particular facts and circumstances you would look and say, well the relationship that Tim has, he's telling Steve what he should be doing and he's expecting that he's going to get hired and get paid for that, but Joe and Karen, and everybody else is waiting behind them.

So you can think of particular circumstances where maybe that, you shouldn't -- you're not creating a relationship where there's an understanding between both of the parties that would create a fiduciary relationship.

MR. RHOADES: If I could interject here just a little bit.

MR. HAUSER: Sure.

MR. RHOADES: I've dealt with hundreds and hundreds of retail investment clients who are rolling out the 401(k) plans and the IRA accounts and otherwise dealing with their retirement savings.

Whether they're dealing with a proprietary agent of the life insurance company selling some form of annuity, whether they're dealing with a broker, in every case they believe, and reasonably so based upon the marketing and the advertisements that they've received, that they're dealing with somebody who is acting in their best interest. We have survey after survey over the last 10 years that also shows this.

So to think that individual investors who don't understand, in most cases, the difference between a stock, bond, and mutual fund understand how to do a request for proposal, to interview four people, which they typically do not do -- they typically go for the first one -- that assumes a level of rationality and expertise that individual investors simply do not have in the marketplace today, and by no degree of financial education are they going to attain that.

MR. HAUSER: So I mean maybe just further exploring where your position is, if I think I understand, I mean one request could simply be to write something in particular to deal with an RFP process, but are you more broadly saying, for example, following up on Mr. Rhoades' observation, that if the insurer, if the agent is selling proprietary products and they're clearly proprietary, that that should, there's no reasonable expectation in that circumstance?

MR. ROBERTS: I would say that, you know -- first of all, I think Mr. Rhoades makes some fairly sweeping statements that are not at all flattering about individual investors and their degree of financial sophistication.

I would say that if you take that view, then perhaps the whole 401(k) system is, you know, ought to be scrapped because no one can possibly understand anything having to do with their investments. That is not where our clients are.

We believe that it is possible to make a recommendation that is in the client's best interest, but not necessarily exclusively in the client's interest. We also believe that it is possible to represent a financial institution honorably and fairly and to say to a customer, I am sitting in front of you on behalf of Company A, I represent, for example, exclusively products of Company A. There were many other offerors of products in the marketplace, and perhaps you might want to explore those before making a decision.

I would say that under such circumstances there ought not to be any expectation that the representative of Company A is going to provide impartial or unbiased investment advice.

MR. HAUSER: And should it matter if the person who is opposite the customer in this scenario calls themselves an advisor or an investment professional, or if the marketing material says that the advice is being given in the best interest of the customer, or that we resolutely --

MR. ROBERTS: Well I think we need to be very careful about best interest because a best interest as the Department has defined it is incompatible with any selling model I have ever seen. Best interest as the Department has proposed it is advice that is only prudent. I don't think any investment professionals have a problem with that part. But it's the exclusively in the interest of the advice recipient that is a problem for selling a model.

MR. HAUSER: Obviously in our best interest contract exemption we contemplate the sale of proprietary products. Similarly, we have principal transaction exemptions where we, you know, contemplate people really in some sense being in a fiduciary relationship, notwithstanding that kind of tension.

Why wouldn't a better approach be to simply define, with more clarity perhaps, what it would mean to comply with the loyalty test, the exclusive purpose test, the best interest test, whatever you want to call it, in that particular context?

So, for example, I mean what if said, well, you know, the recommendation has to be prudent, the payments have to be reasonable in relationship to both the product and the service being provided, the salesperson, or representative, or advisor, or however they call themselves has to, you know, essentially be making the recommendation.

He can be restricted to proprietary products, but subject to that restriction, he needs to have his blinders on and just be making a recommendation based on what's in the customer's interest. You know, and like that, just put some flesh on the bones. Would that resolve these problems and honor customers' expectations, or do you think that's just too dangerous a road to go down?

MR. SAXON: Here's what I think. I think that you have moved away -- we have a very broad definition of who's a fiduciary in the proposal. It's broader than anything we could have possibly imagined. It's broader than anything I've seen in 30 years of practicing law.

That being said, I think that our clients would be -- we would be willing to live with the very broad definition if we have a workable solution in terms of being able to sell the product, and that's where you're going.

When you look at the best interest standard that the Department has now devised, the without regard to language I think -- and Jon Breyfogle referred to this in conjunction with the health plans, but the without regard to language suggests that you can't take into account the, any possibility that you have a financial interest in the transaction.

I think that notwithstanding the fact that FINRA may have said something or somebody else may have said something about that, I'm worried about the plaintiffs' attorneys going to town with without regard to. So the, I think the bottom line is our clients would be, they're okay with the best interest standard -- look, PT 84-24 was first promulgated in 1977.

We've had almost 40 years of living with an exemption for the sale of annuities and proprietary mutual funds side-by-side with Section 404 of ERISA, both the solely in the interest rule and the prudence rule.

I'm not aware of a single case where there has been reliance on an exemption where somebody has been successful in bringing an action under 404. That notwithstanding the availability of the exemption, the seller violated 404. So I think that we do -- there is a method to the madness.

There is a possibility that we could live with the best interest standard. Lots of folks who are commenting suggested they could live with the best interest standard, but the without regard to language in the best interest standard needs to be changed.

You need to recognize that at the end of the day in that conversation I alluded to, I am going to get paid either a commission or I'm going to get paid something. If you don't hire me, then I'm not going to get paid, but if you do hire me, I'm going to get paid something. That's how we do business, and we need to recognize that.

So if we delete the without regard to and put in something like, you know, taking into account the fact that, as I fully disclosed, I am going to get paid as a consequence of this transaction.

MR. HAUSER: I mean one could make a similar argument about -- I mean I appreciate your observation about the scope of, the potential scope of a very literal reading of without regard to, but one could make the same kind of argument with regard to the statutory exclusive purpose and, you know, loyalty provision as well, right?

MR. SAXON: Yeah. And that's why --

MR. HAUSER: But it hasn't been --

MR. SAXON: If it's there, let's use it. If the Department wants Title 1 to apply to IRA sales activity, which is the main, I think, focal point of this whole effort, then why not just say it. Say we're going to apply -- you're going to be subject to a contractual 404 standard.

But when you added the language at the end of the, you know, 404(a)(1)(B) and said without regard to, I think that changed the standard, and I think the plaintiffs' attorney will go to town in pointing out to a federal Judge or a state Judge that this is a difference, and therefore, there's a violation, the exemption's not available.

MR. HAUSER: Okay. Well we -- I mean we pretty clearly said in the preamble that we thought we were just articulating what was the 404 standard. I hear you saying, well maybe, but you disagree, but -- which is fine. So I just want to be sure I've nailed down where you are on this.

So if we were instead to say, yes, you can give advice with respect to these proprietary funds and that's going to be fiduciary, but the contract -- but you're -- and you have to enter into a contract -- and subject, of course, to our making it and, you know, working it so it's workable by your lights -- you'd be okay if the contract provision essentially just repeated the 404(a)(1)(A) and (B) provisions.

MR. ROBERTS: I guess if I could just jump in on that. I mean I think the problem that we're having, and the reason I personally regard the proposed BIC exemption as a black hole, is that once you're inside the BIC exemption's conditions is that you -- I mean the condition, the fundamental condition of the exemption for a conflict is that you have no conflict.

In that regard, the BIC exemption seems to be unlike anything we've ever seen before. Normally if a financial institution has a conflict, for example, as a fiduciary they want to sell the products in which they have a financial interest, they would apply for exemptive relief and most would agree that notwithstanding the exclusive benefit language in 404, that they could proceed in the face of the conflict by complying with the conditions of the exemption.

BIC unfortunately says to obtain exemptive relief you must first shed your conflicts, seemingly, and I think that's why we have such a problem with it.

MR. SAXON: But even -- I don't think we truly can answer your question now until we see -- a lot of folks would suggest, and I'm one of them, that this is the -- there's a lot of information being exchanged here, I think it's been a fruitful experience, but what this calls for is a re-proposal, and I don't know if the Department feels that they have time to re-propose.

If we could look at what the disclosure requirements, what you had in store in terms of changing the disclosure requirements, the record retention requirements, perhaps the warranties, the best interest standard itself, you mentioned the up front contract, moving it to some other time which would be more workable, I think our clients would look at that, at all of those changes in a very positive light because they don't know -- you know, somebody probably will challenge this in Court and say that the Department went too far in terms of the definition.

I don't know if they'll be successful there. We're not banking on that so we want to work with the Department and develop a workable solution.

So the things that you're talking about, they make sense, but the devil's in the details. So if we end up making cosmetic changes to the disclosure requirements and the record retention requirements -- I talked to one, you know, one inside guy from a major financial institution and he said, his IT guys came back to him and said that they thought in order to comply with the disclosure and record retention requirements the cost would be 50 percent of what the Department estimated it would be for the entire country.

It's going to -- so if we can maybe build on what we did under 408(b)(2) and 404(a)(5) and maybe add some things that aren't too expensive, then folks are going to try and live with that. They want to continue to stay in business. I think most of the folks that we represent say that they can live with a best interest standard that makes sense.

A lot of the guys that, folks we represent say, substitute 404 and -- you know, we've lived with 404 for 40 years. We know what it says, we know how it's been interpreted. You're right, it does say solely in the interest. But we've been able to sell our products under 84-24, get exemptive relief under 406(a)(1)(A) and (B) and still live within the confines of 404.

MR. CANARY: Only I guess two questions for Jon on the HSA issue. So currently would there be brokers and insurance agents who would be subject to regulation under FINRA rules or state insurance rules for providing investment advice to HSAs?

MR. BREYFOGLE: That's a good question. I think if a broker was giving advice it would be subject to FINRA suitability requirements. I don't know that they do. I think part of the issue is custodians that make available the investment platforms for HSAs.

So if you look at the request that we have is that there would be a platform carve-out. That's more of our issue, as opposed to people actually giving advice on the HSA itself. It's just that it's a linked product to a high deductible health plan. They don't have to include investment funds.

Custodians that are exposed -- and some of them could be affiliated with insurance companies -- that are exposed to potential liability because the platform exemption doesn't extend to them. I think that would be a concern.

Another concern would be the companies themselves provide educational information and assistance on the health plan selection which could extend to: here's how your HSA works, here are the options that are available under this HSA product that we have.

So there's a worry that just the sales and marketing of a high deductible plan, coupled with an HSA, could push an insurance company, the distribution force also, over the line, again, because of the concerns about the broad definition.

MR. CANARY: All right. Thank you. If I've got it right, so an alternate solution to a total carve-out would be looking at the platform provider provision and having something specific there.

MR. BREYFOGLE: Platform provider provision would be a helpful way. Expanding the examples for the education carve-out would be a helpful way. A carve-out for smaller balance HSAs that are predominantly in bank deposit accounts would be a helpful way.

So there are other ways -- you know, clearly we would like to see a broader exclusion, but there are other suggestions that are in the comments and not necessarily in the testimony of the AHIP and Blue Cross.

MR. CANARY: Thank you.

MR. HAUSER: Thank you all very much. Okay. We are on to the penultimate panel for today, Panel 6.

(Pause.)

MR. HAUSER: Whenever you're ready.

MR. STEWART: Thank you. Good afternoon, everyone. My name is Maurice Stewart, and on behalf of the Penn Mutual Life Insurance Company, I want to thank you for the opportunity to be able to share our views on the proposed rule.

The Penn Mutual agrees that advisors should always serve the best interest of their clients. In fact, I've been doing that for almost 63 years in the business, so I stick by believing it.

Before we get into specific areas of concern with the proposed ruling I'd like to help you better understand how, and why, hundreds of thousands of advisors like me are deeply dedicated to our clients and doing business as we have.

First of all, I'm an old farm boy from Iowa. I ran our family's 600 acre farm from about the age of 13 when my mother was killed in a car accident. I served my nation I think honorably in Korea with the Strategic Air Command. When I came back I felt a great calling to serve people. I was, frankly, very close to going into the ministry but chose to enter the life insurance industry for three basic reasons.

First of all, like the ministry, I could serve people. It's a calling that's been with me throughout my life in the 60 plus years I've been in the business. Secondly, I had the independence to choose the people that I could serve and they had the independence to choose me. Third, it allowed me to be compensated based on the continuing service to my clients, not simply based on a one-time transaction.

This has led me to frankly have a wonderful life based on lasting friendships and relationships that I've developed during my career. These relationships have been built solely on trust, knowing the goals and the needs of my clients and my clients allowing me to help them achieve their goals over their entire lifetime.

Since I began my career in Topeka, Kansas in December of 1952 I've worked with tens of thousands of clients through multiple generations, and the majority of them stayed with us because of their trust in us because trust is everything.

I believe that the reason for my success and the success of my associates is to serve people through building lifelong trusting relationships, and trust is the reason for the success of the vast majority of advisors that I know in our industry.

In fact, I frankly live by a pledge that I took many years ago, some 35 or 40 years ago, from the Society of Financial Service Professionals. Here's the pledge: In all my professional relationships I pledge myself to the following rule of ethical conduct. I shall in the light of all conditions surrounding those I serve, which I shall make every conscientious effort to ascertain and understand and render that service, which are the same circumstances I would apply to myself.

Now, we live by this pledge and we believe that serving with distinction is the only honorable thing to do, and to leave our clients and our companies better off than when we got there.

Over the last few decades that I've been in the business I've been able to witness the fruits of the labors of myself and other associates as many of our original clients have now retired securely and left their families financially securely upon their death. But there's nothing more rewarding than having contributed to that piece of mind in any of those circumstances.

A few years ago I wrote a book entitled *The Miracle Business*, and in it I said, this industry provides us with the privilege and opportunity to help others just when they need it the most. Frankly, we're very, very passionate about our work. We believe in what we do and the impact that we have on the lives of so many, our clients and our associates, and we find new opportunities every day to renew that passion because of the service to our clients.

I hope you can see that this passion is working for the best interest of our clients, and I have always demanded the same standard of those who worked with me. Our success individually and as an industry can only be measured by the good we have in helping our clients.

I've always believed in and made certain, as

I said, my advisors believed in understanding the clients' needs, their goals, their dreams, throughout their entire lifetime, including, of course, retirement. You just can't sell them something and leave them alone. You must be with them throughout their lifetime, helping them through the inevitable changes that we all go through.

Reaching that understanding requires difficult conversations. That's because people don't want to talk about dying, disability, or how much money they really will need for retirement. It's an advisor's job to help the client look in the mirror, help them deal with their eventualities, and make decisions.

When it comes to retirement planning today the majority of responsibility, as we all know, lies with the individual and the small business owner. Defined benefits plans, as been mentioned earlier, are virtually extinct today and social security continues to deal with its ongoing funding concerns, so it's really up to the individual to make that important, the important decisions that will impact them for the rest of their life.

Now where will he and she get that information and education that they need at this critical phase of life? Frankly, I feel that our industry does the best job in helping them learn to make the good decisions.

Now let's talk about the rule. I believe that the Department of Labor focusing on the best interest of class is fully aligned with the way that I, and the vast majority of our advisors, conduct their business, and in my case, over the 60 years.

However, while its intentions are noble, the fiduciary rule as proposed has gotten a number of things wrong. It is particularly unworkable for those of us who sell life insurance products like annuities. I believe that the rule as presently drafted would ultimately work to the detriment of the customers it's designed to protect.

That's because the business is all about building that long-term trusting relationship I mentioned with our clients. It's not a transactional business, a once and done business.

It often takes us up to eight to 10 meetings to work through a client's goals because many of our meetings are with a team made up of the client's attorneys, their accountants, and other advisors that they have because we want to be absolutely certain that we're doing the very best for our client.

Then it becomes our responsibility to meet at least annually with a client to re-educate and update or change, depending on what has happened in their life.

The proposed rule turns everything we've come to love about the business and what our clients have come to expect on its head. Signing a contract with mountains of disclosures before doing anything else immediately erodes the trust that must underlie the relationship that we're building.

You know, it's like my going to the doctor's office with an ailment and I'd have him, before the doctor examines me or even diagnoses me I would have to sign a contract on what it would cost. I would not do that, and frankly, I don't feel that a financial planning client would want to do the same before they had a complete analysis.

Thus, my biggest fear of this proposed rule is that the people who need it the most will walk away from their retirement planning, which will exacerbate an already challenging planning crisis that we have in America that we all know.

I think that companies will limit, or perhaps stop, their participation in the retirement area. I also think that individual advisors will leave the retirement business and focus on other less risky investment areas and insurance. The ultimate loser will be the individual and the small business seeking much needed investment advice.

There will be a, less choice in terms of products and advisors, and there will be less education of the value of the important retirement products like annuities.

The idea of formulating a process and ensuring that an investor's best interest are protected is a great one and one that Penn Mutual certainly supports. However, the present rule does not work in practice, particularly for life insurance products.

The thinking that seems to underlie the rule runs contrary to my 60 years of experience in this great industry. In my life I've lived through four crashes and many market downturns. Through all of that, I don't know of any client that's lost their money in our industry.

We not only educate people, but we also keep our promises, and we often say promises made, promises kept. This is what happens in our day-to-day interactions with our clients.

Now, look, there's no doubt that there's always been bad actors in our business, as there are in professions, institutions, and perhaps even in government. Unfortunately, these people will always find a way around the rule.

Creating regulations that's based on false presumptions that advisors don't act in their client's best interest is inefficient, ineffective, and unfair to the vast majority of good advisors, and ultimately the public.

One thing I'd like to add is this. The Penn Mutual Life Insurance Company was founded in 1847, and during that 168 years it has lived up to what we have talked about here today. At the present time we have $100 billion of life insurance in force, and the reason that we have that is because of the trust that our clients have placed in it.

Last year The Penn Mutual paid out over $650 million of benefits to our clients, and I think that proves that we are looking for the best interest of our clients.

I truly believe that this proposed rule will harm the millions of individuals and small businesses who benefit from our service. I simply ask this. That you consider the millions of good folks that will be hurt in a quest for what I think is almost the impossible. In doing so, we ask that the Department work with the industry experts who will be before you in the future, and will you please redraft this rule into something that will truly serve the public's best interest. So with that, I thank you for your time.

MR. HAUSER: Thank you. Mr. McCaffrey?

MR. MCCAFFREY: Sure. Good afternoon. My name is Steve McCaffrey and I serve as the chairman of Plan Sponsor Council of America, also PSCA. I'm also -- that's a voluntary position. My -- also, my employment, which it pays me to be here, is working as senior counsel for National Grid in which I advise the fiduciary committees both on the investment side and the HR side. I am not representing National Grid in this capacity. I'm not making any testimony in that capacity either.

The Plan Sponsor Council was established in 1947 and is a diverse collaborative community of employee benefit sponsors working together on behalf of more than seven million employees to help Americans save for retirement and expand on the success of the voluntary employer sponsor retirement system.

We are one of the nation's leading consumer advocates for plan sponsors. We represent the interests of plan sponsors of all sizes, industries from around the country with the involvement of planned recordkeepers, investment firms, advisory firms, education firms, and insurance companies.

It might be a surprise to most people, but 44 percent of our members employ fewer than 100 employees, and 34 percent employ fewer than 50 employees. In this respect, PSCA is able to speak to the impact the proposed changes may have on many different stakeholders.

The number of Americans working, saving for retirement has grown dramatically in the past 40 years. The growth in the level of participation in employer-sponsored retirement plans and IRAs has significantly altered the market for retirement advice as a result of all of the fiduciaries are even more critical now than ever.

PSCA appreciates the Department's continued efforts to update the fiduciary standard to reflect the fast-changing investment and savings landscape. We also appreciate the Department's careful consideration and adoption of many of the PSCA's views on important topics over the years.

PSCA members have spent the last several months on a weekly basis to carefully evaluate the proposed rule, and as we continue to understand the rule we stand ready to work with the Department develop and implementing rule that is in the best interest of all American workers.

PSCA supports the core goal and approach of the proposed rule and extended protections of ERISA fiduciary standards. We believe our retirement system will be greatly strengthened by ensuring that investment advice is provided in the recipient's best interest.

PSCA views the proposed rules as a mean to protect pre-retirees and retirees as they approach the decumulation phase, where they begin withdrawing retirement assets. However, after reviewing and discussing the proposed rule a significant segment of our members, it is clear that additional clarification on many of the provisions is needed to avoid regulatory confusion.

As the DOL works to improve the proposed rule, we want to recommend that the final regulations include additional examples and model language to show up in many of the definitions under the rule. The purpose of my testimony today is to discuss in greater detail several of the clarifications we seek and why they are necessary. PSCA hopes today's testimony will help the Department to improve the proposed rule, mitigate the potential for any unintended consequences, and strike a proper balance between investor protections and flexibility.

PSCA submitted a comment letter on July 21st which provides an extensive look at the proposed rule. My testimony today will concentrate on two of those points.

First, PSCA wants to ensure that American workers continue to receive balanced factual investment education. PSCA is concerned that the proposed rule as written could negatively impact access to and distribution investment education materials.

PSCA members are concerned that now IB 96-1 could have unintended consequences that would particularly be harmful to small employees and participants. Plan sponsors are concerned that the availability of educational services would be limited or become more costly if the proposed rule is finalized without additional clarification.

Our principal concern is that if investment education is deemed to be investment advice, providers may no longer offer these services or will impose advisory level fees, making the information unattainable for many employees.

Secondly, we are concerned about the potential adverse impact of the proposed rule on small plans. With respect to my first point, PSCA believes that the current guidance on IB 96-1 should be preserved in its entirety.

In our view, IB 96-1 has worked well in providing a reliable and workable model with which plan sponsors, service providers, participants, and other stakeholders are familiar. This familiarity and reliability would only become more important as the marketplace adjusts to the changes of the proposed rule.

Specifically, PSCA would recommend amending the proposed rule so that the investment education materials that include asset allocations model or interactive investment models also include plan options and asset classes they represent to be included within that categorization without being deemed as investment advice.

We would underscore the absence of these helpful asset allocation models and interactive investment materials would increase decisions required of participants during plan enrollment and investment selection process. This in turn would undermine sponsors' efforts to increase appreciation for one, participation in the plan.

While PSCA understands the Department's concerns about steering participants to particular investments, we believe that the identification of investment categories and the available options in that category within the plan relative to asset allocation models and interactive investment materials helps participant and, understand and connect the dots between general information on asset allocation and correspondent investments in a plan.

Importantly, one without the other runs the risk of failing to educate a participant on how to effectively use an employee's plan and that detriment to his or her interest. Accordingly, PSCA believes that the proposed rule to be finalized with changes, without changes, it could decrease the value and effect of nested invested education.

To underscore the importance I'd like to share with you the results from PSCA's 57th annual survey which shows that the most common reasons for providing education among plans of all sizes was to increase participation 77.5 percent, increase appreciation for the plan 72.9 percent, and increase deferrals 74.9 percent.

The plans with one to 440, 49 participants, 78.1 percent of respondents indicated that plan education was provided to increase their appreciation for the plan.

To the extent that the DOL is unwilling to preserve PS, IB 96-1, PSCA believes that there are ways to permit the identification of specific investment options without risking the abuses described by the DOL if certain principles are taken into account.

For example, proposals that are based on neutral informative descriptions, the participant's option should be permissible under the carve-out. In providing this neutrality the focus should be on factually comparative nature of the information, and whether it's being provided in a manner does not give level to a rise of, to the level of a recommendation.

In this regard, both the DOL and PSCA have been weighing the pros and cons of alternatives, such as permit the identification of a specific investment options when the education is paid for at a fixed unconflicted basis, permit the identification of specific investment options when the education is provided by independent third-party, permit the identification of the specific investment options when the education discloses each available plan option in a given plan asset class, and/or permit plans to continue relying on 96-1, but do not extend this ability to IRAs because the marketplace for employee benefit plans is considerably different from the marketplace for IRAs.

While IRA owners has access to an unlimited universe investments, plan participants and their beneficiaries select investments from a line selected by prudent plan fiduciaries.

We believe that each of these alternative solutions can address the concerns raised by the DOL and would permit plan sponsors to continue it, albeit at greater cost, to provide valuable education in certain instances.

However, as noted above, PSCA believes that service providers should be able to identify specific investment options under principles established in 96-1, subject to certain additional conditions to ensure neutrality. Once again, PSCA welcomes the opportunity to work with DOL as it considers these, and other, alternatives.

With respect to the second point, PSCA is concerned about the potential adverse impact of the proposed rule on small plans. For example, the proposed rule's broad nature could be, cause plan sponsors to and providers to be unsure what they can offer as investment education and this uncertain ambiguity might impact the availability of valuable plan administration or compromise the ability of small plan sponsors to obtain the broad array of services that fit the needs of the plan participants.

Our 57th annual survey of 401(k) providers and profit sharing plans suggest most employers look to their provider to deliver retirement education. For example, among plans with 50 to 199 participants that offer retirement education, 70.6 relied on third-party for part, or all, their education services. Only 27 percent delivered the education themselves.

Conversely, of plans with 5,000 or more participants, 54 percent indicated relying on third-parties. Imposing the burden of developing these programs without the help of the providers could impact small employers' willingness to establish or maintain plans.

Also, the absence of the helpful asset allocation models, interactive investment materials would increase decisions required of participants during plan enrollment and investment selections. This in turn would undermine sponsors' efforts to increase appreciation for and in participation in those plans.

PSCA also believes that the platform provider carve-out should not be limited to large plan sponsors. We would recommend retaining the current construct of the carve-out so that it applies to plan sponsors of all sizes. PSCA does not support limiting the plan's platform provider carve-outs to large plan sponsors for several reason.

Extending the carve-out to plans of all sizes would be more consistent with core ERISA principles. We recognize that small plan sponsors are equally capable of understanding when a platform provider has financial interest and would avoid the imposition of difficult administrative issues related to potential providers.

PSCA believes the decision by the DOL to exclude plans from the platform provider carve-out would create confusion in the marketplace and provide potentially create an undue burden to certain small plan sponsors. Limiting the carve-out to large employers would in essence make every platform available to small employers and advice product.

PS believes that small plan sponsors who want to use a platform but do not need to obtain related investment advice should not be subjected to the increased cost of the advisory platform.

In practical terms, PSCA agrees with the DOL that some small plan sponsors may not be as sophisticated as large plan sponsors, and that those plan sponsors should be protected when they obtain investment advice from a service provider. However, as noted above, plan sponsors of all sizes are obligated to understand and hold their fiduciary duties.

They are clear and many small plan sponsors who, for various reasons, would benefit from having the same platform provided carve-outs that plan sponsors have.

MR. HAUSER: If you could wind it up, Mr. McCaffrey.

MR. MCCAFFREY: In addition, PSCA believes that an undue burden will befall plan sponsors if the platform provider is applied on a size basis. As plans grow, would decline in size since it is unclear how the use of the platforms would be expected to change as the applicable threshold is crossed in either direction.

In closing, on behalf of PSCA I'd like to applaud the Department's efforts to maximize consumer protection for plan sponsors, fiduciaries, participants, and we're willing to listen and work with you on that. Thank you.

MR. HAUSER: Thank you. Mr. Naylor.

MR. NAYLOR: Thank you, Mr. Hauser, Mr. Piacentini, Mr. Canary, Ms. Lloyd, and Ms. Borzi. Thanks for allowing me to testify on behalf of more than 400,000 members and supporters of Public Citizen -- savers, retirees and recipients, and existing -- all of them.

I'm the financial policy advocate. Formerly, I was the chief of investigation for the U.S. Senate Banking Committee, and among other previous positions worked with the Teamsters as the director of corporate affairs which interfaced with the $100 or so billion in retirement savings. Needless to say, ERISA and the Department of Labor has some experience with the Teamsters pension funds.

I've heard a number of fictions tacit today so I'd like to begin with a couple of fictions explicitly. In Douglas Adams' *Galactic Hitchhiker*, Arthur Dent arrives on the planet at about the time of the caveman where he comes upon a debate on monetary policy. It seems that the previous administration had declared the leaf as common tender which led to massive inflation, so the new tough monetarists had ordered that all the trees be cut down to limit the money supply.

And our hitchhiker is aghast, saying that you're cavemen, you're discussing monetary policy when you haven't even invented the wheel. Oh, and we have invented the wheel but the marketing Department has yet to decide on the color. Who are you people?

Well, they explain that there was this advanced planet composed of leaders, workers, and another class of telephone sanitation engineers and this planet was exposed to annihilations so they needed another planet and they chose Earth, but they needed first that all the telephones be sanitized before the workers and the leaders arrived there.

Surprisingly, the telephone sanitation engineers have been there for eons, but the workers and leaders have not come yet. So we are, in Douglas Adams' view, the heirs of telephone sanitation engineers. That is to say people whose purpose in life is suspect, according to him.

Now I think reality intersects with that because in, 1870 is the date at which less than half of us became farmers. In other words, half of us fed the other half. But now fewer and fewer people are really necessary to feed the rest of us -- in fact, it's about one percent of us feed the rest of us -- so we have to find something else to do and one of those things that is highly remunerative is to be close to money.

Now one of the main problems of money, one of the main rules of money that you are the stewards of is fiduciary trust. We can look to another piece of fiction to understand that. Jane Austen wrote a wonderful story called *Sense and Sensibility* where she begins with a legacy that Mr. Dashwood has entrusted to his son, but it is meant for the care of not only the son, but the siblings as well.

Mr. Dashwood confers with his wife and they discuss how giving so much money to these other people would perhaps remove their incentive, it would perhaps be luxury to which they'd be unaccustomed, and basically they talk themselves into the fact that they really shouldn't give them any money at all but just engage in such neighborly acts, I think, as are appropriate.

I think we're here today because we have a lot of people who I think need to receive very careful instruction as to how to manage other people's money. There are roughly 140 million people employed in America, and a little more than two million of those people are in the job of selling other people financial products.

Let's take Penn Mutual, for example. If I want to get financial advice from Penn Mutual, what I'm offered are a series of possibilities. They, themselves, are not going to actually pay me money.

They in turn, for example, Annuity Fund No. 2, will have as one of its options to invest in something else, an aggressive growth fund, for example, for which I'm going to pay a commission to Penn Mutual, Penn Mutual is going to pay a commission to this mutual fund, and then this mutual fund is going to have asset managers, one of them happens to be Goldman, Sachs, and you will have to pay a fee to Goldman, Sachs.

Now it's not Goldman, Sachs that's producing the money. They in turn will be investing in other enterprises. Now one of them I happened to look at was called Chesapeake Hotel Fund. They in turn are a management fund. They actually don't really own properties, that I understand. They actually manage properties.

I chose that one -- I actually worked backwards -- because that's one of the nearest hotels here. It's a Courtyard Marriott. So in other words, the people, the housekeepers and so forth, they're actually creating value that will finally wind up in my pocket once I buy Penn Mutual. It has to go through three, or four, or five stages before it actually does accrue to my pocket.

My colleague on the panel says that Penn Mutual has been in business because it has enjoyed trust. Well, when you read the prospectus it invites you to understand there are conflicts of interest.

For example, at the end of the same mutual fund that I described, and if you'd like, you can maybe answer this, but it says, individual registered representatives typically receive a portion of the compensation that is paid to the broker-dealer in connection with the contract depending on the agreement between the registered representative and their broker-dealer.

Penn Mutual is not involved in determining that compensation, which may present its own incentives or conflicts. You may ask your registered representative how he or she will be compensated for the transaction.

So among my questions is, are these questions, do they come up? And how do you explain, for example, that compensation does not interfere with the proffering of advice? If I may.

MR. HAUSER: Honestly, I'd prefer that questions, that we do the questions --

MR. NAYLOR: Well, Mr. Hauser, could you ask specific questions about Penn Mutual? It's a company that is not public so that one can only see what they publish in a limited amount, but its first and repeated phrase, it's that it serves a noble purpose. Now I mentioned that there are certain fictions, but there are certain truths that apparently the insurance industry wants me to understand.

I was in Rehoboth yesterday and I learned that 15 minutes can save me 15 percent or more. I have learned by watching sports that I am in good hands with Allstate and -- or was it State -- I -- pardon me. That's what, apparently, State Farm, or Allstate, or Geico want me to understand.

I actually haven't seen an advertisement that says, as one of my colleagues said before, it's not wise to invest in one stock. You know, that's almost more in tune to me than 15 minutes will save me 15 percent or more. Or that diversification is wise. I don't see constant repetition of that.

So my -- I guess my bottom line point is I am concerned that these are products being sold. This is not impartial advice. I doubt that Penn Mutual says, listen, looking at your portfolio you should buy an Allstate product. I don't think they would be compensated that way.

Listen, I actually think you shouldn't buy, you should just put yourself in a Vanguard Mutual Fund that's indexed, you really should not buy our annuity. I rather think that's not reality. Therefore, I welcome this.

I welcome the fiduciary standard. Public Citizen is very concerned with the mandatory arbitration proposal. I think it renders, it's a fatal flaw in the best interest provision. That -- I think much needs to be done to help Americans save. You're on the right track. There's clearly far more to go. We stand in strong and enthusiastic support of this rule.

MR. HAUSER: Thank you.

Mr. McCaffrey, if -- maybe I'll just start with you. I just have a couple questions. The first is I don't know if you were here for the first panel of the day.

MR. MCCAFFREY: I was not.

MR. HAUSER: Okay. But the -- we had people I would say who are generally supportive of the rule, but they all, kind of like you, thought that we should permit in the plan context when somebody's being given asset allocation guidance, we should go ahead and permit that to be coupled with, you know, specific references to the products on the fund line up that match those allocations.

The suggestion further was that one way to deal with the, our issue, I mean in light of the fact that there's a separate fiduciary overseeing the funds, was to provide that that would be perfectly fine if all of the plan options that fit within the category were provided as illustrations, and if that advisor didn't have a stake in, you know, a direct financial interest in the reference. Does that make sense to you? Do you think that's where we should be heading?

MR. MCCAFFREY: Yes. I mean I think if we're able to, as a plan sponsor or as a plan sponsor community, if we're able to say that it should be a large cap investment of say 20 percent and we can lay out all the possible category, all the possible components in that fund -- you know, some investments, some plans only have that one large cap fund which is going to make it difficult. Very often it's a provider's fund.

I mean to the extent that we can go out there and say there's five different funds that meet this cap, large cap investment alternative, then, yes, we'd be fine with that.

MR. HAUSER: And by the we, you're referring to the financial services company that works for the sponsor?

MR. MCCAFFREY: No. I'm talking plan sponsor. Yeah.

MR. HAUSER: All right. So I mean there's a separate issue there that I think is just worth mentioning which, from our standpoint at least, unless a sponsor is getting compensation in connection with the communication, they're not going to be an investment advisor for a fee under our statute, regardless.

MR. MCCAFFREY: Agreed.

MR. HAUSER: They may have other fiduciary issues, but this rule doesn't change that. I mean just so --

MR. MCCAFFREY: Right.

MR. HAUSER: Okay. Then the other thing I think you mentioned, and I just want to be sure we're, at least that I understand what you're saying, is that you think that neutral descriptive materials should be able to, about fund options I guess and the like should be able to be provided.

MR. MCCAFFREY: Right. I mean if we're able to go out there -- well now you're talking about from the financial services or you're talking about from the plan sponsor?

MR. HAUSER: Well either -- yeah. I mean from -- I don't -- as I said, I'm not sure the plan sponsor often has a problem under, you know, a liability issue under this rule. I think --

MR. MCCAFFREY: Right. So I guess if a participant's asking what is a large cap investment and we're trying to give them factual information, I think either the provider or the plan sponsor would be very happy to be able to provide them with that information and say this is investment education, it's not advice.

MR. HAUSER: Right.

MR. MCCAFFREY: I think, from that perspective, we'd be fine with that.

MR. HAUSER: And is your organization clear that this was our intent -- I mean tell me if you think we need to say more on this score -- but that, you know, when it comes to describing what the fund options are, what their attributes are, what the fees are, what the historical performances, and expenses, and all that is, that none of that is covered as investment advice under this proposal.

MR. MCCAFFREY: Right. We're comfortable that you're explaining that that's a factual point of view. If we're suddenly then going, or they're going further than saying something about a specific investment which happens to be their own, we understand you're considering that advice.

MR. HAUSER: Right, but I guess my point is that you're always able to describe the attributes of the particular funds on the fund line up without crossing a line and giving fiduciary advice. It's only when you make a recommendation under our proposal --

MR. MCCAFFREY: Right.

MR. HAUSER: Okay.

MR. MCCAFFREY: We're good with that. I mean the other point, and we've had discussions with this as far as on the decumulation phase, the plan sponsors would appreciate some type of safe harbor where they can go out and say I can talk about the current investments in the plan, sponsor's plans versus what's an IRA, what's a, versus annuity and so forth, because currently, today, we don't feel comfortable being able to say that. We don't think we have fiduciary protection to do that.

MR. HAUSER: Can you walk me through that?

MR. MCCAFFREY: Sure. So as a group of plan sponsors, I won't say specifically me, as I said, I'm not testifying on my behalf, but I mean I don't think plan sponsors today feel comfortable being able to walk out and say there's a bright line out there saying, you know, if you go into an IRA there's much greater fees, there's greater, there's no fiduciary protection similar to what you currently have today in your plan. So is it a good idea to stay in the plan, or are you, as a plan participant, are you knowing of all the different alternatives you may have?

Plan sponsors today, I don't think, are comfortable being out there and saying to a participant, you might want to consider staying in the plan and evaluate all these different reasons, or if you decide to go out into the IRA you may lose your fiduciary protection, you may incur additional fees.

Yes, you have a whole lot of investments that you can go into, but there are other sides to it that are not necessarily the value of what, being, staying within the plan.

MR. HAUSER: So under the rule as proposed we provide as one, as part of one category of information that would not be treated as investment advice describing the terms or operation of the plan or IRA, informing a plan fiduciary, participant, beneficiary, or IRA owner about the benefits of the plan or IRA participation, the benefit of increasing plan or IRA contributions, the impacts of pre-retirement withdrawals on retirement income.

So we intended that you be able to tell your participants about the benefits of essentially leaving their money in the plan and the importance of taking advantage of whatever contribution arrangements the plan provides without crossing the line of being fiduciary, but do you think we need to do more work on that score?

MR. MCCAFFREY: I would think if you're able to give us some type of a bright line through a schedule or something that actually shows it to people so they can see this is what, where you go -- as I've explained to people is this is, here's the different advantages you have as a in plan model, here's the disadvantages or advantage you have in the IRA world, here's what you may have in the annuity world. If there's some type of example or a statement in the regs, I think that would be wonderful.

If that gives us the comfort -- it may not be a safe harbor as we know safe harbor, but additional explanations and examples would be wonderful. Yes. Definitely.

MR. HAUSER: Thank you.

Mr. Stewart, thank you very much for what I thought was a very eloquent and heartfelt discussion of your life's work. The only question I really have for you is that it seemed to me that part of what concerned you the most about our proposal was essentially the, that requirement that you execute a contract and the timing of that contract proposal. Again, I don't know if you heard this morning's --

MR. STEWART: I did not.

MR. HAUSER: -- conversation either, but one of the suggestions that was made was, well what if -- you know, the contract essentially doesn't need to be executed until you're actually at the point of, in this case, investing in the annuity, and then essentially, if you're at that point and money's going to transfer and you're entering into the contract with the person, at that point you would just indicate in the contractual papers that, you know, the recommendations I made to you adhered to these standards, these best interest standards.

So they're -- and as to existing customers, if you have ongoing advice relationships maybe you just send out essentially a notice to the participants or to your customers with negative consent.

If you send out the notice you say, you know, this is -- we're going to be acting in a fiduciary capacity, we're going to act in your best interest in this matter and, I suppose, tell us if you object, but -- and that would be that. Would that -- how far would that go towards answering your concerns?

MR. STEWART: I think if we had the opportunity to understand what the client's needs, desires in all areas of their financial world and we arrive at what would be a proper conclusion, then some type of an agreement, as far as I'm personally concerned, would be agreeable. May I answer the gentleman's question?

MR. HAUSER: Yes.

MR. STEWART: Would you ask me the question?

MR. HAUSER: As I heard it, he was -- he read some of the disclosures from Penn Mutual which suggested that the representatives may have conflicts of interest, but that Penn Mutual itself wasn't exactly telling you what the magnitude of those conflicts of interest were, you should go ask, and I think he was asking.

MR. STEWART: With The Penn Mutual, as with a lot of good companies, first of all, our associates and our agents, advisors, whatever we should choose to call them, they have a contract with The Penn Mutual, but might also have contracts with several other companies. May I just use one situation as an example?

If you have a client that has a particular need for a particular product that The Penn Mutual does not offer or is not very, very competitive with, then we want our associates to place that business where it's going to be in the best interest of the client.

The answer to the other question is, would we tell them what our compensation? Absolutely. I have no problem in the world in telling someone what my compensation is for any particular product.

Now do I have the understanding and the ability to break out all of the different charges within some of the say annuities, or variable annuities, or something of that nature? I frankly don't. But what I will do is to have a client get in on a call with the executive vice president of our, of The Penn Mutual or whatever company it is. They will in turn lay out entirely what the charges are, what the compensation is, because I want the client -- see, understand one thing.

The most important asset that I have in life is my reputation. After 60 years, I think I have a pretty decent reputation with my clients and the industry. That comes from being absolutely certain that the clients understand what I do for them and I understand what they need, and we follow through no matter who that business is going to go with.

Now we would hope that it will, a lot of it will go with Penn Mutual, and it does because The Penn Mutual has very, very competitive products, very, very competitive compensation agreements, but, and as important as anything else, they go to the 'nth degree, as does our industry, in education of the advisors.

Here I am at the age of almost 86 still learning. Of course as we go through all of the changes that we have in the financial world today, there's a lot more to learn. Our folks are going through constant education from the company, from the American College which is in Bryn Mawr, Pennsylvania, that does all of the advanced education, or a lot of the advanced education of our industry, we all have extra degrees. I have three separate degrees from the American College, which is simply getting more knowledge to understand better how to serve our clients.

In the final analysis, I want my reputation to be intact. I want The Penn Mutual's reputation to be intact. I want the client to look me in the eye the day before they die and say thanks, or before, and after they retire and say thanks because they really mean it.

MR. HAUSER: Thank you.

MR. CANARY: One question, Mr. Stewart. Let me follow up on Tim's question. There's been a certain amount of testimony about a seller's exception.

MR. STEWART: I'm sorry?

MR. CANARY: The seller's exception to the fiduciary rule. Have you heard any of that? Well, if you have or not, I think the --

MR. STEWART: I've heard about it, but I'm not that up on it.

MR. CANARY: Okay. My question is from the sounds of at least your practices, you're not looking to have a seller's exception where you can act as a salesperson in providing sort of information to your clients without becoming responsible as a fiduciary or at least responsible for acting in their best --

MR. STEWART: I think it all depends on how the fiduciary standard would be established and what's written because we're going to deal on top of the table, so to speak, with our clients.

I have never had in my 63 years a complaint or a suit, and I've known very few cases that, of all the agents that I've had or advisors I've had with The Penn Mutual and with other companies where we have -- probably less than half a dozen complaints that have been handled very judiciously. So it would depend an awful lot on what that fiduciary statement were to say.

MR. HAUSER: So could you maybe describe, just out of my own curiosity, what kind of help do you find your customers need in thinking about these products? What --

MR. STEWART: Well I think the first thing that they need, that we need to find out from them -- and this may be oversimplification but it's something they seem to understand -- I want to know, as -- let's talk about investments or retirement plans.

You know, at one time we had the defined benefits plans, which was everything that we had. At one time we had 1,800 clients with their defined benefit plans. As life went on and ERISA and everything else happened, and as the longevity, as I'm a proof of, got higher and higher, it had to be changed and we went to 401(k) plans, et cetera.

The important thing there, I think, is the fact that we understand that we must be able to move with the client in their particular -- I want to know what their sleep level is. Here are two situations that I was involved in in the last couple of months.

One client, as we went through everything -- and it was about the sixth or seventh interview, meeting that we had had. The attorneys were there, the accountants were there. That particular client is what I call a crap shooter, in a way. I mean they're, they want to invest, they want to take risk.

The other client, with about the eighth meeting that we had, is an engineer, very conservative, his sleep level is almost nil when it comes to -- he thinks a CD is a great deal. So there's a lot of education on behalf of both of them before we can make a recommendation as to what particular product or what particular service should be rendered. So I just can't nail it down to one thing.

MR. CANARY: Mr. Naylor, could you expand a little on your observation about the arbitration, the mandatory arbitration provision being a fatal flaw?

MR. NAYLOR: Fatal?

MR. CANARY: Right.

MR. NAYLOR: Yeah. Well I think it has been discussed by people far more expert who were present this morning. Mandatory arbitration, basically in violation of the Sixth Amendment, basically circumvents one's ability to join in a class-action where the pecuniary end goal of certain amounts of problems may not be such for a full court press.

In other words, if I'm scammed by $100 or $200 I may not wish to go through arbitration where, at best, I'm going to get $200 back, and possibly even less. But for low level scams, for example, I think it's important that there be class-action litigation.

I'm looking, by the way, at some of the record of Penn Mutual, before, the predecessor of FINRA, where sales contests, for example, led people to buy these products. Now presumably they, many of them aren't even aware how much they're scammed. Many of them may be aware but realize that, you know, I'm not going to spend 20 minutes on the phone with customer service getting my $18 back, let it going through arbitration.

So in other words, I think allowing the full throat of the American judicial system to prevail and keeping Wall Street, mutual fund, the insurance industry honest is important.

MR. CANARY: Thank you.

MR. STEWART: May I comment to that for just a second?

MR. HAUSER: Of course.

MR. STEWART: As I mentioned in my remarks, there are bad apples once in a while in our business, as I think there are in every facet of life. If we find that there is an advisor that is giving improper advice, then we're going to act on it ourselves once we find out about it.

We have the state insurance commissioner that we will deal, they'll deal with them, and in many cases -- let me give you an example. When I went to Minneapolis and took over an agency that had 27 agents when I got there, in less than, well four months, I had terminated all but four. Why? Because, simply, they did not live up to the standards of what you might call fiduciary standards to the clients. Then we rebuilt the organization with good people who believed in the right things.

So we have a lot of ways to be able to, first of all, weed out the bad apples and we're constantly watching for it. Take rollover plans as an example. We have a complete compliance Department that if there is to be a rollover on an IRA or something of that nature, it has to be approved by that compliance Department. I can assure you of one thing. They go through it with a fine tooth comb.

So we do have different areas that are established to be able to test the validity of the advice and to make certain that the client is taken care of.

MR. NAYLOR: If I can add that I think Penn Mutual, by structure, is probably better positioned than others which are, have a fiduciary responsibility to their shareholders to maximize profits, whereas Penn Mutual is essentially owned by its own customers.

But this is an industry that has some other actors in it. JP Morgan convicted of fraud, Citigroup convicted of fraud, Lehman Bros. that led to the crash. I mean this is an industry which, by its nature, attracts people who want to make money as quickly as possible, and unfortunately, according to the Department of Justice, which is about three blocks away, have committed frauds on macroeconomic level.

So I think if Penn Mutual can self-police the few bad apples, that's certainly welcome, but I think we have a serious problem that requires Department of Labor supervision.

MR. PIACENTINI: So I have two quick questions, the first one for Mr. McCaffrey. An earlier witness today said that they thought that fiduciary advice ought to include advice on the form of distribution, the form of annuity to take from a defined benefit plan. Whether, for example, to forego the joint and survivor provision.

An example was given where somebody did, was advised to forego that and then invest the extra that was paid as a single life annuity and some other vehicle. So do you have a view on that? On whether advice about a defined benefit, form of benefit should be fiduciary?

MR. MCCAFFREY: I guess from the plan sponsor side we are -- you know, 401(k) and most 401(k)s do not have annuities.

MR. PIACENTINI: Right.

MR. MCCAFFREY: And from the national grid side I guess I should not speak as to that point, but I do have an opinion which I'll tell you about offline.

MR. PIACENTINI: Okay.

MR. MCCAFFREY: But I'll decline to comment on that.

MR. PIACENTINI: Okay. Then I guess my second question for Mr. Stewart, the panel that just preceded this one, I think I understood some of the witnesses to say that there really ought to be an accommodation that the advice -- the interaction with somebody selling insurance products ought not to be held to a best interest standard when there's not a reasonable expectation on the part of the consumer that somebody would be acting impartially.

Yet I thought I've understood you to say that, in fact, you expect the salespeople who are distributing the insurance products to be acting impartially; specifically, for example, when you said if my company doesn't have something competitive, they ought to recommend something else.

So is it your view that a consumer who's talking with a representative about insurance products ought to be able, or usually does expect impartiality or not?

MR. STEWART: I believe that a consumer, a client that we are advising wants to: 1) be certain that we understand or -- let me back up. Most of our clients that we call on have never sat down and really thought through their financial future.

They spend more time getting a hair cut than they do thinking about their financial future, unfortunately, and they certainly haven't thought through the retirement area and how much money, honestly, it's going to take to be able to retire in the way that they and their spouse, you know, they've been thinking about.

So I really believe that it's important for us to understand their needs and the client to understand that we understand their needs. There's an old adage that somebody taught me, it was a minister that taught me, a long time ago when he said, they don't care how much you know until they know how much you care.

Once there is a caring, you might call it a caring relationship there, then we can have an open discussion as to what is in their best interest. Now that's why I welcome attorneys in the conversations, I welcome their accountants in the conversation, I welcome other advisors into the conversation.

One of the instances that I talked about was kind of interesting because the guy that's the, I called the crap shooter that likes to take risks, his attorney was on my side. He said, no, no, don't take those risks. But the person really believed that that's how he wanted to conduct his life.

MR. NAYLOR: Mr. Piacentini, you're hearing some interesting quandaries. You're hearing from Mr. Stewart that there's no need for a fiduciary standard because we're all good guys and we weed out the bad guys. You heard from the previous panelists that, hey, let's be serious, nobody thinks that we're doing anything other than selling. That we're not actually offering financial advice.

You're hearing the crocodile tears of an industry who believes it will not be able to help the small saver. That somehow -- what I take that to mean is they have to scam the small saver just a little bit to make up for the, you know, lack of percentage commission that they're going to make.

I think that, first of all, as Prof. Rhoades has pointed out, the small saver really isn't served very well at all. Frankly, I would welcome the Wall Street industry, if you will, staying away from the small saver. I think that will be a good thing if that threat is made good.

MR. HAUSER: I thank you all very much. Okay, the last panel of the day.

(Pause.)

MR. HAUSER: Okay. Well you're the last panel of the day so we're expecting great things.

MR. LABY: That's a lot of pressure.

MR. HAUSER: Okay. Whenever you're ready.

MR. LABY: Thank you for the opportunity to present my remarks. Good afternoon. My name is Arthur Laby. I am a professor of law at Rutgers University, and formerly, assistant general counsel at the Securities and Exchange Commission. I'm also a director of the Certified Financial Planner Board of Standards, but the views I'm giving you today are my own and not necessarily those of the CFP Board. My research at Rutgers focuses on the fiduciary relationship and on the duties and obligations of financial services providers.

I would like to use my time today to discuss what it means to be a fiduciary, to give a few concrete examples of why imposing a fiduciary duty on retirement advisors would be meaningful, and to address the argument that the DOL should defer to other regulatory agencies.

Under the rule, if a person gives advice to a retirement client, that person must do so under a fiduciary standard of conduct. What does this really mean? A person is a fiduciary if he or she has been given rights or powers to be exercised for the benefit of another.

The most common example of a fiduciary is a trustee who manages trust assets for beneficiaries. But many advisors, as you have already heard earlier today, are also fiduciaries, such as lawyers, doctors, and some, but not all, investment professionals.

In certain respects, requiring retirement advisors to be fiduciaries should not be controversial. Giving advice, unlike selling a product, is an inherently fiduciary activity. To give advice necessarily means to impart information in another's best interest.

Think of other types of advisors: lawyers, doctors, or even high school or college counselors who advise on a course of study. They all must do so objectively based on the recipient's interest, not based on self-interest or some other motive.

Once a person is a fiduciary, he or she must act in the client's best interest and in accordance with two primary duties, the duty of loyalty and the duty of care. Let's take a minute to understand what these entail.

The duty of loyalty is primarily a negative duty to avoid activity that would jeopardize the fiduciary's loyalty. Don't engage in theft or misappropriation. Don't abuse your position or otherwise take advantage of your client. Avoid or mitigate conflicts of interest or, at a minimum, disclose any conflicts to your client.

The duty of care has a different emphasis. The duty of care is primarily positive and it requires the fiduciary to exercise the care and diligence that a prudent person in similar circumstances would exercise.

Think about it. Most people engage a fiduciary, as you've heard earlier today, because they cannot or do not want to handle some aspect of their affairs on their own. What the client wants most is for the fiduciary to be diligent and work hard to promote the client's best interest. This requirement is captured by the duty of care.

Perhaps the best way to understand the fiduciary obligation is to look at examples of how imposing a fiduciary duty on a retirement advisor would actually matter to investors. And I will turn to some examples now.

Under the law today broker/dealer representatives who advise retirement clients are not always held to a fiduciary standard, although many present themselves as advisors and use titles, as you know, such as financial advisor or financial planner. Instead, brokers are held to a duty of suitability. They must ensure that investment recommendations are suitable to a client's financial situation.

As important as suitability is to investors, brokers, in most cases, are not required to act in a client's best interest. Why is this important? Take the example of a broker/dealer representative advising an investor on which mutual fund to purchase.

The broker is permitted to receive payments, sometimes called revenue sharing, from mutual fund companies in the form of 10, 20, or 30 basis points when the broker markets and sells the fund. Needless to say, when a broker is paid to market and sell a particular fund, the broker may be predisposed to favor that fund over others.

Now it is possible that this fund is suitable for the investor. It offers the appropriate level of risk for the investor at this time in the investor's life. The fund, however, may not be in the investor's best interest. Perhaps it's a higher cost fund than alternatives, or because performance has been lagging compared to peers, or other reasons.

Absent the rules we are discussing today, the broker can market and sell the fund to our investor because it is still considered suitable. Under a fiduciary standard, the broker must recommend the fund in the investor's best interest, even if that means a fund resulting in lower payments to the broker.

Another example of how a fiduciary duty matters is the way investments are allocated. Imagine a broker who has a limited quantity of a valuable investment. The broker faces a conflict among its clients when dispensing this valuable asset. This might happen, for example, in the case of an initial public offering.

An individual who is not a fiduciary could allocate the asset to favor clients, while other clients would never know what they missed. The suitability standard does not impose a duty to manage conflicts. A fiduciary obligation, however, would require the broker to manage and disclose the conflict and to arrive at a fair process for the allocation decision.

I would like to spend my remaining time discussing the view that the Department should defer to other regulators, such as the SEC and FINRA. Some argue that these regulators have securities expertise and developing a best interest standard should be left to them, or that Dodd-Frank gave the SEC authority to address a fiduciary standard and a DOL rule would contradict this congressional intent.

I am not convinced by the argument that the Department should delay. First, the SEC and the DOL administer different statutes with different philosophies designed for different purposes. Congress treated retirement assets specially by giving them preferential tax treatment and by protecting them through a fiduciary standard under ERISA.

Moreover, ERISA prohibits certain transactions, whereas the SEC very often regulates through disclosure. Thus, it is not logical to ask the DOL to wait for the SEC when the philosophical approaches diverge.

Second, as a practical matter, the SEC is not required to adopt a fiduciary rule, and it might never do so. In my view, the argument to delay, at least in some cases, is based on a hope that the SEC will not act or will adopt a rule that will weaken the applicable fiduciary standard.

In any case, waiting for an eventual SEC rule seems pointless. It would be one thing if the

SEC were under a deadline, but an SEC rule is discretionary. Also, it seems counterintuitive that the SEC's delay should cause the DOL to delay as well. If anything, the SEC's inaction makes the DOL's initiative more pressing.

Third, if the concern is conflicting regulation, there is little chance of that. The DOL has consulted with members of the SEC and its staff to guard against conflicts. Rules issued by the two regulators may, in fact, not be identical, but the financial services industry is used to dealing with multiple regulators who regulate the same activity.

In fact, advisors to ERISA plans are already subject to both ERISA and the Advisors Act. The key is to avoid genuine conflicts, and the agencies are working to that end.

Finally, action by the Department now could have salutary effects on an SEC rule down the road. First, I say what's wrong with a little healthy competition between regulators, right? But more seriously, despite the philosophical differences underlying the two statutes, there is great potential for the SEC to take advantage of what the Department is doing.

The best interest contract exemption, for example, establishes a framework for application of a fiduciary duty in the context of different compensation structures which are permitted by Section 913 of Dodd-Frank. If the SEC works to establish a uniform fiduciary duty, this framework and other aspects of the proposed rule could help inform the SEC's approach.

That concludes my remarks. Thank you very much.

MR. HAUSER: Thank you.

Mr. Allen?

MR. ALLEN: Thank you. Thank you to the panel for allowing me to be here today. Boy, what a process for all of you. I'm glad I'm here for a day. You're here for the week. So --

MR. HAUSER: You can stay the whole week.

MR. ALLEN: Yeah. I appreciate your hospitality, but I'll pass. I'm Jim Allen, CEO of Hilliard Lyons, and I've been with the firm for 34 years, in my twelfth year as CEO.

Want to introduce Hilliard Lyons which has a history that dates back to 1854, so we're 161 years old. Not quite as old as Penn Mutual, but in the same category. Based in Louisville, Kentucky. We have approximately $43 billion in client assets that includes about $6.5 billion from a trust company.

We have 70 offices in 12 states, and so we're, as a dual registrant -- we have a registered investment advisor along with our broker/dealer, and also the trust company -- we're accustomed to dealing with clients at all levels.

We share the DOL view that retirement savings is critically important. As we have considered the proposed rule changes we're concerned that client choice, pricing and/or cost, and access to valuable information all will be negatively affected if the rule is enacted.

This is especially true for smaller investors who have the greatest need for support. We believe that the proposed rule would create tremendous investor confusion as different rules are applied to different assets and accounts within the same household. Unworkable in its current form.

Now I'd like to highlight a few facts that I think support this view. You'll hear reference to numerous studies and surveys. The Oliver Wyman study reflects the fact that investors prefer a traditional brokerage account for holding IRA assets. In fact, for smaller IRAs, $25,000 and less, 98 percent of those accounts are in a brokerage context. I think for all IRAs that same number is 85 percent.

From a Hilliard Lyons perspective, our clients that have approximately $11.5 billion of IRA assets are represented by 82,000 accounts, for an average size of just under $140,000.

Hilliard Lyons' client data is consistent with the industry information in that 84 percent of our IRA accounts are in a brokerage format, while the remaining 16 percent are in managed advisory accounts. The assets in the managed advisory accounts on a per account basis are, on average, larger by a 2:1 margin, so $240,000 to $120,000.

This information is consistent with the Wyman data that larger accounts are better suited to support the costs and added responsibilities that go along with an advisory relationship. Accordingly, the managed advisory accounts carry a higher fee or cost component when calculated as a percentage of assets. In other words, the nonmanaged brokerage accounts are less costly, and as they should be.

I think it's also important to note that there has been a very distinct overall trend in our industry of client relationships moving in the direction of advisory. So against an industry landscape where there has been a strong push for advisory, IRA accounts have continued to be dominated by the use of the traditional brokerage account.

I strongly believe that IRAs, especially smaller ones, have been maintained in a traditional brokerage account because it's the right place, the most cost-effective place, for them to be. And I really think the facts support this.

It's our view that this should be re-proposed, that the best interest standard presented by FINRA is on the right path, and we would love to see a re-proposal and something done along those lines and would withhold judgment pending an ability to review a re-proposed rule. So, again, thank you very much for the opportunity to be here.

MR. HAUSER: Thanks.

Mr. Stolz?

MR. STOLZ: Okay. So we've gotten to the last opening statement of the day. I'm sure everybody in the room is very glad of that.

MR. HAUSER: We're always glad to see you.

MR. STOLZ: I know. I have to congratulate the four of you for staying so engaged. I was kind of hoping to score some points for the most creative opening statement but I think the last panel wrapped that one up.

So I am Scott Stolz, Senior Vice President for Private Client Group Investment Products at Raymond James. On behalf of Raymond James' 6,500 advisors, 10,000 employees that take care of, every day, the about million clients that we have, I want to thank you for having the opportunity to share our views here with you today.

I also want to thank the four of you for informally meeting with us several weeks ago. I thought it was a very healthy dialogue and I was very encouraged that we were all heading in the same direction, and that's to try and increase the retirement readiness within this country.

Raymond James is based in St. Petersburg, Florida. We've grown to a national firm like Jim's firm. I don't think anybody would describe us as a Wall Street firm by any stretch of the imagination. Our core principle is really service first. We believe that if we take care of the client, everything else will take care of itself.

This emphasis on taking care of the client and looking at things long term as opposed to worrying about the next quarterly earnings cycle has allowed us to achieve 110 quarters of consecutive profitability, something that we're proud to say was not interrupted during the financial crisis.

It's with this in mind that I way to say first and foremost that we understand the impassioned and serious debate that surrounds the issue here today.

Most of those in favor of this proposal want to frame this debate solely on whether or not a financial advisor should put the client's best interest first. Obviously, who can argue against that. As we've heard numerous witnesses today, they've all basically said they're in favor of that.

But as an example, a recent Department of Labor email to federal employees asking them to support the proposal stated the following. When you go to a doctor you expect that they will treat you in your best interest. When you hire an attorney you pay them to represent your best interest. Shouldn't the same be true for financial advisors who manage our hard-earned savings? Similarly, the AARP petition that's gathered about 31,000 signatures managed to reduce the whole issue down to a mere 189 words.

But, while we wholeheartedly agree with the objective of what the Department of Labor is trying to accomplish, we believe this debate is not about that, but the debate is on how we get there.

Once one fully understands the 600 page proposal the Department has put forth to achieve this mutually agreed upon goal, the only possible conclusion is that the rule as currently written is overly complex, would be incredibly expensive to implement, and would expose hundreds of thousands of trusted and well-meaning advisors to unfair legal liability.

Now, we understand that by opposing this proposal as currently written that we may be viewed as though we're not trying to put our client's best interest first, and this conclusion could not be further from the truth.

A full two decades before the Department first offered the revised fiduciary standard we put forth for our clients a client bill of rights that we give to every client when they become a client of Raymond James.

Amongst these 10 rights are the following: you have the right to expect financial investment recommendations based solely upon your unique needs and goals, consistent with the objective in enhancing your financial well-being. You have the right to reasonable investment alternatives selected based on your individual objectives and presented with full disclosure of risk and benefits. You have the right to know all costs and commissions associated with investment, as well as fees our firm charges for services.

I think anybody would agree that our advisory associates could not live up to that standard if we did not put our clients' interest first each and every day. We provided the Department with this document in our recent meeting and suggested such a document could be used by others as a guide to the fiduciary north star that the Department seeks.

Now on more than one occasion Secretary Perez has cited the case of the Toeffels as an example as to why this rule is needed. It's been stated that the Toeffels had accumulated a fair amount of money by investing in a series of Vanguard mutual funds.

They went to their bank who suggested to them that they purchase a, take $650,000 of that money and purchase what the secretary has labeled a very complex variable annuity. This annuity cost four percent per year and carried a charge to get out in the first year of seven percent, a charge that would disappear somewhere between the fourth and the seventh year depending on the share class they bought.

As best as I can tell, everybody who's heard this proposal has said that this is an example of poor advice. Even those who are against the proposal have been dismayed at the fact that they were recommended such a costly and potentially illiquid investment. However, if you look at other facts in this case the conclusion may not be quite so clear.

According to a *New York Times* article on this case, the Toeffels went to the bank saying that they needed an investment that would give them an income for life. The variable annuity that cost four percent would have included in that a lifetime income benefit that would provide them an income for life regardless of what the markets did to their account value, a concern that many retirees still have today after the financial crisis.

In addition, this variable annuity, as part of that cost, would provide a guaranteed death benefit that would provide Ms. Toeffel the whole, full $650,000 back upon Mr. Toeffel's death. The Vanguard mutual funds, while a much cheaper solution, would not have provided either one of these guarantees.

Unfortunately, the Toeffels' situation changed when Mr. Toeffels' health deteriorated. Not surprisingly, financial flexibility for them became far more important than lifetime income.

So as a result, one looking back would probably conclude that staying in the Vanguard mutual funds would have been a better choice, but what if the stock market had declined in value significantly by the time Mr. Toeffel had passed away?

Within the Vanguard mutual funds Ms. Toeffel would have been left with that depressed value of that fund. In the variable annuity she would receive the full $650,000, less any withdrawals that she had made. Under this scenario, clearly the variable annuity would have been better.

Let's change the facts yet again. Let's say Mr. Toeffel had lived a long and healthy life and all of a sudden the need for the lifetime income would have been very important. While the Vanguard mutual funds may have been a cheaper solution, they would not have been able to guarantee a lifetime income.

Now please don't misunderstand me. I'm not suggesting that the Toeffels received good advice or bad advice, nor am I making a case for variable annuities even though it may sound that way. What I do know is when doing retirement planning, unless you can tell me when the individual's going to die and what the markets are going to do until then, then all you can do is make the best suggestions you can based on certain assumptions.

But here's what else I know, is that any plaintiffs' attorney who would be quick to say that this four percent variable annuity was the wrong choice would be equally quick to say that the advisor did not put their client's best interest first if they did not suggest something that had a guaranteed income for life or provided some sort of protection on an untimely death.

Current securities laws and regulatory practices protect advisors from unwarranted Monday morning quarterback playing to some degree. Unfortunately, the Department's proposal will strip these protections and open a Pandora's box of litigation based on investment outcomes that could never be predicted with certainty by even the best-intentioned advisor.

By crafting the best interest contract exemption along with the rule it is clear the Department recognizes the importance of allowing clients to choose between various fee and commission structures to pay for the services they receive from financial professionals. A one size fits all pricing rarely, if ever, works in any industry. Ours is no different.

However, the fact that the BIC relies on an individual contract as a means of enforcement is what places the advisor in the very legal quagmire I've described. The potential liability only grows more if the advisor inadvertently forgets to check the box on one of the many requirements, even if the advice given was sound.

The bottom line is that as a practical matter, advisors will not choose to utilize the BIC. Instead, advisors will choose to provide advice on a fee-based account structure where clients pay either a flat hourly fee or a fixed fee based on the dollar amount of the assets.

On the surface that might sound like a good thing. However, for all the reasons that you've already heard from many people today, the end result will be one size pricing for all clients on all products. Smaller clients will be left with the choice of paying too much or not getting any advice at all.

Certainly some of these clients will switch to the robo advisors that have popped up on the scene today. And if all they need is asset allocation, that will work fine, but if they need help with retirement planning, saving for college, choosing when to have social security start, whether they need long term care insurance or life insurance, then they're going to basically be on their own because anybody, any robo advisor's not going to provide that.

So with this in mind we ask the Department the following changes to the existing proposal. One, eliminate the need for the individual contract. The doctors and lawyers at the Department continually quoted as the standard are not required to sign such a contract. Instead, require firms to give each client a bill of rights similar to the ones used by Raymond James.

Reduce the amount of disclosures to those that really matter to clients who want to evaluate the advice they're receiving. In our opinion, these disclosures include full disclosure of the terms of the product and why it's being recommended at the time the recommendation is made, disclosure of material product cost at the time of recommendation, full disclosure of material forms of compensation received by the financial institution and the advisor, along with the information regarding how this compensation will impact returns at the time of recommendation, and regular updates in the performance of the individual product, net of fees.

Finally, we urge dropping existing wholesale product exclusions. A best interest standard will ensure that products are recommended appropriately to clients.

So, again, I want to thank you for allowing me to testify on behalf of Raymond James, and I'll be happy to take any questions.

MR. HAUSER: Thank you. Mr. Stolz, maybe starting with Raymond James, you know, we did review the handbook you gave us on the rights and responsibilities of Raymond James and the customers and I also took a look at your website.

As you know, Raymond James tells its customers that it's going to act resolutely in their best interest. I think that rights and responsibilities say that recommendations are going to be based solely on your, being the customer here, your needs and goals, and it refers to the person making the recommendations as an advisor, not as a salesperson.

So I put those things together, and putting aside for a moment the question of a contract, it seems wholly consistent with that set of kind of representations and the way your folks are holding themselves out as professionals that they should be willing to be held to a standard where the advice is going to be prudent, where it's going to be in the customer's best interest in the sense that the advisor making the recommendation is going to be thinking about what the customer needs, not what is going to make him richer, that there, the fees, as you say, will be fully and fairly disclosed, as will the conflicts of interest, that the fees will be reasonable in relationship to the services that are provided, and that the people making these recommendations that are solely based on the unique needs and goals of the customer will not be incentivized to give, make recommendations that run contrary to the customer's interest.

So I think the first question I have is just is any of that problematic from your standpoint? I mean say that's what the -- in just -- say put aside all the operational issues and all the rest. If that was just the set of obligations being imposed upon Raymond James, would that pose a problem?

MR. STOLZ: Well I would actually look at it this way and that, you know, I believe that that's pretty much the standard that's put on us today and what we expect our advisors to do. Clearly when FINRA comes in from audits they -- while we work under a suitability standard, that is not how they review us.

As we've heard earlier today, the vast majority of any of the arbitration claims, the biggest complaint is that we didn't come up with a fiduciary standard.

So my belief is that the bill of rights that we give to the client lays out that that's exactly what they should expect from us, and if we do not deliver that, they're not shy about bringing some sort of cause of action against us. My issue is that I do not believe we need a specific contract in order to get there.

MR. HAUSER: Why is that? I mean so you may not need it, but, you know, normally one would think for a person really to have a right there's going to be a commensurate remedy when that right is breached. The contract essentially affords that.

It says, look Raymond James, you can go ahead and receive conflicted compensation streams, you can give advice on a transactional basis, but the price for that is you just agree up front with your customer that you're going to adhere to these basic standards that you already tell your customer you adhere to, and if you fall short, they're going to be able to enforce it, and, by the way, they're going to be able to enforce it in arbitration proceedings in the case of FINRA, so you don't really face that kind of litigation exposure outside the class-action context. So why the resistance to that?

MR. STOLZ: Well my belief is that the contract raises a level of liability that doesn't exist with any other professional standard. I guess I would look at it and ask kind of why back, why is the contract necessary?

The last time I went to my doctor and sat down with him there was no contract offered to me that I had to sign with that individual and any other profession that I'm aware of, yet we all seem readily willing to believe that they are providing and putting my client's best interest first without that.

So my response to your question is why is the contract necessary in order to do it? Clearly, from my mind, it just adds -- raises -- it lowers the bar of what the plaintiffs' attorney has to do. I think, from a practical matter, no advisor, once they understand that, will actually utilize the BIC, and therefore they will all move to a full fiduciary standard instead.

MR. HAUSER: Well, you know, because you're the last person and the last panel I'll --

MR. STOLZ: How are we doing on time? Is it time to go yet?

MR. HAUSER: I'll take your question. It strikes me that, you know, in -- there are really two responses. I mean the first is as a default matter under our statute, under ERISA and the Internal Revenue Code, generally, if you're going to make a fiduciary recommendation the default rule is it's without a conflict of interest. You're prohibited from that.

What strikes us is that in this marketplace where the firms receive so many different conflicted payment streams and where we can't just route all of those conflicted payment streams out, that a reasonable approach here is to say we'll give you an exemption from what would be the default rule, which is you simply have to give unconflicted advice, as long as you're willing to step up to the plate and execute an enforceable commitment to your customer that you'll really adhere to these basic standards. To us, that seems equitable.

These other contexts, often the duties are directly imposed -- you know, the duty is not to refrain from acting in a conflicted way as it is under ERISA, but there is a duty to directly act in your customer's best interest that's imposed directly by the statute on the person rendering the service without a contract, and that's actionable.

So lawyers have to zealously act on behalf of their clients, doctors have to, you know, adhere to a malpractice standard, kind of on and on. You can't sell cars, even, without adhering to certain standards of merchantability and the like.

All of these things expose one to litigation, but part of the idea is that litigation, that risk of litigation has a salutary purpose. It aligns -- it makes sure that the people who are overseeing the brokers, and the advisors, and the consultants, and the people that can get the company in trouble have an incentive to make sure that they're going to act in accordance with that standard and that, and in this case would mean that they're going to act in a way that's aligned with their customers interests. So in answer to your -- that's my answer to your question.

Mr. Laby?

MR. LABY: May I just make one brief comment? I just want to point out, as you all know, in this industry there are already contracts, of course.

So when I go to my investment advisor I have to typically sign an investment advisory agreement before that relationship begins, or when it begins, if I go to a broker I have to sign an accounting opening agreement, certainly for lawyers there's typically an engagement agreement, but in the financial services industry, in particular, there are of course contracts today, the question is what will the terms of those contracts be. I think that is what the BIC exemption gets at.

MR. HAUSER: Okay.

MR. STOLZ: If the goal of the Department is to eliminate all conflicts and that any, and if there are conflicts then you would have to utilize the best interest exemption I think you're going to find that, from a practical matter, that's very difficult because the reality is anybody in this business is conflicted in some way.

We've centered mostly on the commissions and how they are a conflict. If I'm a registered investment advisor and I'm paid on, based on the assets, my conflict is I only get paid if I have more assets, so therefore I'm going to be incented and conflicted to give you advice that gives more assets and I will be reluctant to offer any things like immediate annuities that will actually reduce your assets over time because that will reduce my fee. If I'm paid based on the hourly wage, then my conflict is that I'm incented to spend as much time on your case as possible because I'll get paid more.

So the reality is if the objective is to get rid of all conflicts and that you can only utilize the BIC, if that is the case, in my view, you could find that virtually every financial advisor in RIA would have to fall underneath that best interest contract exemption.

MR. HAUSER: So I take your point and, that, you know, it's practically impossible to just eradicate all conflicts, but that's not really the approach here.

The approach would be you agree to adhere to certain standards, the best interest standard that you already commit in your papers to adhere to -- which really is an expression. I could use your exact language in this rule and that would be fine.

But you agree to adhere to those standards and you agree to have policies and procedures in place that are reasonably designed to ensure that your folks act consistent with those standards and their, you know, incentives don't work to keep them from acting consistent with that structure.

It's not going to be -- you know, you're not going to be able to eliminate all conflicts, but that's the idea. Our hope would be that this, you know, and our expectation would be as far as litigation goes that this, these are all familiar standards under ERISA: the prudence standard, the loyalty standard. They have a developed body of caselaw, as well as hundreds of years of trust law behind them.

It's not a hindsight standard, it's not -- you know, it's was it a reasonable recommendation at the time you made the recommendation, you know, was, did you have those policies and procedures in place at the time. It's not how did the investment do or not do. So given all that, what's the problem?

MR. STOLZ: Well that sounds great.

MR. HAUSER: Well I think we'll end it for the day. Thank you all very much.

MR. STOLZ: I just know, from a practical matter, that when a client loses money or something does not turn out as expected, then it's great to say that hindsight is not used, but it is. I would, again, use the advice in the Toeffels case as an example.

Everybody's been quick to say that that was horrible advice, but it was not because of the recommendation they made, it was because their circumstances changed and the recommendation that was made based on the prior circumstances no longer made sense, yet it's being second-guessed. That's, from a practical matter, the way it would work out, in my view.

MR. CANARY: One question for Mr. Allen. In your testimony, your requested testimony, there was a point expressing concern about movement away from some well-tested SEC and FINRA arbitration provisions. So one, what are you talking about there? If you could just be a little bit clearer.

And two, in light of the other testimony that we've received that the mandatory arbitration provision, which we borrowed essentially from the FINRA provision, is a fatal flaw in the rule, what would you say about that?

MR. ALLEN: Well I wouldn't -- in fact, I'd like to see what you're referencing is a submission from us that said we'd want to move away from arbitration.

MR. CANARY: No. It was expressing concern about movement away.

MR. ALLEN: Okay. So I think moving -- so in other words, moving away from that arbitration process to --

MR. CANARY: Yeah. Maybe I misunderstood the bullet point. I was reading into it a suggestion that somewhere in our proposal there was a movement away from --

MR. ALLEN: No. No. I think there's some confusion there.

MR. CANARY: I may -- maybe I misread the bullet.

MR. ALLEN: Right.

MR. CANARY: The other point is can you respond to the other testimony we've had where people have identified the mandatory arbitration provision, which we largely borrowed from the FINRA structure, as a fatal flaw.

MR. ALLEN: Yeah. I do not believe that is a fatal flaw. I think, if anything, the arbitration process, which used to be much more self-regulation, has moved to much more professional in nature. So I think that the arbitration process is actually, from the industry standpoint, stronger than it's ever been if you're taking the, or -- excuse me -- if you're taking the regulatory position on it.

MR. CANARY: Thank you.

MS. LLOYD: Prof. Laby, there's been a lot of talk today about a best interest standard and exactly what the best interest standard means, and there's been a suggestion put forth by SIFMA sort of based on the FINRA existing standard. I was wondering if you had a chance to look at that and if you could evaluate that based on your experience.

MR. LABY: Yeah. I mean I've seen some of the FINRA literature over the past year where they're advocating a best interest standard. It's a little bit hard for me to understand exactly what the FINRA standard means. I've seen it come up in different contexts.

At one point I was very heartened by some FINRA literature which struck me as FINRA moving much more towards what I consider to be the sort of true trustee fiduciary best interest standard. I've seen some things more recently that suggest that that's not exactly what they mean.

I do think it's important to think through the question as you're presenting it. Best interest I don't think necessarily means only one single possible investment, for example, for a client. In other words, it doesn't mean the single best investment. It does mean keeping the best interest, or the high interest, of the investor in mind, at heart, when making an investment recommendation.

As I say, that doesn't necessarily mean of a array of 40 possible funds there's only one single fund in my example that would be in the investor's, "best interest".

MS. LLOYD: I guess to follow up, there have been a lot of questions about our formulation of best interest and how it has a part that says that the advisor has to act without regard to the interests of people other than the client. There seems to be concern that that means that people can't actually get paid or can't have an interest. I was wondering what your reaction to that --

MR. LABY: No, I think those concerns are legitimate. I think that the without regard language can be interpreted differently by different individuals. I don't think it means that the advisor can't be paid. I don't think anybody intends that to be the result.

I do think that's one area where, in my own view, that's exactly why a proposing release and an adopting release is a wonderful invention under the APA. That's exactly the kind of thing that just, since you asked, I would like to see fleshed out of it in the final rule.

To say, look, yes, we have that without regard language, some have raised questions, here's what we mean, we don't mean that the advisor -- of course we don't mean the advisor cannot be paid, assuming that's true, and then to spend at least a few sentences, if not a paragraph, fleshing out what your view is of without regard.

Because I don't think, I hope the Department's not suggesting it means that the advisor cannot receive reasonable compensation, and based on other provisions of the BIC and other parts of the rule, that that's not the case.

MR. STOLZ: If I may make an observation. Like the four of you, I've been here all day and we've heard multiple definitions now of what the best, what best interest is, and perhaps that's part of the problem. Perhaps as you go back and rethink the proposal, as much clarity as you can give as possible as to what you mean by best interest, I would suggest would be extremely helpful.

MR. HAUSER: Yes. Well I would certainly expect that we're going to, you know, provide a little more context, a little more in the way of the examples. Certainly, you know, it's quite plain both from the structure and the words in the exemptions and the rules that it does not mean you cannot get paid. I mean there's a whole section on reasonable compensation, as well as selling proprietary funds. Neither of those things make any sense if you can't be compensated. So, but we can say more about that.

One thing I wonder, I mean since the topic of variable annuities and annuities has come up generally a number of times today, do you think there's some additional guidance that we need to give there?

I mean we certainly take your point that, you know, to the extent there's an insurance component, to the extent there's a set of guarantees, that those things are -- have pricing that goes with them and that one can't just naively compare an entirely different category of investment that doesn't have those guarantees with this one.

Is there more you would be looking for us to say just to relieve whatever anxiety there seems to be about those kind of comparisons?

MR. STOLZ: I think the challenge you have with annuities in general, whether it be variables or indexed annuities, is that they're, almost all of them are sold based on a commission model. The critics of annuities will almost uniformly say that the compensation is not reasonable.

What they forget is that these annuities are designed to be held for a long time, the lifetime of the individual -- that's the whole purpose of it -- and so you really have to look at the commissions over the lifetime of that individual and say is it reasonable, but that's not what people do.

So the -- where you could address that is in providing some clarity as to what you mean by reasonable compensation because absent that you will always have the critics saying that this is too highly of a complex and commissioned product, therefore you must be doing it based on what you're getting paid.

MR. HAUSER: So, again, I can't recall, Scott, whether you were here for the first panel this morning, but --

MR. STOLZ: I was.

MR. HAUSER: -- we had a number of people who were already fiduciaries and advisors on that panel, all of whom, you know, professed a degree of comfort with being defendants under a fiduciary standard and did not foresee the kind of litigation consequences that you forecast. Do you derive any comfort from that?

MR. STOLZ: I would have to know more about what their business model looks like. It confused me. The testimony confused me a little bit. I will note that the one individual did say that his representatives do get commissions on annuity and insurance products, which means they would be conflicted like everybody else.

So I don't know if he had a different understanding as to how the rule works or he's got a business model that has some sort of magic formula, but I would certainly need to understand a little bit more. So it didn't provide me with a lot of comfort.

MR. HAUSER: Well, that's a shame.

MR. STOLZ: Did you expect a different answer?

MR. HAUSER: Anyone else?

MR. CANARY: Well I suppose, just because we've covered it in many of the other panels, can we talk a little bit about the education provision and the identification of specific investment products in an asset allocation, particularly in the IRA space. A number of the witnesses have talked about changing the education provision in the plan space where you have an independent fiduciary making a judgment about the investment options that are available.

If I understand the comment letter that we've gotten, you would want the IB to also allow specific investment options to be included in asset allocation in the IRA space where there is no such sort of intervening fiduciary making a decision about investment options. Can you talk to that a little bit for us, please.

MR. ALLEN: So the providing specific recommendations or examples of recommendations rather than trying to do it at a higher level. I just believe that the more specific you can be in terms of -- rather than just talking conceptually or asset class-based, that you talk more specifically about recommendations, that the more informed that the investor is going to potentially be.

MR. CANARY: Okay. You used the word recommendation as opposed to education.

MR. ALLEN: Well they're going to be better educated by the -- and recommendation might be the wrong word to use in terms of you're providing a recommendation, but you're providing an illustration of what the investor could be looking at versus at a more granular level than providing it in just a conceptual asset class level. So I think the more --

in other words, the more specific you're allowed to be, the more informative that your conversation could be.

MR. CANARY: Prof. Laby?

MR. LABY: I don't disagree with that. I would say at the same time I think one really has to think about whether the information that's being given is evaluative or it's not evaluative. So if it's -- comes close to or borders on a recommendation, then I think we have to be very careful because it looks like the advisor in that case or the individual is presenting some sort of evaluative information. That is, that they're suggesting or recommending one investment over another.

That evaluative component, in my mind, would trigger moving into advice and out of education, as opposed to presenting an array of options without making any particular evaluative judgment with respect to any given investment.

MR. CANARY: You know, I guess I see that as the way the proposal is currently structured because it, using a particular investment in the asset allocation would take you out of the education carve-out, but to be investment advice you would still have to meet the general definition to be a recommendation where the carve-out would then be more of a bright line, where where you're talking about this being careful about whether it's evaluative would be a more facts and circumstances judgment based on application of the general definition.

MR. LABY: I don't disagree with that. I just, I worry a little bit about what will happen in the adopting release as opposed to what's currently in the proposing release, which I think gets it about right.

MR. CANARY: Okay. Thank you.

MR. HAUSER: Thank you all very much, and thank you all for being here. We'll start up again at 9:00 in the morning.

(Whereupon, at 5:00 p.m., the hearing in the above-entitled matter was adjourned, to reconvene at 9:00 a.m. on Tuesday, August 11, 2015.)

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REPORTER'S CERTIFICATE

CASE TITLE: Conflict of Interest Proposed Rule Meeting

HEARING DATE: August 10, 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.

Date: August 10, 2015

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